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THE EMERGENCE AND TRANSFORMATION OF CHINA'S EDUCATION  
AND TRAINING INDUSTRY, 1980-2010

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To Xuebin

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## **List of Abbreviations**

ETI: Education and Training Industry

ETO: Education and Training Organization

GRE: Graduate Record Examination

IELTS: International English Language Testing System

IPO: Initial Public Offering

PE: Private Equity

TOEFL: Test of English as a Foreign Language

VC: Venture Capital

VIE: Variable Interest Entity

WTO: World Trade Organization

## Acknowledgements

Sociologically examining the social world where one used to be an insider is a rare privilege. Many novelists start as insiders of various groups but often lack disciplinary lenses; ethnographers usually do not start as insiders but become so upon receiving academic training. My dissertation is a product of such a privilege. This dissertation concerns the transformation of China's education and training industry. I worked in this industry as a teacher and manager for four years before receiving sociological training at the University of Chicago. Writing about this industry after sociological training was like discovering a familiar world with a new pair of eyes. Looking back, I realize that the greater privilege is the opportunity to be empowered by a five-star team of teachers, fellow students, colleagues and family members. They helped me cast doubt on what I thought I knew. They reminded me of the pitfalls of relying on my past experience. Most importantly, they always reassured me of the value of what I was about to tell. My deep gratitude goes to all of them.

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## **Abstract**

This dissertation investigates organizational change and market transition through the study of the emergence and transformation of China's education and training industry (ETI). I ask how and why the ETI evolved into a for-profit industry led by large, private, formal and globally financed enterprises from 1980 to 2010, despite systematic restrictions placed on private ownership and for-profit activities in this industry by the Chinese state.

Using interview, archival and observational data on 16 existing and defunct educational and training organizations and secondary data on additional 12, I develop a theory of double ambiguity. Doubly ambiguous industries, where it is unclear whether organizations are private or non-private and whether they are for-profit or not, draw on the state and the black market for teachers, facilities, information and organizational models. I argue that the ETI transformed not only because the ambiguous social space provided divergent resources and organizational models, but also because double ambiguity instilled in organizations a high concentration of socially marginalized entrepreneurs and internal conflicts. These entrepreneurs, their nonconforming practices and the internal conflicts of organizations pushed the non-incremental transformation of the industry from below. Nonconformity and conflicts, rather than compliance and cooperation as new institutionalists suggest, are the initial engines for the capitalistic development of doubly ambiguous industries. State restrictions on market behaviors and nonconforming practices further accelerated the transformation. Although institutionalization replaced nonconformity and conflicts as the new engines of development in later stages, fast institutionalization of doubly ambiguous industries created new areas of nonconformity and unpredictability.

My dissertation moves beyond two major debates in organizational and economic sociology: the one between new institutionalism and existing theories of ambiguity, and the one between selection and adaptation. It also improves our understanding of the state's role in China's market transition. My study presents a novel trajectory for the rise of China's private economy.

## Chapter One

### Introduction

Walk into any high-end office building in Beijing or Shanghai. You will notice that these buildings not only house Goldman Sachs and McKinsey, but are also packed with Chinese education and training organizations (ETOs) that provide supplementary and non-degree-oriented education services, such as test-preparation and language training programs. The prime locations expose the enormity and high profitability of China's ETI.<sup>1</sup> Since the early 2010s, the ETI's market volume has surpassed 103 billion U.S. dollars (Deloitte, 2012). Its total annual enrollment is also over a hundred million people, which means almost one-tenth of China's enormous population attend ETOs each year (KPMG, 2011). With regard to profitability, leading ETOs could obtain a gross profit rate of 50 percent, making the ETI a goldmine for entrepreneurs and investors (e.g., Supernova Archive No. 1; Doo & Cool Archive No. 1).

The ETI also has extensive social impacts. The percentage of primary-secondary students taking ETI classes has climbed up to 55 percent across urban areas and over 80 percent in major coastal cities such as Beijing in late 2000s (Xue and Ding, 2009; The 21st Century Education Research Institute, 2012). In other words, attending ETI classes before taking high-stakes tests has become taken-for-granted by urban students. Given such high participation rates among urban and especially elite families, the ETI has constituted a significant channel for educational

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<sup>1</sup> The ETI is also known as the "shadow education" (e.g., Bray, 2009), "cram schools" (e.g., Roesgaard, 2006), "private tutoring" (e.g., Aurini and Davies, 2004) and "supplemental education" (e.g., Yi, 2013). The existence of multiple names for this field suggests the fluidity of its internal and external boundaries. All the names used in previous studies only capture one particular niche or dimension of the field. I therefore follow business analysts and practitioners of this field and name it the ETI.

inequality and social stratification. Even U.S. higher education is under the heavy influence of China's ETI, since over 70 percent of Chinese students studying in U.S. universities have taken TOEFL/GRE<sup>2</sup> test-prep classes in the ETI (Lu, 2002).

The ETI has undergone fundamental transformation since its inception in 1980. In the late 1970s when China's market reform was unveiled, this industry was non-existent. In the early 1980s, the ETI emerged as fragmented and local niche markets. All ETOs were educational entities under the supervision of local Education Bureaus (*Jiaoyu Ju*, 教育局).<sup>3</sup> Although Education Bureaus started to allow private individuals to found and operate ETOs, only a small portion of faculty members and educators within the state education system were qualified as founders. ETOs were under state and professional control. State influence is also evident in the fact that leading ETOs were all affiliated with the state education system. Even though non-professionally trained founders entered the market in late 1980s, for two decades it was unclear whether their ETOs were private or non-private and whether they were for-profit business enterprises or not-for-profit social organizations. With regard to the structure and operation, most founders worked on their ETOs on a part-time basis. They used family capital as startup funds and operated ETOs with their family members. There was no trace of formal structure or procedure in these ETOs.

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<sup>2</sup> TOEFL is Test of English as a Foreign Language and GRE is the Graduate Record Examination. International students were often required to submit the results of the two tests as required application materials to U.S. colleges and universities.

<sup>3</sup> In the 1980s and early 1990s, the supervising agency was called the Adult Education Bureau (*Chengren Jiaoyu Ju*, 成人教育局). The Education Bureau at that time was a separate government agency only responsible for degree-oriented education. In the mid-1990s, the Adult Education Bureau merged with the Education Bureau. For simplicity, hereafter I use Education Bureau to designate the supervising agency of ETOs regardless of timing.

All this had changed by 2010 when the ETI became a nationally integrated industry, with a dozen nationally operating brands leading the market.<sup>4</sup> All market leaders were corporate entities founded and operated by private entrepreneurs. The ETI had turned into a for-profit industry led by private enterprises. Now profit maximization and other market-based principles rather than professional norms were governing the daily operations of ETOs. The ETI had also become China's leading edge in connecting with global capitalism: eleven leading brands were listed on global stock markets by 2010, and the taken-for-granted way of founding an ETO had shifted to obtaining investments from domestic and international venture capital and private equity firms. Even the internal structures of ETOs had changed. Market leaders had evolved into large and formal organizations. Some of them had developed full-time and salaried managerial teams.

The ETI's transformation was puzzling given the heavy regulations by the state. In fact, the Chinese state has long been against the privatization and marketization of the ETI. I have shown that Education Bureaus imposed heavy regulation on the registration type and founder profiles of ETOs. The state's initial intention, therefore, was to put the ETI into the hands of professionally trained faculty members and educators. The ETI was positioned by the state as a complement to, and extension of, the state education system. The state even forbade ETOs to be listed on domestic stock markets and stipulated that the ETI was "public goods" (Tao and Wang, 2010).

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<sup>4</sup> Despite the existence of large and nationally influential ETOs, the concentration of market shares by these market leaders is low. It has been reported that the first three ETOs controlled less than ten percent of the total ETI market.

## Research Questions and Arguments

This dissertation investigates *how and why the ETI evolved into a for-profit industry led by large, private, formal, and globally-financed enterprises from 1980 to 2010, despite systematic restrictions placed on private ownership and for-profit activities in this industry by the Chinese state*. I unravel this broad puzzle with four specific questions: 1) Why did a particular model of prototypical private enterprises that was more nonconforming with formal state regulations and informal norms become dominant in the early 1990s?<sup>5</sup> 2) Why, during the mid- and late 1990s when there was the competition among these prototypical private and nonconforming enterprises, were some able to gain market dominance and push forward the innovations of their teaching models while others were not? 3) How and why did the ETI and ETOs that used to be disconnected from financial markets become quickly embedded therein in the 2000s? 4) Why were some ETOs able to build a large and full-time managerial team while others were not? I provide specific answers to each one of these questions in the four empirical chapters.

My dissertation is also intended as a sociological study of organizational change and of China's turn to market capitalism. These are the inquiries on the micro and the macro level respectively, to the extent that the investigation of the industry transformation operates on the meso level.<sup>6</sup> On the micro level, I aim to reveal the possibilities, engines and mechanisms of organizations' adaptation, after taking full consideration of environmental selection's role in the evolution of an industry's dominant organizational forms.<sup>7</sup> On the macro level, the ETI's privatization and marketization illustrates a novel development path of China's private economy.

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<sup>5</sup> See Chapter Two for the cooperation norms that are essential for sustaining transactions.

<sup>6</sup> It is, of course, arbitrary to choose the inquiry about the industry as "meso-level".

<sup>7</sup> I will discuss the meaning of selection and adaptation in detail in Chapter Two. For now, we can think about selection as the births and deaths of organizations and adaptation as the change of existing organizations.

I develop a systematic theory of double ambiguity to unfold the aforementioned multi-level inquiries. In doubly ambiguous industries such as the ETI, organizations used to be ambiguous both in terms of whether they were private and whether they were for-profit. These industries drew on the state and the black market for resources and organizational models. I argue that the ETI accomplished this transformation not only because double ambiguity provided a wide array of resources and organizational models, but also because double ambiguity instilled in organizations with a high concentration of marginal entrepreneurs<sup>8</sup> and internal conflicts. Ambiguity attracts adventurers. It also imbues organizations with internal struggles. Marginal entrepreneurs blended organizational elements of divergent sources into practices that were nonconforming with formal state regulations and informal norms. These marginal entrepreneurs, their nonconforming practices and the internal conflicts within organizations not only provided impetus to the adaptation of these organizations, but they also pushed the non-incremental transformation of the industry from below. Nonconformity and conflicts, rather than compliance and cooperation as new institutionalists suggest, are the initial engines for the development of the ETI. The global and national trend toward neoliberal capitalism, together with the state's restrictions, further accelerated the transformation and conditioned the direction of the change toward privatization, marketization, financialization and formalization.<sup>9</sup>

In the first decade of this century, the ETI disembedded from the black market and became embedded in more formal institutions, such as the global financial market.

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<sup>8</sup> By marginal entrepreneurs, I mean those who have low social status, or those who are excluded from entering a particular niche, or both. They are also known as “entrepreneurs from the social periphery” (Haveman, Habinek and Goodman, 2012). Scholars on China's market transition also noticed the early capitalistic entrepreneurs as “marginal entrepreneurs” (e.g., Tsai, 2007, p. 50; Nee and Oppen, 2012, p. 33). But they do not develop this term systematically nor do they link this term to ambiguous social spaces.

<sup>9</sup> Financialization here means using financial markets as the primary source of initial capital. Although existing literature generally equates financialization with the securitization of economy (e.g., Davis, 2009), I will show in Chapter Five that this conceptualization needs to be expanded when it is applied to China.

Institutionalization replaced nonconformity and conflicts as the new engine. With that said, the fast institutionalization of the doubly ambiguous industry can create new areas of nonconformity, unpredictability and uncertainty. All the patterns and mechanisms described above are generalizable for other doubly ambiguous industries such as China's specialty healthcare industry and fashion publication industry, as my concluding chapter will show.

In the rest of this chapter, I first introduce my methods and data. Then I provide a narrative of the ETI's transformation that highlights the themes, puzzles and key organizational actors in different stages.

## **METHODOLOGY**

This dissertation is both contemporary and historical. It is contemporary because I only study the emergence and transformation that occurred after the late 1970s when China's market transition took off. But my dissertation is also a historical study. It inquires into the evolution of an industry that lasted for thirty years. My inquiry into the historical dynamics starts with case selection and goes beyond random sampling. Case, in organizational and management studies, is often referred to as individual organizations (e.g., Eisenhardt, 1989).

Randomly selecting cases from the population of all existing ETOs might enhance the representativeness of my study. However, this method is inadequate for capturing the historical dynamic because it ignores ETOs that were once influential but are now defunct. Random sampling of all historical cases is impossible since both the population size and individual cases for any given year prior to 2010 are unknown in this not-well-documented industry. Even for existing cases, random sampling runs the risk of missing important cases that have shaped or is shaping the industry's landscape. Another pitfall in case selection is only examining cases that

survived and thrived. The problem, according to population ecologists, is “sampling on the dependent variable” (Hannan and Freeman, 1989, pp. 26–27). Finding out causal explanations only based on successful cases is problematic because failed cases might hold the same characteristics as the successful ones do.

To the extent that the idea of case runs on multiple levels (Ragin, 2009, p. 8), my case selection starts at picking up the cases of niche markets within the ETI. I focus on the five most important niche markets of the ETI: 1) TOEFL/GRE; 2) Graduate School Entrance Examination (*Kaoyan*, 考研, hereafter the Graduate Exam); 3) Spoken English; 4) IELTS;<sup>10</sup> and 5) K–12. These five niche markets are important not only because they have vast market volumes, but also because each one has bred nationally influential market leaders in the ETI.

With regard to the cases of individual organizations, my dissertation draws on 28 existing and defunct ETOs. They all originated from the aforementioned five niche markets. Each one of these ETOs was once a top three market leader measured by enrollment,<sup>11</sup> either in a local niche market, the national niche market, or China’s ETI in general. My dissertation, therefore, is a study of the upper echelon of the ETI. This way of selecting organizations might disappoint some readers who are solely interested in an average picture of the current population. However, it is not a problem for my dissertation because my research questions primarily concern leading organizations, their competition for market dominance and their influences on the entire industry. In the Appendix, I present detailed information and my data sources on the 16 ETOs on which I

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<sup>10</sup> IELTS is the equivalent to TOEFL for the British Commonwealth.

<sup>11</sup> In the early stages, educational products among different ETOs were undifferentiated and with a similar unit price, so enrollment is a good indicator for revenue and market share. Compared to revenue, profit or market share, enrollment is easier to obtain.

have primary data. To protect the identities of my informants and their organizations, I use pseudonyms for all people and organizations throughout my dissertation.<sup>12</sup>

The fact that the five niche markets boomed in different time periods requires a shift of focus when investigating each period. Whereas TOEFL/GRE, Graduate Exam and Spoken English took off in the 1980s, IELTS and K-12 did not flourish until the early 2000s. Even for the first three niche markets, competition was local and only unfolded within the niche in the first two decades. Therefore, it is inevitable to choose an important local niche to demonstrate early competition dynamics. My inquiries of the pre-2000 dynamics focus on Beijing's TOEFL/GRE niche. This local niche is important because Beijing has undoubtedly bred the most market leaders. China's largest ETO and most long-lasting top market leader, Supernova, originated from Beijing's TOEFL/GRE market. After showing the patterns of Beijing's TOEFL/GRE in the first two empirical chapters, I also use Beijing's Graduate Exam and Guangzhou's Spoken English to illustrate the generalizability of these patterns.

From 2000 to 2010, a nationally integrated ETI market took shape. There has been not only competition for dominance within each local and national niche market, but also competition across niche leaders. In the meantime, new niche markets, such as IELTS and K-12, arose with their new leaders. For example, United IELTS in IELTS and Doo & Cool in K-12 not only outcompeted other specialist ETOs within their niche, but they also challenged Supernova, the national market leader across all five niches. My inquiries of the 2000-2010 period, therefore, use this multi-level competition to capture both the within-niche and the across-niche dynamics.

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<sup>12</sup> In a dissertation that is based on non-random cases with specific market status and historical events, complete anonymity is impossible. Still, using pseudonyms is preferable because it creates a buffer for my informants. To make the names consistent throughout the dissertation, I had to change some titles in the reference when they use the real names. I also have to put a reference under the category of archive, because both the author and the title contain real names.

It is clear from the description above that my dissertation is also heavily comparative. As Table 1.1 shows, each empirical chapter is organized so that it both captures a time period and compares the rise and fall of multiple models and organizations as market leaders. Chapter Three compares the nonconforming Underdog ETO model that had survived and thrived by the early 1990s with the other two failed models—State and Intellectual ETOs. Chapter Four compares successful and failed cases within the Underdog model: it details how Supernova outcompeted Seven Swords, Pioneers and Cornerstone and had grown into a local monopoly and nationally dominant ETO in TOEFL/GRE by 2000. Chapter Five and Chapter Six continue the comparison between Supernova and other contenders for national leaders across niche markets.

Table 1.1 Chapters Organized around Themes and Temporality

Chapter Name	Theme	Period	Models and Organizations
Chapter Three	Privatization and Marketization I (Cross-Model Competition)	1980 – Early 1990s	Underdog ETOs ( <b>Supernova</b> ) State ETOs Intellectual ETOs
Chapter Four	Privatization and Marketization II (Within-Model Competition)	Early 1990s– Early 2000s	<b>Supernova</b> Cornerstone Seven Swords Pioneers
Chapter Five	Financialization	Early 2000s– 2010	<b>Supernova</b> Doo & Cool United IELTS Roaring English Blue Ocean
Chapter Six	Formalization and Rise of Managerial Class	Early 2000s– 2010	<b>Supernova</b> Doo & Cool United IELTS Roaring English Blue Ocean

In addition to the comparison in terms of the rise and fall of specific firms, I also compare organizations and models on their levels of achieving certain themes of transformation, as the second left column of Table 1.1 illustrates. Chapter Three and Chapter Four feature privatization

and marketization, showing how the competition among multiple models and individual organizations catalyzed the rise of a particular kind of prototypical private enterprise. Chapter Five features financialization, comparing ETOs that succeeded in going public on stock markets, such as Supernova and United IELTS, with others that used to be market leaders but failed at the point of public listing, such as Blue Ocean and Roaring English. Chapter Six focuses on the themes of formalization and the rise of the managerial class. Here I not only compare winners and losers, but I also compare the divergent paths toward formalization among winners. I show how Roaring English and Blue Ocean failed to develop a managerial team with their franchise model, whereas Supernova and Doo & Cool succeeded with their directly managed model. I further show how Supernova adopted a decentralized managerial model while Doo & Cool developed a highly centralized model.

Although my dissertation is heavily comparative, I go beyond the conventional balanced comparative method. Balanced comparison, especially with a relatively small number of cases, not only runs the risk of determinism and lack of degree-of-freedom, but it also limits the questions a researcher can ask (Liebersohn, 1991; Zhao, 2015, pp. 24–25). For an organizational study, balanced comparison of multiple organizations has the potential problem of neglecting rich and complex internal dynamics that are only seen in a single organization. To avoid this pitfall, I direct more attention to the internal dynamics of Supernova than I do to other organizations (Supernova in bold in Table 1.1). Supernova enjoys unparalleled significance not only because it has been dominant across all five niches since the late 1990s, but also because it had played the paramount role in shaping the teaching, financial and marketing forms of the entire industry. Any satisfactory account has to be able to explain the internal dynamics of Supernova and its impact on the ETI. The fact that Supernova needs the closest scrutiny also



has bred the largest number of market leaders, including the most successful ETOs such as Supernova and Doo & Cool. Guangzhou is the city where Roaring English started its business and housed its headquarters. Shanghai and Hangzhou are used primarily for comparing with the other two cities. Although these two coastal cities have enjoyed economic prosperity, they had not contributed to any nationally influential brands until the early and mid-2000s when the K-12 segment flourished.

I conducted interviews with 76 informants. I used the snowball method but focused on targeting specific informants who have significant influences on or special knowledge of the ETI. For example, in order to pinpoint how the internal conflict associated with Supernova's IPO on the U.S. stock market, I interviewed eight of the earliest 11 shareholders as well as two former financial managers. Arguably, targeting specific organizations and specific people is a far more formidable task than using snowball or random sampling. As a former teacher and manager who worked in the ETI from 2003 to 2007, I relied on my former colleagues and friends to establish initial contacts.<sup>13</sup> This allowed me to locate some of the most elusive informants and also enabled me to finish my fieldwork in eight months. Compared to existing ETOs, interviewing people from defunct ETOs posed a greater challenge. I acted like a detective in search of the missing people from these ETOs and I was in the end able to interview multiple members. My interviews are both structured and semi-structured. On average, each interview lasted for two hours.

Using interview data to reveal historical patterns means my research is subject to the poor memory and justification of the informants. I examine the validity of interview data by crosschecking multiple interviews. Let me provide an example: Supernova's founder, Su

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<sup>13</sup> With that said, I do not include any work-related information as my data. I only developed the idea of studying the ETI after I left the industry and started my graduate study in the U.S.

Leidong, used to tell a story about how he was publicly humiliated by his employer, Capital University, and had to quit because he was organizing ETI classes under the name of Capital University faculty. But later, in a more recent TV interview, he said that he had to quit because his recruitment of students within Capital University conflicted with the ETI classes organized by the Capital University's English Department. Such inconsistency called for the necessity for crosschecking, so I asked multiple informants associated with Capital University. I found that numerous faculty members at Capital University used their faculty titles to work part-time in organizing ETI classes. Although it was formally forbidden, it was considered acceptable in most cases. Only when there are direct conflicts of interest with the University, as Su's second version indicates, was the sanction more likely to be in place. An informant even revealed the story behind Su's conflict of interest: the director of the English Department was unhappy and jealous about Su's making money. This director asked Su to stop organizing his own classes and to help the department's classes. When Su refused, this director demanded that the University sanction Su publicly. In China's early reform era, being sanctioned by *danwei* and disliked by supervisors meant the potential loss of all kinds of social welfare, including housing. Su had no choice but to quit. Thus the crosschecking not only provided an accurate version of the story, but it also helped us understand why Su became one of the earliest entrepreneurs to quit an elite university and work in the ETI on a full-time basis when private entrepreneurs still carried a social stigma. As I will show in the empirical chapters, the fact that Su was the one of the earliest full-time entrepreneurs with a faculty background from an elite university is crucial for understanding Supernova's innovation and dominance.

Archives are another important primary source. These include government registration records, teachers' profiles, paychecks and meeting records. The third primary source is

participant observation, which focused on events in 2014 and 2015 but shed light on historical patterns. In addition to these primary sources, I also include various secondary data. They are helpful in depicting a complete picture of underrepresented cases as well as crosschecking memory-based interviews.

## **THE TRANSFORMATION OF THE ETI: A CHRONOLOGY**

In this section, I offer a narrative of the ETI's development from 1980 to 2010. This narrative serves two purposes. First, I use this narrative to situate the four specific questions in social, economic and political contexts. As I mentioned before, my historical study starts with asking time-specific questions and selecting relevant organizations for a given time. All these presuppose an accurate delineation of the context. Second, I use this chronology to complement the narrative within each chapter that focuses on a particular theme about a local niche. To this aim, I not only discuss the broader social processes that are outside of the scope of a local niche, but I also emphasize the interconnections of the themes across chapters.

Let me first briefly introduce the history of the ETI prior to China's market reform. It is worth noting that many historical counterparts of the ETI are hardly equivalent to its current structure or function. The contemporary ETI lumps together supplementary education, private education, language learning, foreign language learning and test-preparation. But the historical equivalents of these subfields might not be linked together or didn't even exist in a particular time period. Therefore, I will shift among these subfields depending on a particular period of time.

Private education has a long history in China. In the absence of a state-organized school system, local schools that dated back to Spring-Autumn and Warring States eras (770 B.C. to

221 B.C.) were founded and organized by private individuals. Confucius, Mencius and many other thinkers were the most famous organizers of these schools. After the establishment of the Imperial Examination system (*Keju*, 科举) in the Sui and Tang Dynasties, various forms of education sprouted. Under the *Keju* system, there were state-organized tests and an imperial academy (Ho, 1964, p. 16). Nonetheless, education was largely beyond the reach of the masses in rural China until the Ming and Qing Dynasties (ibid). There were local schools organized by the local gentry and these schools were aimed at preparing students for the *Keju* examination. These local schools (*Sishu*, 私塾) were so deeply embedded in local kinship that often all members of the clan would provide financial support to a child who had the potential for passing the test and becoming an official (He, 2009, p. 25). The *Keju* system was abolished in 1905 when China's last dynasty (Qing) was coming to an end. During this time and during early Republican China, local officials, liberals, revolutionaries and even warlords attempted to establish local non-degree-oriented schools to complement the limited state-organized schooling.

The first study-abroad wave also started in the late Qing and early Republican period. After an embarrassing defeat by Japan, the officials of the Qing Empire sent multiple groups of Chinese students to study in the U.S. with the specific aim of learning from the West and strengthening China. During the Republican period, privately sponsored studying-abroad also became popular among revolutionaries. Accordingly, individually organized schools that prepared students for foreign languages and studying-abroad mushroomed. For example, Deng Xiaoping attended an individually organized preparatory school before studying in France (Stewart, 2001). Individually organized schools were also common during the 1930s and 1940s when the Kuomintang was in power. According to statistics, in 1949, 56 percent of schools were individually organized schools, and they had 38.8 percent of the total student population of

China (Qiao, 1985). In addition to its role in basic education, privately organized and non-degree-oriented schools also served an important channel for mobilizing revolutionaries and their supporters. In fact, Mao Zedong was one of the pioneers in developing these schools (Perry, 2012).

After communists took power in 1949, individually organized non-degree-oriented schools were suppressed. During the 1950s when China was marching toward socialism at a fast pace, all individually organized schools were considered capitalistic (Lü, 2003). All schools that were not operated by the state were confiscated. From the mid-1960s to mid-1970s, the Cultural Revolution interrupted the operation of China's education. Urban Chinese were no longer able to attend schools and move upward with the College Entrance Examination (*Gaokao*, 高考, hereafter the College Exam). As formal education halted, organized supplementary education also disappeared. In the meantime, however, the Chinese state pushed toward more egalitarian education between urban and rural China (Whyte and Parish, 1984, p. 58). Educational opportunities, quality and motivation for urban education declined during this time (ibid).

This direction was reversed in the late 1970s when the Cultural Revolution ended and the market reform began. As the state resumed the College Exam in 1977, the opportunity window for education was once again open. Students' enthusiasm for education soared.

#### *1980 – Early 1990s: The ETI Took Off*

China's ETI took off in the early 1980s. The inception of market transition and restoration of the education system spurred a demand for education. Within this education demand, the demand for English, studying-abroad-oriented test preparation and the Graduate Exam rose most rapidly.

The ice-breaking diplomatic progresses with U.S. and other Western countries in the late 1970s laid the ground for Chinese students' overseas studies. Under the direct endorsement of Deng Xiaoping, China started the program to send state-sponsored students abroad (Li, 2007). As state control over studying-abroad loosened, students also figured out how to attend foreign universities as self-sponsored students. In accordance with these changes, English replaced Russian as the most popular foreign language and became a compulsory subject from middle school to universities. All this led to the “social fever” of going abroad and learning English (Zhao, 2001, pp. 42–46).

On the supply side, the state also began to encourage non-state education (*minban jiaoyu*, 民办教育), also known as education with the support of societal resources (*shehui lilian banxue*, 社会力量办学). The state perceived non-state education as a viable means to meet the demand that went beyond formal schooling. Despite the expansion of education opportunities, the post-Cultural Revolution China abounded with uneducated and unemployed urban youths (Wen, 1983). A large portion of these students had passed the age for formal schooling, so short-term and part-time training schools were most helpful for their employment and incorporation into the society.

The state tapped retired faculty members and educators as entrepreneurs for non-state education. A vast number of faculty members and educators were obliged to retire early or leave their positions in previous political upheavals. Many of them were associated with the democratic parties, such as the China Democratic League (*Minmeng*, 民盟). The state called for these retired people and their parties to “contribute (their) remaining energy” (*fahui yure*, 发挥余热).

Municipal governments of major cities implemented policies for encouraging and regulating non-state and non-degree-oriented ETOs. For example, the Beijing Municipal Government issued “Temporary Regulations on Schools Operated by Private Individuals” in 1980 (Wen, 1983).<sup>14</sup> For the first time since 1950s, private individuals were allowed to establish and operate schools. Classic brands that existed before 1949 but had been suspended since 1950s, such as Shengsheng Typing School (*Shengsheng Dazi Xuexiao*, 声声打字学校), came back into play (China Non-state Education Green Book, 2002, p. 99). These ETOs were put under the supervision of district-level Education Bureaus. To put ETOs into the hands of educators and marshal local societal resources, the Education Bureau stipulated that only professors or educators with associate level or above were qualified as founders. Apparently, the state’s initial intention was not to develop the ETI into a for-profit industry, but rather as an extension of the state education system supervised by state educational agencies.

During this period, there were only fragmented and local niche markets. No one had brought up the idea of an integrated ETI. People working and learning in one niche market (e.g., TOEFL/GRE) would not consider themselves in the same field as those in a different niche market (e.g., the Graduate Exam), even if they were in the same city. Each city’s market was also a closed system that had little connection to that of another city. Not only did ETOs only deal with district-level Education Bureaus for registration and regulations, but their consumers also came primarily from local regions. Accordingly, the vast majority of ETOs were local specialists.<sup>15</sup> For example, ETOs in Beijing targeted three major categories of niches: 50 percent

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<sup>14</sup> In 1984, a new regulations used “education with the support of societal resources” to replace the phrase of “private individuals” (China Non-State Education Green Book, 2002, p. 99).

<sup>15</sup> With that said, the boundary between specialist and generalist during this stage was fluid. Many ETOs targeting TOEFL/GRE niche offered classes Business English and Spoken English, depending on the availability of teachers (Qian, 1996, p. 44).

of ETOs were targeted for foreign languages and all kinds of test-preparation; 30 percent were targeted for vocational niches such as sewing, typing and accounting; and the rest were targeted for art, such as music and painting (Wen, 1983).

To the extent that the earliest ETOs relied on the state education system for teachers, students, facilities, information and organizational models, major cities, such as Beijing and Shanghai, where there were huge state education systems, became the largest local ETI markets. For example, Beijing's Haidian District became the center for the ETI's change and innovation partly because over thirty top state universities were concentrated in this area (Zhao, 2001, pp. 240–244). Huge demand and easy access to state resources contributed to the birth of a large number of ETOs in Haidian. This district's first ETO was founded in 1982, but the number of ETOs increased to 87 in 1990 and 190 in 1992 (Wang, 1992). As I mentioned earlier, a large number of nationally influential ETOs also came from Haidian.

ETOs during this period were individual and family-based informal organizations. The vast majority of ETOs depended on founders and their family members for initial capital, teaching and daily operations. It was not uncommon for a school with 600 students to be taught and organized by three retired educators (Wen, 1983). The informality was manifest in the lack of a clear division of labor, formal procedures or a full-time managerial team. Despite the lack of division of labor and specialization, recruiting students was in general not a problem in the early and mid-1980s. There was abundant demand and a low level of competition.

There was an increase in competition and a shift of market leaders across niches in the early 1990s. During the early and mid-1980s, State ETOs that were affiliated with state universities were the earliest market leaders. State ETOs not only had easy access to resources and organizational models of the state education system, but they were also trusted by consumers

given the dominance of the state education sector and the stigma associated with private business entrepreneurs. The situation was different in the late 1980s. A large number of people who were not qualified as founders found their way into the ETI. These people either had no work experience at the state education system or only held peripheral positions therein prior to their entrepreneurship. I call this type of ETOs Underdog ETOs. These ETOs adopted practices that were more nonconforming with formal state regulations and informal norms than other ETOs. By the early 1990s, Underdog ETOs had occupied the majority of top market leader positions across niches and cities.

The initial success of Underdog ETOs is crucial for the subsequent development of the entire ETI. As they became leaders, they were able to set the rules of the game. They pushed the privatization and marketization of the ETI from below.

#### *Early 1990s – Early 2000s: Acceleration of Privatization and Marketization*

Right after the 1989 Student Movement, the conservatives within the Communist Party attempted to roll back market reform (Naughton, 2007, p. 99). Although they eventually failed, there was widespread anxiety and uncertainty over the fate of China's market transition as a result of the political unrest. This situation changed in 1992 when Deng Xiaoping toured Southern China. During this tour, he sent a clear signal that China would deepen its course of economic reform. He also provided an endorsement for market institutions such as the stock market (Walter, 2011, p. 237). After 1993, there were clear signs of economic revival, expansion of foreign direct investment and exports (e.g., Gallagher and Ma, 2011, p. 137).

The general political context was neoliberal and favorable to the development of the private economy in the 1990s, although there was debate about whether the state in the 1990s

was more neoliberal than in the 1980s (Huang, 2008; Andreas, 2010). In 1993, the Third Plenum of the 14<sup>th</sup> Party Congress endorsed a “socialist market economy.” The state initiated the privatization of state-owned enterprises, targeting specifically small enterprises (e.g., Lardy, 2014, p. 45). As these small enterprises began to lay off workers, these workers became an essential source of labor for rising service sectors such as the ETI. Furthermore, the passing of the Regulation on Registration of Private Enterprises in 1988 and the Company Law in 1993 led to a boom of formally registered private enterprises. Township and village enterprises, many of which previously registered as collective enterprises but were controlled by private individuals, started to take off their red hats and register as private enterprises (Tsai, 2007, p. 78). As the entire private sector was booming, the service sector that was predominantly private grew substantially. The output of the service sector increased from 22 percent of China’s total output in 1978–1980 to 42 percent in 2002 (Lardy, 2014, p. 129).

Despite the favorable environment to the private economy during this period, the specific political context for the ETI was hardly encouraging. In the wake of rampant nonconforming activities, the state imposed heavier restrictions. In 1995, the state passed the Education Law (*Jiaoyu Fa*, 教育法) stipulating that education of all forms were “public goods” and were not supposed to be used for “making profits.” In 1997, the Peoples’ Congress passed the Regulations on Non-State Education (*Shehui Liliang Banxue Guanli Tiaoli*, 社会力量办学管理条例). The sixth clause of this regulation declared that when a non-state ETO dissolves, its remaining assets “should be left to the supervising government agency for arrangement after paying off overdue salaries and debts” (Tao and Wang, 2010). This regulation was widely interpreted by ETI people as the state ready to take over the private property of the ETOs (Wang, 2003).

The lack of state support for the ETI to become a private and for-profit industry meant that the fruits of development in China's private economy were kept out of the ETI. For example, the favorable environment for and the rapid growth of the private sector were associated with the rise of a managerial class, diffusion of corporate governance and the expansion of the regulatory state agencies (Yang, 2004; Naughton, 2007, p. 104; Oi and Chaohua, 2011, p. 25). The people, resources and organizational models associated with these changes, however, could not enter the ETI. This is because it was still unclear whether ETOs were private and whether they were for-profit enterprises. Although China's private economy rapidly institutionalized, formalized and converged with the global capitalistic models (Guthrie, 1999), the ETI was still crossing the river by groping for stones.

These economic, political and social contexts conditioned changes in demand and supply in the ETI. During the 1990s, K-12 and IELTS niches were still underdeveloped. Demands for TOEFL/GRE, Graduate Exam and Spoken English were growing rapidly for most of the times during this period. The economic boom in the mid-1990s, however, led to a short-term drop of demand for some test-preparation programs. For example, since young people's opportunities within China were enlarged, demand for studying-abroad and TOEFL/GRE dropped. Newspapers documented the "cooling off of the study-abroad fever"(e.g., Xia, 1993). On the supply side, the entrance of more people and founding of new ETOs made the niche more crowded. In Beijing, the number of ETOs increased from 190 in 1992 to more than 1900 in 1999 and they trained 580,000 people annually (China Non-State Education Green Paper, pp. 100-101). Shanghai also saw the growth of the number of ETOs to over one thousand and the number of students to over two million by 1999 (ibid). Despite the growth of student numbers, the founding of more ETOs made recruiting students more difficult than the previous stage.

The competition for market leaders was now among Underdog ETOs since they had become the dominant model by the early 1990s. Locally dominant and specialist ETOs started to appear in TOEFL/GRE, Graduate Exam and Spoken English niche markets. These new market leaders were most likely founded and operated by people who had work experience in the state systems on one hand and enjoyed accesses to the black market on the other hand. These founders still conducted nonconforming practices. But compared to others who had no experience in the state system and tended to use highly deviant and even illegal approaches, these founders confined their nonconforming practices within the realm of teaching. These new market leaders gained their dominance in part by developing various advanced forms of mass teaching. These advanced forms of mass teaching allowed them to institutionalize their large class size and high profit rate. These market leaders also used the advanced forms of mass teaching to attract students from all over China. Although a few leading brands started to use the franchise model to expand to other regions, the weak institutional support for and the poor quality control of the franchise model did not take these leading brands further.

There was little advancement in organizational structure during this period. Although some ETOs started to circumvent the state regulations by registering as private corporations, most ETOs remained educational entities operated by family members. Although it was still unclear whether ETOs were private and whether they were for-profit, private entrepreneurs of surviving and new ETOs had substantial autonomy in profit distribution, hiring and firing and other strategic decisions.

*Early 2000s to 2010: Financialization, Formalization and Spatial Expansion*

The succession of China's top leadership in the early 2000s triggered the shift of an overall policy agenda toward more emphasis on egalitarianism and less reliance on market forces (Gallagher, 2005; Naughton, 2007, p. 108). The state consolidated its direct control of the economy by putting large state-owned enterprises under the supervision of the State-Owned Assets Supervision and Administration Commission (Lardy, pp. 55–57). In doing so, the state kept prioritizing state-owned enterprises (ibid; Wang, 2015). Direct increase of state loans and infrastructure investment also pulled China out of the global financial crisis during 2007 and 2008. During this period, China's GDP and urban residents' purchasing power maintained a high growth rate.

Despite the rolling back of the neoliberal agenda of the past two decades, education in general and the ETI in particular witnessed a shift of state policy toward much more tolerance of—and even support for—market-based education. Starting in 1998, China's higher education system dramatically increased the number of admitted students, with an explicit goal to spur domestic consumption (Tsang, 2000, p. 21). In 1999, top party and state leaders endorsed the idea of the “industrialization of education” (*jiaoyu chanyehua*, 教育产业化). The growth rate of enrollment in the higher education system exceeded 40 percent in 1999 and 2000 and maintained a growth rate over 20 percent until 2004.<sup>16</sup> Moreover, the People's Congress passed the Non-State Education Promotion Act (*Minban Jiaoyu Cujin Fa*, 民办教育促进法) in 2002. For the first time, this act suggested that the founder of ETOs should receive “reasonable financial rewards” (Tao and Wang, 2010). Although this law kept the clause on non-state education as “public goods” (ibid), it laid the legal foundation for ETOs to be operated as corporations.

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<sup>16</sup> See the websites of China's Ministry of Education ([www.moe.gov.cn](http://www.moe.gov.cn)).

Another institutional change was China joining the World Trade Organization (WTO) in 2001. According to the WTO treaty, China needed to open its ETI and higher education market to foreign organizations, although China could maintain its exclusive control over basic education (Jin, 2009). The state also encouraged forming joint ventures with high-quality foreign schools (Deloitte, 2013, p. 12). Consequently, a large number of foreign ETOs flocked in.

China's continued economic growth, rising urban middle class and expanded education system conditioned the soaring demand for ETI. The ETI's annual total output doubled from 90 to 180 billion U.S. dollars within five years in the late 2000s (Deloitte, 2013). The existing niche markets of TOEFL/GRE, Graduate Exam and Spoken English maintained high growth rates. Political and social contingencies also complemented economic prosperity, facilitating the creation of new niche markets. These new markets include IELTS and K-12.<sup>17</sup> For example, IELTS was not introduced into China until the late 1990s when it started to be used as a criterion for immigration to Canada and overseas studies to Commonwealth countries. The 9/11 attacks and the subsequent tightening of visa policy of the U.S. provided further opportunities for the expansion of IELTS. As obtaining visas from the U.S. was becoming increasingly more difficult, Chinese students turned to Commonwealth countries. The number of test-takers increased from 130,000 in 2006 to 350,000 in 2010.<sup>18</sup>

The K-12 niche market also took off in this period and became the fastest growing niche market (Deloitte, 2010, 2011). Before 2000, primary and secondary school students in China had to spend most of their weekdays and even weekends in their formal schools. Even when some students and parents found it necessary to obtain supplementary education, they most often

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<sup>17</sup> In addition to these niches, the huge demand for computer skills and study-abroad opportunities for young students also contributed to the thriving of ETOs on computer training and SAT.

<sup>18</sup> See the year-by-year change at <http://liuxue.eol.cn/html/lxrep/>. This website is part of China Education Online ([www.eol.com](http://www.eol.com)).

turned to their own teachers and received additional tutoring within their schools. Behind these was an enrollment system that was primarily based on school districts (21<sup>st</sup> Century Education Research Institute, 2012). In the late 1990s and early 2000s, however, high-quality K–12 schools in major urban centers increasingly allowed alternative enrollment approaches, such as math contest awards and school-selection fees (*zexiao fei*, 择校费). These new enrollment approaches either required training outside of formal schooling or an economic contribution, both of which required the support of higher income. By the mid-2000s, these new enrollment approaches had replaced district-based enrollment as the more important selection mechanisms (*ibid*). In the meantime, the state’s Education Ministry and local Education Bureaus continuously launched campaigns against within-formal-school tutoring. They also took measures to reduce the heavy course load. These changes, when combined with the shift of enrollment approaches, led to a vast number of students with craving demand and free time for supplementary education outside of the formal education system. Hence, a colossal K–12 market took shape.

The rise of new niches was associated with the rise of new specialist market players. Dominant players in K–12 and IELTS grew out of large local markets and expanded to other cities. In the meantime, Supernova also expanded to new niches. The competition in the upper echelon of the ETI increasingly took the form of one generalist competing with a few specialists: Supernova was a nationally dominant player in multiple niches, competing with Doo & Cool, United IELTS, Blue Ocean and Roaring English as nationally dominant players in their respective niches.

With regard to the organizational structures of ETOs, they became larger, more capital-intensive and more formal during this period. Becoming more capital intensive was closely related to the ETI’s shift in primary capital source from family capital to investors and financial

markets. Before the early 2000s, ETO entrepreneurs relied much more heavily on family capital than external investments when founding their ETOs. By 2010, eleven ETOs had been publicly listed on overseas stock markets. The primary capital source to start an ETO had also shifted to investors such as venture capital and private equity firms.

The ETI's turn to the financial market started with market leader Supernova's public listing on the U.S. stock market. Its public listing facilitated and hastened the public listing of its competitors, which in turn created a cascade of ETOs turning to financial markets across all niches. Through this process, domestic and global investors discovered the goldmine of the ETI. They rushed into the ETI, together with a large number of financial analysts, reporters, researchers and institutions. They promoted the idea of a nationally integrated education and training industry. As a result of these changes, ETOs increasingly relied on global financial markets and other formal institutions for resources and organizational models. ETOs had to depend on the capital from their investors for survival and development. In 2010, the Chinese state even changed its original policies against for-profit operation of the ETI and permitted the first public listing of an ETO on a domestic stock market (Li et al., 2014).

The ETI's turn to financial markets was accompanied by the formalization, corporatization and bureaucratization of ETOs. As the 2002 law laid the legal ground, a growing number of ETOs registered themselves as corporate entities. There was also an aggrandizement of full-time managers in ETOs. Whether or not an ETO developed a strong and bureaucratic managerial team was closely related to its spatial expansion strategies. ETOs that relied on directly managed branch schools were more likely to develop bureaucratic managerial teams than those that adopted the franchise model. As the corporatization and bureaucratization

deepened, the internal procedures for hiring, financial distribution and other strategic decisions were also formalized.

To the extent that the turn to financial markets and growth of corporate structures increased the norm compliance and predictability of the ETI, they could be considered an institutionalization process. The state and consumers have taken for granted the ETI as a for-profit industry. ETOs, investors, media and associations have formed a nationally integrated ecology. The fast pace of advancement toward greater predictability and clarity, however, also spawned new areas of uncertainty and unpredictability. Some organizational processes became taken-for-granted, whereas others were pushed toward greater ambiguity. In addition, the fast institutionalization process brought about new nonconforming practices.

## **Chapter Two**

### **Toward a New Theory of Organizational and Economic Change**

New institutionalism is arguably one of the most popular theories in economic and organizational sociology. Since its inception, it has been widely used to account for the continuity and constraint of the social structure (Scott, 2008 as cited in Thornton, Ocasio and Lounsbury, 2012, p. 7). To better explain change, scholars have made revisions on new institutionalist theories by incorporating perspectives of cultural theories, population ecology and social movements (e.g., Haveman and Rao, 1997; Rao, Morrill and Zald, 2000; Thornton, Ocasio and Lounsbury, 2012). Despite the differences among the revised versions, they all highlight the importance of organizations complying with well-classified normative orders. According to them, innovation takes place when the rising normative order selects a simple and clearly classified organizational form as the new form (e.g., Haveman and Rao, 1997; Thornton and Ocasio, 1999; David, Sine and Haveman, 2013).

There are, of course, theoretical traditions that are vastly different from the new institutional perspectives. One of them can be labeled as theories of ambiguity. These theories consider ambiguity, hybridity, interstices, boundaries and other not-well-classified or less institutionalized social spaces as hotbeds for innovation (e.g., Abbott, 2001; Stark, 2012). My study is more in line with this tradition and I will also show how the ETI case could further develop this tradition.

My dissertation proposes a new theory of organizational and economic change. I focus on the idea of “double ambiguity” and also discuss ambiguity in general. Double ambiguity means that organizations in a given field are unclear whether they are private or non-private and whether they are for-profit or not. This is a commonly seen social space during the market transition period in China and other post-socialist countries. There are two social sources for double ambiguity: a giant state system and the second economy.<sup>1</sup>

My theory of double ambiguity is both a structural and an agency theory. Indeed, the structural benefits of ambiguity—allowing organizations to blend and recombine diverse resources and organizational repertoires<sup>2</sup>—play an important role in catalyzing change, as existing theories of ambiguity suggest. However, my theory of double ambiguity outlines agency and other factors that move beyond the structural arguments. There are four distinct patterns of change associated with double ambiguity. First, double ambiguity attracts marginal entrepreneurs who use nonconforming practices to outcompete others and push transformation from below. Second, double ambiguity instills in organizations internal conflict, which in turn facilitates the changes within organizations and their industry. Third, innovation under double ambiguity, especially in the early stages of an industry’s development, is often contingent and non-incremental. Fourth, even institutionalization under double ambiguity is distinct in the sense that it triggers a counter-movement: as institutionalization becomes the new engine for change in

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<sup>1</sup> Second economy is the sociological term for the black market in socialist countries. As one type of informal economy, it can be defined as the sum total of income-earning activities with the exclusion of those that involve contractual and legally regulated employment (Gabor, 1979 as cited in Portes and Sassen-Koob, 1987). They are different from the informal economy of developed economies in that they are not only nonconforming from the formal bureaucratic processes but they are also conducive to social change (e.g., Stark, 1989). Despite the fact that some scholars such as Rona-Tas (1994) do not consider second economy as an important source of large-scale private enterprises, there is no question that the second economy was a purely private and economic sector and accordingly an important origin of private economy.

<sup>2</sup> Organizational repertoire is the sociological term for organizational model, or modular way of organizing. The organizational repertoire of a given organization can be conceptualized as the set of organizational models that are culturally and experientially available (Clemens, 1993).

later stages, it also creates new areas of nonconformity and unpredictability. I will elaborate on specific mechanisms associated with these four patterns of change after I offer a systematic critique of new institutionalism and existing theories of ambiguity. I will further show how my new theory can illuminate organizational adaptation and market transition.

## **NEW INSTITUTIONALISM AND THEORIES OF AMBIGUITY: A CRITIQUE**

### **New Institutionalism on Organizational and Economic Changes**

Although some early versions of new institutionalism have expressed interest in individual organizations and their roles in effecting broader changes (e.g., Tolbert and Zucker, 1983), later versions have shown greater interest in the succession of organizational forms than individual organizations (e.g., DiMaggio, 1991, p. 268; Haveman and Rao, 1997).

According to these scholars, an industry or field undergoes a fundamental transformation when there is a major shift in the dominant organizational form. Their idea is that a shift in organizational form takes place when the rising normative order selects a simple and clearly classified organizational form as the new legitimate form. Theorizing organizational change in this way, they focus on selection and other inter-organizational dynamics rather than on adaptation and intra-organizational dynamics (ibid). Some of them also contend that complex and ambiguous forms that do not conform to the rising normative order will face harsh sanctions and legitimacy discount (e.g., Zuckerman, 1999; Zuckerman et al., 2003).

Despite the insights into these new institutional accounts, they have been criticized for being less attentive to agency, power and conflict (Friedland and Alford, 1991; Stinchcombe, 1997; Clemens and Cook, 1999), for being sensitive to imitation but less clear about what to

imitate (Clemens, 1993; Padgett and Powell, 2012), and for emphasizing formal rules but ignoring circumventing rules as an important source of innovation (Fligstein, 1990, 2001).

In response to these critiques, some scholars used the idea of “institutional entrepreneurs” to bring social actors back to new institutionalism (DiMaggio, 1988; Fligstein, 1997). Others modified new institutional accounts by incorporating perspectives of cultural theories and social movements (Aldrich and Fiol, 1994; Thornton and Ocasio, 1999; Ruef, 2000; Rao, Morrill and Zald, 2000; Thornton, Ocasio and Lounsbury, 2012). Most recently, institutional logic theorists combine the idea of institutional entrepreneurs, highlighting the role of “hybrid organizations” as institutional entrepreneurs (Rao and Giorgi, 2006; Battilana and Dorado, 2010). According to these studies, hybrid organizations that face multiple and contradictory institutional logics could facilitate organizational change. These organizations enjoy advantageous positions in decoupling, blending, segregating and selecting institutional logics (Binder, 2007; Pache and Santos, 2013).

Although these revised versions of new institutionalism have made progress in bringing actors and power back in, they put their focus on well-institutionalized social spaces. According to the institutional logic perspective, for example, “inter-institutional” spaces are worth special attention because these spaces are governed by multiple and often contradictory institutional logics (e.g., Thornton, Ocasio and Lounsbury, 2012, pp. 5–10). The uniqueness of inter-institutional spaces is the multiplicity of well-classified normative and cognitive systems within these spaces. In other words, these spaces seem to be over-institutionalized because there is “way too much consensus in the field about what is going on” (Fligstein and McAdam, 2012, p. 11). Under-institutionalized social spaces, such as ambiguity, interstices and boundaries where there is not a coherent institutional logic or even a clear classification system, have escaped the radar of the institutional logic paradigm. Given that multiplicity is a characteristic of inter-institutional

spaces, social actors in these spaces seem to only care about which institutional logic to choose from. They do not have to worry about how to resist other actors' powers or make sense of the world (Weick, 1995; Fligstein and McAdam, 2012, p. 7).

### **Existing Theories of Ambiguity**

My dissertation is more in line with a different tradition that can be labeled as theories of ambiguity. According to these loosely connected theories, we should look at ambiguous identities and blurred social spaces as hotbeds for economic, professional and organizational change. Using various labels such as recombinant (Stark, 1996), ambiguity (Stark, 2009; Lester and Piore, 2006), multivocality (Padgett and Ansell, 1993), hybridity (Padgett and Powell, 2013), interstices (Morill, 2006; Fligstein and McAdam, 2012, p. 87) and boundary-in-between (Eyal, 2011; Medvetz, 2012), these theories start with the assumption that no social system is sufficiently institutionalized or can be taken for granted as a fixed entity (Mann, 1986, p. 16; Abbott, 2001).

Despite their insights, they left some important questions unaddressed. First, these existing theories are exclusively structural theories of ambiguity. The role of ambiguity in facilitating change is attributed to the structural characteristics of ambiguous social spaces. They neglect how ambiguous social spaces could attract social actors who act differently from those in clear social spaces. Neither does the interaction between these actors and the ambiguous social space receive enough attention. The second limitation of the existing theories is that they debate with new institutionalists over advantages and disadvantages of ambiguity (e.g., Stark, 1996, 2012; Zuckerman et al., 2003), but they neglect the complex competition *within* the ambiguous field and the consequences of the competition on the trajectory of the field. Still less is known

about how organizations maneuvered in the ambiguous environment, especially their practices in changing their ambiguous organizational identities.<sup>3</sup>

Table 2.1 Industries in Which Organizations Have Clear or Ambiguous Identities

Dimensions	Clear Commerciality	Ambiguous Commerciality
Clear Ownership	For-profit business enterprises with clear ownership	Social enterprise industries with clear ownership: e.g., microfinance (Battilana and Dorado, 2010), work integration (Pache and Santos, 2013)
Ambiguous Ownership	Ownership-ambiguous for-profit enterprises: e.g., Chinese township and village enterprises (Nee, 1992; Tsai, 2007), Hungarian “Recombinant model” (Stark, 1996)	Doubly ambiguous industries: e.g., China’s ETI, specialty healthcare industry, fashion publishing industry

Third, these existing theories only focus on a single dimension of ambiguous organizational identity. Studies of ownership-ambiguous enterprises in post-socialist countries, as illustrated in the lower left cell of Table 2.1, only deal with ambiguous identities on the dimension of *ownership*, or simply whether organizations are private (Nee, 1992; Stark, 1996; Tsai, 2007). Similarly, various studies of social enterprises, as seen in the upper right cell, give primary attention to ambiguous organizational identities on the dimension of *commerciality*—whether multiple stakeholders agree that organizations of a certain industry are for-profit

<sup>3</sup> According to Polos et al., (2002), Zuckerman et al., (2003), Hsu and Hannan (2006), organizational identity is audience-based. Ambiguous identity, therefore, can be measured by the level of agreement by multiple stakeholders such as the state, consumers and employees.

businesses or not-for-profit social enterprises (e.g., Battilana and Dorado, 2010; Pache and Santos, 2013). Little is known about industries that are ambiguous on multiple dimensions.

## **TOWARD A THEORY OF DOUBLE AMBIGUITY**

This dissertation builds a systematic theory of ambiguity in organizational and economic changes. I focus on double ambiguity in particular and also discuss ambiguity in general. As the lower right cell of Table 2.1 shows, double ambiguity means organizations therein have unclear identities on dimensions of both commerciality and ownership. Typical doubly ambiguous industries include specialty healthcare and fashion publishing, which emerged during China's market transition. I will introduce these industries in the concluding chapter.

There are two social sources for double ambiguity. For all doubly ambiguous industries mentioned above, a colossal state system and the second economy undergird ambiguity. In China's ETI, for example, the giant state education system was one of the major sources for teachers, facilities, information and organizational repertoires of all ETOs. Similarly, other doubly ambiguous industries drew their resources and repertoires from the state medical and publishing systems. These giant state systems not only provided resources and repertoires, but they also brought heavy state regulations into doubly ambiguous industries. These regulations dictate the nature of early doubly ambiguous industries as being partly non-private and not-for-profit. Doubly ambiguous industries are most evident in post-socialist countries because their education, medical and publishing systems used to be giant systems with complex social welfare functions. Their states also tended to delay the privatization and marketization of doubly ambiguous industries for strategic and ideological consideration. With that said, the counterpart industries in non-post-socialist countries also face heavy regulations, although they are not

necessarily doubly ambiguous. The ETI in South Korea, for example, is subject to state regulation in terms of price and hours of services (e.g., Chandler, 2011).

On the other hand, private education all over the world is subject to the influence of the black market (Portes and Sassen-Koob, 1987). ETOs in China and other countries drew on the black market for organizational repertoires. Accordingly, there is a high level of informality in ETIs around the world. ETOs in the U.S., for example, rely on part-time teachers and could benefit from the tax loopholes accordingly (Informant No. 74).

### **Mechanisms of Change under Double Ambiguity**

In doubly ambiguous industries, the way the state regulates enterprises and how enterprises maneuver in the environment are different from how they act in other industries. Accordingly, how economic changes and organizational innovation unfold is different in doubly ambiguous industries compared to other industries.

First, doubly ambiguous social spaces attract marginal entrepreneurs, and they push economic and organizational change with nonconforming practices from below. Marginal entrepreneurs are often denied access to critical social resources and social institutions. They tend to have different motivational structures<sup>4</sup> from mainstream actors and draw on non-mainstream organizational repertoires. In the ETI, for example, marginal entrepreneurs drew on resources and organizational repertoires of the second economy and adopted more nonconforming practices. Accordingly, they were more likely to “tunnel ahead” and circumvent “closed-off” routes (Mann, 1986, p. 16; Fligstein, 1990, p. 21, 2001, p. 13). They transpose

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<sup>4</sup> According to Zhao (2015, pp. 37–38; p. 45), different social actors have different motivational structures. He develops Weber’s theory on value rationality and instrumental rationality, arguing that these are the two basic types of motivational structures.

informal sources into practices that are nonconforming with formal regulations and informal norms.

These marginalized actors and their organizations can push change through outcompeting other actors. These actors and their organizations not only benefit from the structural condition of double ambiguity, but their nonconforming practices are also made more effective and less likely to be sanctioned under such conditions. In the next chapter, I propose four specific mechanisms—low risk of state take-over, taxation benefits, low sanction risk in blind spots and innovation advantages—through which marginalized actors and their organizations outcompete others. Through gaining dominance and defining the rules of the game, marginalized social actors and their organizations could turn into the agents of change in the ambiguous social spaces.<sup>5</sup>

Second, double ambiguity breeds structurally conditioned internal conflicts. By structurally conditioned internal conflicts, I mean certain types of intra-organizational struggles shared by organizations in the same or similar social spaces. These conflicts are not sporadic. Rather, there are systematic occurrences of these conflicts among organizations. For example, I will demonstrate the presence of systematic internal conflicts regarding profit distribution among doubly ambiguous ETOs. Structurally conditioned internal conflicts can also be spotted in singly ambiguous social spaces. In China and other post-socialist countries, for example, ambiguity in ownership is associated with widespread internal conflicts among business partners regarding profit distribution, ownership transfer and share distribution (Francis, 1999; Su et al., 2008).

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<sup>5</sup> This is like providing a “field theory” answer to the question of ambiguity (Fligstein and McAdam, 2012). A “challenger” model can push the field toward less ambiguity by outcompeting others and setting the new rules. This is potentially a generalizable route for ambiguous industries to grow out of ambiguity. With that said, my findings move away from the field theory’s prediction that organizational models that are proximate to the state are likely to build strong alliance with the state and win out.

Internal conflicts do not necessarily lead to innovation. They are destructive to organizations in most cases. However, internal conflicts can catalyze innovation of organizations. In Chapter Five, I propose four conditions under which internal conflicts are more likely to lead to innovation instead of destruction: a) conflicts are severe enough for attention and worth solving among multiple parties; b) conflicts are not fatal, or at least the “technical core” is buffered (Thompson, 1967); c) multiple parties do not easily quit from organizations due to constraints such as close ties; and d) conventional solutions cannot alleviate the conflicts. I further introduce two mechanisms—organizational lock-up and infrastructural readiness—through which a market leader turned internal conflicts into an engine that led to a public listing on the stock market.

Chapter Five will further show how structurally conditioned internal conflicts can contribute to a shift in organizational form of an entire field. Of course, the shift in organizational form is often inseparable from the isomorphic pressures and other institutionalization processes. Nevertheless, there are mechanism through which internal conflict and double ambiguity could effect field-level changes: a) similar, structurally conditioned internal conflicts shared by a large number of organizations can equip these organizations with the impetus toward change in the same direction; b) the competition structure and relative market status among top market leaders, partly associated with double ambiguity, can impact the pace of isomorphism; and c) to the extent that the conflict-induced changes only occur under certain conditions, such changes are highly contingent. This leads to the next point.

Third, innovation under double ambiguity requires a long locking-in process and is often highly contingent and processual. According to existing theories of ambiguity, the reason why ambiguity facilitates innovation is because ambiguity avails organizations with flexibility and

alternative options (March, 1991; Stark, 2009; Padgett and Powell, 2012). The way organizations innovate under ambiguity, according to them, is primarily through exploring, blending and recombining divergent organizational elements. Despite the merit of these accounts, they cannot explain why some organizations in the ambiguous social space and not others are able to push forward innovations.

Ambiguity indeed offers organizations a wide variety of raw materials, but it also adds difficulty for gluing these elements into a stable model. Due to the existence of heterogeneous actors and ambiguous product standards, it often takes a longer process for organizations under double ambiguity to mold existing organizational elements into a stable new model.<sup>6</sup> As I show in Chapters Four and Six, the formidable challenge facing leading ETOs is not exploring, but rather how to exploit different combinations of existing elements. Until multiple elements are locked-in, innovations are too inchoate to be used for competition. Here, locking-in is not an obstacle to innovation, as theories of ambiguity suggests (e.g., Stark, 2009). It is a pinnacle organizations aspire to achieve.

Locking-in innovations are processual and contingent. Being processual means that the success of innovation is unintentional, non-incremental and highly susceptible to the influence of turning points (Sewell, 1996a, 1996b; Abbott, 2001, pp. 261–279; Zhao, 2015, pp. 377–380). To the extent that locking-in organizational elements is time-consuming and difficult, whether and how an organization can lock-in organizational elements is uncertain. This claim, however, does not mean that there is no pattern for locking-in under double ambiguity. In Chapter Four, for example, I point to the social embeddedness of founders as an important indicator of the initial direction of organizational innovation under double ambiguity. Furthermore, since it is

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<sup>6</sup> Many theories of historical sociology have reminded us of the disparate temporality in different social spaces (Abbott, 2001, pp. 285–286; Zhao, 2015, p. 36).

contingent and difficult for organizations to lock-in innovation, competitors cannot easily imitate an innovation that an organization unintentionally developed. Accordingly, we observe less diffusion of innovative practices in doubly ambiguous industries, as Chapter Four elaborates.

Fourth, economic and organizational changes in later stages indeed take the form of institutionalization, but even institutionalization is distinct under double ambiguity. As time passes, organizational structures and procedures become increasingly formalized, predictable and bounded by written rules. Mainstream actors enter the field with taken-for-granted organizational repertoires. This does not mean all doubly ambiguous industries move in a teleological direction. Under the general trend of globalization and neo-liberalization, however, there is an observed turn of doubly ambiguous industries toward greater clarity all over the world. Some new institutional mechanisms, such as isomorphism, could be more applicable to the later stages in the development of double ambiguity, although I have shown their inadequacy in explaining early changes. In fact, many studies associated with new institutionalism depict a far more predatory and opportunistic picture than when they describe the early stages of development (Fligstein, 1990, pp. 33–34; Nee and Opper, 2012, p. 36). Changes in the late stages of double ambiguity are not antithetical to institutionalization.<sup>7</sup> With this said, institutionalization under double ambiguity demonstrates two distinct patterns. First, the fast institutionalization in an under-institutionalized space can create new areas of uncertainty and unpredictability. Second, institutionalization is a dynamic process, which means some areas become clearer but some formerly clear issues can become ambiguous.

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<sup>7</sup> In fact, if we set us free from the definition of institutionalization in the U.S. literature, the economic and organizational changes in the early stages might also be called institutionalization with a Chinese character. It means that, although actors do not comply with written rules and cooperation norms, there are certain boundaries they cannot go beyond. For some preliminary discussions, see Yan (1996, pp. 3–10).

## **APPLICABILITY OF THE NEW THEORY**

### **Organizational Change: Selection or Adaptation**

My new theory of double ambiguity can illuminate economic and organizational changes on micro and macro levels. This section will show that my theory of ambiguity leads to breakthroughs in solving the selection versus adaptation debate.

The debate about whether organizational changes are governed by selection (i.e., the founding of new organizations) or adaptation (i.e., evolutions of existing organizations) is a classic topic in economic and organizational sociology. Whereas earlier studies used in-depth case studies to highlight the adaptation of individual organizations (e.g., Cyert and March, 1963; Thompson, 1967; Miles, 1982), organizational sociology since the late 1970s had turned toward selection thanks to the rise of population ecology (e.g., Hannan and Freeman, 1977, 1989; Carroll and Hannan, 2000). Although much ink has been spilt on how selection and adaptation can be complementary (Astley and Van de Van, 1983; Aldrich, 1999; Levinthal and Posen, 2007; Peli, 2009), selection has been shown to be a more dominant mechanism. For example, studies under the label of new organizational form show that the succession of dominant organizations forms is largely a function of the founding of the new organizations complying with the rising normative system (e.g., Haveman and Rao, 1997).

My empirical work and theory of double ambiguity sheds new light on this old debate. My empirical chapters will illustrate that succession of organizational form is primarily shaped by selection. It is indeed extremely difficult for existing firms to adapt to the changing environment. With that said, some firms can adapt successfully while others cannot. Below I will outline specific conditions under which adaptation can be successful. Moreover, I will discuss the situation where adaptation of organizations can even catalyze the selection of an industry.

Change of organizational form is primarily shaped by selection. To begin with, my empirical study shows that organizations founded in different periods are marked with different structures. This finding corroborates the “imprinting hypothesis” (Stinchcombe, 1965; Johnson 2007; Marquis and Tilcsik, 2013).<sup>8</sup> This hypothesis claims that organizations are imprinted with environmental characteristics, and these characteristics tend to persist. Second, a change in the dominant forms, especially in later stages under double ambiguity, is largely shaped by legitimacy-oriented environmental selection. The shift to financial-market-dependent ETOs as the dominant form in the ETI, for example, is largely the result the founding of new ETOs, rather than the evolution of existing ETOs. The institutional environment selected the financial-market-dependent form as the legitimate form.

Nevertheless, form succession under double ambiguity, especially in the early stages, is not solely governed by legitimacy-oriented selection. For example, Chapter Three complements a competition mechanism to the selection mechanism. To be sure, structural characteristics played an integral role in selecting Underdog ETOs as winners. These ETOs, however, were not legitimate because they adopted practices that were nonconforming with formal regulations and informal norms. Underdog ETOs used nonconforming practices to compete with other ETOs. They were not selected as the dominant; rather they competed to be dominant.

With regard to adaptation, it is extremely difficult for existing organizations under double ambiguity to adapt to the changing environment. Of course, organizations in clear social spaces also have limited capacity for adaptation, given the ubiquity of structural inertia (Hannan and Freeman, 1977, 1989). Adaptation, especially toward a more legitimate form, is a more

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<sup>8</sup> The imprinting hypothesis is largely a selection mechanism, especially the so-called second stage when organizations are bounded by structural inertia. This is why Johnson (2008) claims that imprinting means non-adaptation of organizations. Interestingly, the first entrepreneurial stage Johnson (2007, 2008) describes seems to be highly adaptive, as the organization is constantly molded with the incorporation of new elements.

formidable task for organizations under double ambiguity. This is because nonconforming organizations often dominate the early stages of development in a doubly ambiguous space. The adaptation of nonconforming organizations is challenging, if not entirely impossible. In the ETI, for example, a large number of Underdog ETOs that used to dominate the market with their nonconforming practices failed to adapt to the heightened institutional pressures.

Although adaptation of a particular organization is difficult, it is not impossible. Structural inertia can be overcome. I call the adaptation of a particular organization the “weak version of adaptation.” I present empirical cases that document the transformation of individual ETOs. My research design opens up the black box of organizations’ internal dynamics and puts in the spotlight the adaptation processes. I use these processes to outline specific conditions under which such adaptation is successful. These conditions include: a) controllable internal conflicts; b) leadership succession; and c) organizational learning (Nelson and Winter, 1982; March, 1991). Meeting one or more of these conditions is the precondition for organizations to overcome inertia. However, it does not guarantee success in adaptation. As I have mentioned earlier and will elaborate upon in the empirical chapters, adaptation and the related innovation processes under double ambiguity are susceptible to the influence of contingent factors.

Adaptation of particular organizations can even bring about succession of organizational forms in a field. This is the “strong version of adaptation.” I use the role of Supernova in initiating the ETI’s turn to the global financial market as a case and document the whole process in Chapter Five. To the extent that this process can be construed as an institutionalization process (e.g. Espeland and Hirsch, 1990; Dobbin and Zorn, 2005; Davis, 2011; Carruthers, 2015), my research not only demonstrates the important role of individual organizations in a field’s

evolution, but it also revives a lost tradition in institutional studies. This tradition emphasize individual organizations' pioneering role in institutionalization (e.g., Tolbert and Zucker, 1983).

### **A New Theory of Market Transition**

My theory of double ambiguity and empirical study on its privatization and marketization also contribute new perspectives to studies on China's market transition. My theory presents a novel bottom-up trajectory for the rise of China's private economy, a neglected mechanism for the rise of China's private entrepreneurs and a new role for the Chinese state.

Until recently, the three major theoretical approaches for understanding the rise of China's private economy were: clear private property rights, state-led accounts and bottom-up accounts. Since the private sector flourished long before the state's formal recognition of private ownership, economists' emphasis on clear private property rights as a precondition for capitalistic development does not hold water (e.g., North, 1981; Sachs, 1991). The absence of the state's direct support also challenges the top-down development path described by various state-led models (e.g., Oi, 1995; Walder, 1995; Blecher and Shue, 2001). Due to the state's ambivalent stance, China's private economy has three points of origin with corresponding developmental trajectories: privatization of state-owned enterprises, development of purely private individual businesses, and most importantly, privatization of ownership-ambiguous enterprises such as township and village enterprises.

In light of the state's limited role, recent studies have shifted to a bottom-up entrepreneurial perspective (Tsai, 2007; Huang, 2008; Nee and Opper, 2012). A common theme across these bottom-up accounts is that China's private economy emerged below the state's radar in distant rural areas. Another growing consensus is the importance of norms and other informal

institutions (Tsai, 2007; Nee and Opper, 2012). Nee and Opper (2012) represents a recent and systematic attempt to explain the bottom-up trajectory. Employing a rational choice version of new institutionalism, they focus on the significance of the informal norms of trust, reciprocity and cooperation (hereafter cooperation norms) in undergirding the development of China's private enterprises. They show that cooperation norms are generated and institutionalized in the repetitive interactions among private economic actors in close-knit networks. Through mutual monitoring and recognition, private enterprises complying with cooperation norms are likely to thrive; those that do not are likely to fail. As private entrepreneurs mimicked each other, private entrepreneurship diffused and spilled across China.

The privatization and marketization of doubly ambiguous industries presents a novel bottom-up trajectory. In these industries, socially marginalized entrepreneurs did not rely on complying with formal rules and informal norms. Rather, they blended organizational elements of two divergent sources into new and nonconforming practices. Benefiting from the ambiguous social space, their nonconforming practices and the interaction between the structural forces and these practices, these private entrepreneurs and their enterprises outcompeted other organizational models. As they became dominant players and were able to set the rules of the game, they pushed the privatization and marketization of the industry from below. Doubly ambiguous industries did not emerge below the state's radar in rural areas, as previous bottom-up accounts suggest. Rather, they thrived right under the state's nose in metropolitan centers. They flourished within and grew out of the shadow of the state.

The discovery of the privatization of doubly ambiguous industries means China's private sector has more diverse origins and broader social foundations than previous studies suggest. The aforementioned three points of origin of China's private economy are incomplete. There is at

least a fourth point of origin: doubly ambiguous industries. In addition, since no study of China's private economy has included doubly ambiguous industries, even the studies with high figures about the size and economic impact of the private sector tend to be understated (e.g., Dougherty and Herd, 2005). China's private economy has grown far bigger, stronger and deeper than was previously realized.

My theory of double ambiguity also means that we need to rethink the question of "who wins and how" in the market transition debate. With regard to winners, some scholars consider former cadres as the winners (Oi, 1992; Rona-Tas, 1994; Parish and Michelson, 1996), whereas others present evidence on the winning of new private entrepreneurs (Nee, 1989). Despite their divergent views, they all emphasize the political connections of cadres and private entrepreneurs (e.g., Ding, 2000; Wank, 2001). Other theories focus on private entrepreneurs' education, norm compliance and innovative spirits (Zhou, 2000; Wu and Xie, 2003; Huang, 2008; Nee and Opper, 2013). My theoretical and empirical work will show that marginalized social actors with poor political connections became the initial winners. Moreover, I point to the significance of nonconforming practices and their roots in the second economy. Nonconforming practices are what private entrepreneurs used to maneuver in China's ambiguous business environment.

My theory of double ambiguity also involves a new role for the state in market transition. Existing theories, in general, fall into three categories. First, state-led scholars argue that market capitalism rises when the state provides direct support to market development (e.g., Amsden, 1989; Wade, 1990; Evans, 1995). Such support can be in the form of explicit policies or provision of institutional foundations. Second, scholars with greater exposure to rational choice and economics tend to see the opposite: market capitalism only develops when the state retreats (e.g., Huang, 2008; Nee and Opper, 2012). According to them, state restriction on market

behaviors only leads to the withering of market capitalism. Even the third approach, the “turning a blind eye” argument (Tsai, 2007, p. 150; Nee and Opper, 2012, p. 36), assumes state tolerance as a necessary condition for market development.

My study captures a more complex role for the state. I will show how, under double ambiguity, the state’s restrictions on market and nonconforming practices unintentionally facilitated the creation of a highly marketized industry. In short, capitalism could develop not only in spite of, but also because of, state restrictions. On the one hand, this finding refutes economists’ claim that markets develop naturally and supports the Polanyian thesis that active state involvement is crucial for market formation. On the other hand, my findings move away from the emphasis on the positive role of the state in providing institutional foundation found in the Polanyian thesis. I illustrate how the state’s negative planning toward a market contributed to an exactly opposite outcome.

## Chapter Three

### **The Dawn for Underdogs: Initial Privatization and Marketization**

*The ETO affiliated with Capital University was even more magnificent. It was located in those buildings of historic charm. Anyone who gave it a look would know that this ETO had great capacity and high quality. Among those students who went for consultation, few people were not touched (by the ETO) and they would all sign up for classes.... People would not hesitate to pay their money within the Capital University campus. They knew that, within the Capital campus, (the founder) would not run away (with their money). Even if (founders ran away), Capital University was there. After all, people had unparalleled trust in the reputation and authority of Capital University.*

—Supernova Archive No.5, p. 53

*Foreign language is a weapon in the struggle of life. TOEFL, for many Chinese students, is a struggle against their destiny.... In April 1989, the time before I came abroad, I signed up for a “TOEFL Intensive Course” at a foreign language ETO. The school was located within a (state) middle school. It used the middle school’s classrooms that were vacant in evenings. My classes were from 7–9pm on Tuesdays and Thursdays. The whole course lasted for two and half months, with tuition of 150 RMB. In the meantime, this school had other classes, such as “Grammar Intensive Course,” “Advanced Spoken English” and “Business English.” What attracted me most on the advertisement was “taught by teachers who have graduate degrees from the U.S. and are native speakers of English.”*

—Qian, 1996, p. 42–44

In the 1980s, any Chinese student who was learning a foreign language or preparing for a standardized test would first consider attending an ETO class organized by or affiliated with a state education institution. ETOs founded by retired faculty members or educators were also an indicator of trustworthiness. ETOs affiliated with elite state education institutions had no difficulty in becoming early market leaders. Their teachers who worked part-time in ETOs and full-time in state education institutions applied their familiar pedagogies to ETO classes. In

ETOs that helped students learn English and TOEFL, for example, it was common for professionally trained faculty members from English departments to analyze grammar and sentence structure as they did in universities.<sup>1</sup> Native speakers of English were also used as a symbol of good teachers. Just as in state education institutions, students did not evaluate teachers. Instead, teachers used homework and quizzes to check the educational gains of students.

All this had changed by the early 1990s. A group of new players—Underdog ETOs—became top market leaders across niche markets. They were all founded and operated by a group of entrepreneurs who were not qualified as ETO founders according to the state regulations. Prior to their entrepreneurship, a large portion of these entrepreneurs only had low levels of education or low social status. By the early 1990s, they had transformed from underdogs to successful entrepreneurs by operating ETI business. This initial victory is crucial because the underdogs became the rule-makers. As a prototype of private enterprises, they not only shaped the mainstream practices for the ETI, but their dominance also paved the way for the ETI to become a for-profit industry led by private enterprises. Their success was also accompanied by the rise of a different model of operating ETOs—mass teaching. Featuring large class size, non-professionally trained teachers, market-based teacher evaluations and class content that was not directly related to educational goals, this model resembled neither the then mainstream model of operating ETOs nor the model commonly seen in the U.S. and Europe.<sup>2</sup>

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<sup>1</sup> In the 1980s and early 1990s, Chinese considered TOEFL and GRE as tests of English. Therefore, teachers who were professionally trained in English had the legitimate professional control over TOEFL and GRE. Although GRE is supposed to be an aptitude test rather than language test, classification of a test depends on its social context. In the 1980s, the only educational resource available was state universities and their English departments. So even if the GRE was about to test logic reasoning, teachers framed it into and operated as a language test. When teaching GRE quantitative sections, for example, teachers spent most of time translating the English terms of equations into Chinese (Lu, 2002).

<sup>2</sup> The U.S. and European models feature small class size, interactive, flexible and even individually tailored schedule etc.

This chapter investigates the rise of Underdog ETOs from the 1980s to the early 1990s. Why did this particular model of prototypical private enterprises that was more nonconforming become dominant? Here, dominance means becoming top market leaders measured by student enrollment. Nonconformity in the 1980s has specific references to three kinds of activities: First, it refers to nonconformity with formal state laws and regulations regardless of industry. Second, it refers to nonconformity with the legitimate forms of schools and teaching that are specific to this industry. As I mentioned before, the state's initial intention was to develop the ETI as an extension of the state education system. Accordingly, the state imposed restrictions on ETOs regarding the social backgrounds of founders, distribution of profits and access to stock markets. It is against the backdrop of these heavy regulations that the dominance of Underdog ETOs was puzzling. Third, there is nonconformity with cooperation norms among business partners. Cooperation norms are informal norms of cooperation, trust and reciprocity that constrain people from favoring oneself at the expense of others. Many scholars consider these norms as essential for sustaining modern commercial transactions.<sup>3</sup>

I present my findings and arguments using the case of Beijing's TOEFL/GRE niche market. Eight ETOs from this niche market were selected as primary cases because each one of them was once a top-three market leader from the 1980s to the mid-1990s. Additional cases are drawn from China's Graduate Exam and Spoken English niche markets. These additional cases are used to check if the TOEFL/GRE pattern is generalizable to the whole industry.

Below I first present the social and historical context of TOEFL and GRE training, followed by a periodization and succession of market leaders. Then I show how all ETOs relied on the state education system and the second economy for their resources and organizational

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<sup>3</sup> See Axelrod (1984), Uzzi (1996) and Nee and Opper (2012).

repertoires. Underdog ETOs brought resources and repertoires of the second economy into the ETI, creating new and nonconforming practices. Underdog ETOs came to dominance not only because they benefited from the structural condition of double ambiguity, but their nonconforming practices were also made more effective and less likely to be sanctioned under such conditions. I propose four specific mechanisms through which Underdog ETOs gained dominance: low risk of state take-over, taxation benefits, low sanction risk in blind spots and innovation advantages.

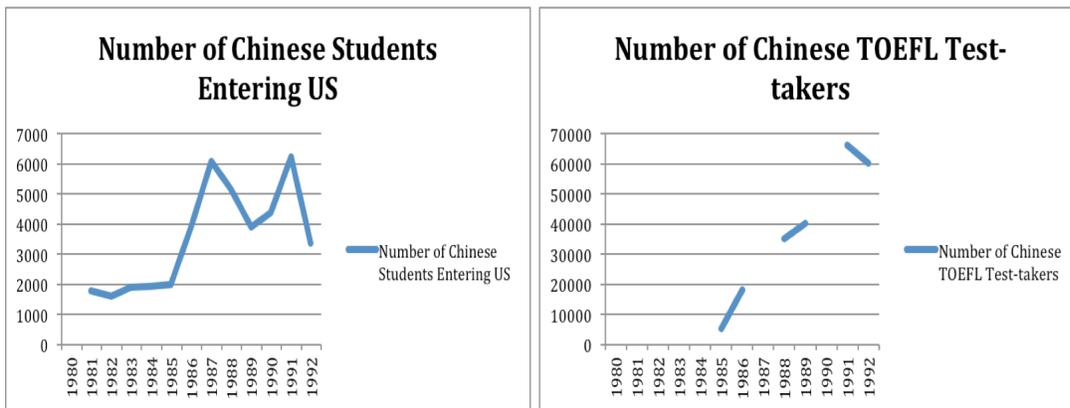
## **CONTEXT, DYNAMICS AND ALTERNATIVE EXPLANATIONS**

I have introduced in Chapter One how studying abroad and learning foreign languages gained popularity in China in the late Qing Dynasty and early Republican era. Strong nationalist ethos at that time encouraged the Chinese to pursue these two intertwined courses in order to strengthen the nation. Although studying abroad and learning foreign languages were suspended during the Cultural Revolution, they picked up momentum again in the late 1970s. With the endorsement of top leadership, state-sponsored and self-sponsored studying abroad rose with the booming interest in English in the 1980s.

In the early 1980s, obtaining state sponsorship was the primary, if not the only, approach to study abroad. The state scrutinized candidates' political backgrounds and required service to the state after the studying-abroad period was over (Zhao, 2001, p. 133). Candidates only needed to pass English tests organized by Chinese state agencies. U.S. colleges and universities also relied heavily on Chinese state's recommendation in order to decide who to admit. In addition, since there were initially so few Chinese students in U.S. colleges, these students were considered precious and warmly welcomed. Therefore, a large number of students were

exempted from TOEFL test (Qian, 1996, pp. 35–40). As Figure 3.1 shows, each year the number of new Chinese students studying in the U.S. dwarfed the number of each year’s Chinese TOEFL test-takers in the early 1980s.

Figure 3.1 Increase in Number of New Chinese Students Studying in the U.S. and Number of TOEFL Test-Takers



Sources: multiple sources, including *Open Doors: Report on International Educational Exchange* (New York: IIE, 1980-1992) and Qian, David. 2010. *English Language Assessment and the Chinese Learners*. p. 101. Routledge.

Chinese students had quickly figured out how to circumvent state regulations and study abroad on a self-sponsored basis by the mid-1980s. The so-called “going-abroad fever” primarily consisted of the boom of self-sponsored students (Qian, 1996, p. 40; Zhao, 2001, p. 130). As Chinese students emerged in U.S. universities at an increasing pace, U.S. universities imposed stricter policies regarding language proficiency. Competition among applicants intensified. Having a satisfactory TOEFL score increasingly became the necessary requirement for application, especially for obtaining financial aid. Chinese students even developed the idea that TOEFL was one of the most important determinants for studying abroad. The demand for higher score and test-preparation skyrocketed (Lu, 2002). Accordingly, we see that the number of

Chinese TOEFL takers increased at a faster speed than the number of new Chinese students to the U.S. in Figure 3.1.

China's worsened domestic economic and political situation in the late 1980s provided the most direct catalyst for the quick surge of TOEFL/GRE test-takers. Despite the economic prosperity in the early 1980s, Chinese society was inflicted with high inflation and corruption in the mid- and late 1980s. Economic and political crisis finally led to the 1989 Beijing Student Movement (Zhao, 2001). This movement facilitated the boom of Beijing's TOEFL/GRE market in several ways. First, this movement made students increasingly anxious about not being able to study abroad, which hastened their decisions to take tests (Zhao, 1996). There was stricter control of leaving the borders of China before and after the movement. The tightened control was both due to maintaining stability and the fact that very few Chinese students kept their promise to return to serve their homeland (ibid). As a result of the stricter control, the number of new Chinese students to the U.S. showed the first downward trend in the late 1980s since the market reform (Figure 3.1, right). There were even rumors that the government would close the gate of China again and suspend studying abroad. These situations led students to conclude that they needed to leave China before it was too late. Students rushed to test centers and waited in long lines until midnight in order to secure test opportunities (Zhao, 1996; 2001, p. 131). Second, the bloody crackdown made students "disillusioned" about the future of China, and they became determined to "escape from China" (ibid). Students who were hesitant about going abroad now made up their minds. Consequently, the number of Chinese TOEFL test-takers soared in the late 1980s (Figure 3.1).

The third and often neglected contribution of the 1989 Student Movement to Beijing's TOEFL/GRE market was the availability of more free time for students and teachers. Classes

were suspended from April to August 1989. Multiple informants reported that they started organizing TOEFL/GRE classes in the summer of 1989 because as faculty members, they had no classes to teach, and students were craving for test-preparation classes (Informants No. 4, No. 9, No. 61). Furthermore, the student movement provided an opportunity for cross-school and cross-department association. For example, the founder and a senior manager of a leading ETO who belonged to different departments within Capital University did not know each other before the movement, but they became friends because both of them demonstrated on the Tiananmen Square (Informant No. 9).

In addition to the direct catalysts mentioned above, the rise of TOEFL/GRE, studying abroad and English came from a broad social and political background. Globalization and neo-liberalization swept the globe in the 1980s and 1990s. Higher education systems in English-speaking and especially Commonwealth countries embraced internationalization by recruiting more international students. A related linguistic process was the rise of English as a cultural capital for global stratification (Koo, 2016). The global trend toward neoliberal capitalism conditioned the direction of the ETI's change toward privatization and marketization. This broad trend, occurring simultaneously with China's market transition, laid the foundation for the expansion of ETI services related to studying abroad and foreign languages.

Three competing models succeeded each other as the top three market leaders in three stages. During the first stage (early to mid-1980s), State ETOs emerged as the earliest top players. As Table 3.1 shows, typical examples were those ETOs affiliated with elite state universities, such as State ETOs of Capital University (hereafter Capital University ETO) and Central College of Foreign Languages. It is important to note that the focus here is on organizational *forms*, although I also mention the names of individual organizations. State ETOs

were affiliated with state universities and therefore not a prototype of private enterprises. Their affiliation means they were listed under state university names, partially funded by universities and led by universities' administrators or veteran professors. These leaders were entitled to a large proportion of the tuition revenue, after the agreed portion was paid to the university and the department.

Table 3.1 Succession of Top Market Leaders in Beijing's TOEFL/GRE

	1 <sup>st</sup> Stage (Early to Mid-1980s)	2 <sup>nd</sup> Stage (Mid- to Late 1980s)	3 <sup>rd</sup> Stage (Late 1980s to Early 1990s)
Top Three ETOs	1. Capital University Training Division (State ETO)	1. Capital University Training Division (State ETO)	1. Cornerstone School (Underdog ETO)
	2. Central College of Foreign Studies Training Division (State ETO)	2. Questing School (Intellectual ETO)	2. Pioneers School (Underdog ETO)
	3. Questing School (Intellectual ETO)	3. Seven Swords School (Underdog ETO)	3. Nova Academy Training Division (Intellectual-Underdog ETO)

Sources: Author's compilation based on Lu (2002) and multiple informants.

State ETOs benefited from the resources and the good reputation of state universities among Chinese students. As the example at the beginning of this chapter illustrates, Capital University ETO was located in a historic building within this elite university's campus, and a majority of their teachers came from Capital University's English Department. Feeling that they were to take classes just like Capital's students, students who went there for consultation almost all signed up for class eventually (Informants No. 9, No. 39; Supernova Archive No. 5). These

State ETOs also enjoyed additional advantages in TOEFL and GRE classes, since the earliest test centers were located on the campuses of the elite universities they were affiliated with.

The second model, Intellectual ETOs, also rose in the first stage (early to mid-1980s). They registered under the category of non-state ETOs. They were a prototype of private enterprises. The initial rationale of the state to allow non-state ETOs was to marshal societal resources and supplement the state education system. To put societal resources into the hands of educators, the local Education Bureau made it clear that only professors with associate level or above were qualified as founders. Since retired professors tended to have higher titles, more free time and were also mobilized by the state with the slogan to “contribute remaining energy,” the majority of faculty founders of Intellectual ETOs were retired professors. The founder of Questing, for example, was a retired professor from the state-led Central Academy of Sciences (Informant No. 61). These retired professors were familiar with and had rich connections to state universities. In addition to relying on the resources of state universities, State and Intellectual ETOs shared similar practices. For example, they all put their priority on students’ educational gains by emphasizing conventional methods, such as quizzing and tracking.

During the second stage (mid- to late 1980s), the third model Underdog ETOs entered the market, although these organizations initially trailed behind the other two models. Underdog ETOs were also a prototype of private enterprises. They were founded and operated by marginal entrepreneurs. In the ETI case, marginal entrepreneurs refer to those who were not qualified as founders according to the Education Bureau’s formal regulations. They include two types of people. The first type are those who did not have any work experience in the state education system; these people tended to have low levels of education and were even unemployed prior to

their entrepreneurship. The second type includes those who previously held peripheral or junior positions in the state education system.

Although Underdog ETOs started with similar practices as the other two models, they soon developed a different set of strategies. A common practice among Underdog ETOs was mass teaching. It featured large class size, non-professionally-trained teachers, competition for students' evaluation among teachers and performative pedagogy.<sup>4</sup>

During the third stage (late 1980s to early 1990s), Underdog ETOs had secured all top-three positions. This pattern applies to other niche markets, such as Graduate Exam and Spoken English, as well. In all these niches, we can identify three models that correspond to the three outlined here. Moreover, State and Intellectual ETOs were early leaders but were replaced by Underdog ETOs across all these niches. Underdog ETOs in these niche markets also resorted to mass teaching. In Spoken English classes that were supposed to be interactive, for example, the mass teaching model represented by Roaring English featured shouting nationalist slogans in large classes and employing non-native speakers as teachers.

What happened after these three stages is the task of other chapters. For now, it is important to know that some leading Underdog ETOs were able to adapt to the changing environment and maintain their leadership positions. Consequently, they made their nonconforming practices the rules of the game and pushed the privatization and marketization of the industry from below. For example, Underdog ETOs were the pioneers in deviating from the state's restrictions on cross-region expansion and building national brands. Had the state's

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<sup>4</sup> Performative pedagogy de-emphasizes students' gains and redirects attention to students' perceptions of teachers' class performances. Accordingly, teachers put their priority on fancy elements such as motivational stories, nationalist slogans and even singing and dancing.

restrictions been followed (the other two models did follow them), the ETI would have remained local and fragmented markets.

Existing accounts are inadequate in terms of explaining this succession of market leaders. Various economic accounts fall short. It is tempting to consider the soaring demands for TOEFL and GRE as an explanatory factor. Although the soaring demands are crucial for explaining the expansion of the TOEFL/GRE niche market, it does not help explain why one organizational model trumps another. All three models faced exactly the same demands. Another economics perspective concerns the differentiated efficiency in operations among the three models. As I will elaborate, Underdog ETOs indeed employed more efficient operations practices, such as the mass teaching model. However, as Fligstein (1990, p. 18) points out, efficiency is socially and institutionally produced and it needs to be explained. In my case, the essential question is why Underdog ETOs were able to manage these efficient practices while other types were not.

We can rule out a psychological explanation that centers on founders' incentives. Since State ETO founders were entitled to the performance-based revenue, there was not much difference in founders' incentives among the three models. Accounts of political connection and corruption do not work in my case, although they appear to be an important factor in the rise of private entrepreneurs (Ding, 2000; Wank, 2001). Underdog ETO founders did not have rich political connections; founders of the other two models fared better in this aspect. Finally, it is worth considering the state "turning a blind eye" to private enterprises and their nonconforming practices. According to this perspective, although the state was not hospitable to the development of the private sector, it did not much care what was happening in the private sector (Tsai, 2007, p. 150; Nee and Oppen, 2012, p. 36). This perspective, however, does not work in the ETI since the

Chinese state imposed more systematic restrictions on private ownership and for-profit activities in doubly ambiguous industries than it did on other industries.

### **ALL THREE MODELS BEING DOUBLY AMBIGUOUS**

The rise of Underdog ETOs is inseparable from the ETI's nature as a doubly ambiguous industry. All three models used to be doubly ambiguous.

To the state, all ETOs were non-private and not-for-profit educational entities. In the 1980s, the Chinese state began to encourage the development of the ETI but specified that founders be educators, stipulated that ETOs register as schools and mandated that ETOs be supervised by educational departments. The initial logic, therefore, was to develop the ETI as an extension of the state education system rather than a for-profit industry. The same logic continued in 1995 when the state passed the Education Law to stipulate education of all forms as “public goods” (Li et al., 2014). These laid the foundation for the legal status of ETOs as non-private and not-for-profit educational organizations.

On the other hand, founders of Underdog ETOs and some Intellectual ETOs had a very different interpretation. They perceived their ETOs as private and for-profit enterprises and considered themselves owners because they made the initial investment. They also enjoyed full autonomy in hiring, firing and internal control. Even some State ETO founders considered themselves as partial owners because they were entitled to financial return instead of a salary.

To put this in the language of organizational identity literature, all three models were non-private and not-for-profit in the eye of the state, but they were private and for-profit in the eyes of entrepreneurs and their employees. This caused considerable confusion among business partners and students as consumers, and sometimes this confusion went hand-in-hand with

deliberate misinterpretation in favor of a party's interest. For example, all retired professors, as founders of an Intellectual ETO (Nova Academy), had signed a contract to sell their ETO, but later two of them annulled the deal because, according to them, they could not transfer something that they did not have legal ownership of (Informants No. 16, No. 26). Although consumers were generally indifferent about ETO identities, they would often choose to consider ETOs as state-led educational institutions when problems arose. For example, a group of students' parents protested to Haidian's Education Bureau in June 2014 because the founder of their ETO absconded with their money (Field notes, 06/10/2014). The rationale of these parents was that, unlike regular firms, ETOs were educational entities under the supervision of the state's education department. Accordingly, they demanded that the Education Bureau organize make-up lessons. Ultimately, the Education Bureau organized other ETOs to accept these students. Although this was a recent case, government officials admitted that students always considered ETOs as educational entities when such problems arose (Informants No. 15, No. 20).

I have shown that the state education system and the second economy are the two social sources for ETI's double ambiguity. All ETOs drew on both the state and second economy for resources and organizational repertoires, although the three models did so in different ways. First, all three models started with teachers, facilities, venues and other tangible resources within the state education system. Since no non-state educational entity existed prior to the early 1980s, the state education system was the only source. Besides tangible resources, knowledge and information about teaching and educational operations through the state education system were also essential resources for survival. A large number of Underdog founders who used to work in state education system with junior titles but did not have rich network connections therein benefited from these intangible resources. Even those who did not have such work experience

tended to look for a partner who did. Very often even entrepreneurs' initial knowledge about the ETI as a business opportunity came from having a colleague who worked full-time in the same university and part-time on ETO classes (Informants No. 5, No. 8, No. 61). After all, it requires certain structure-conditioned prior knowledge to discover entrepreneurial opportunities (Shane, 2000). Second, all three models lived in symbiosis with the state education system.

Supplementary education sectors around the world draw heavily on the formal education sector for students as a critical resource for survival. Accordingly, they are under the heavy influence of the regulations on the formal education sector. This is why supplementary education sectors are often referred to as the "shadow education" (e.g., Bray, 2009). In China, the formal education sector has long been dominated by the state. The ETI's close tie to the formal education sector means a symbiotic relation with a colossal state system. Third, all three models drew organizational repertoires from the state education system. They started with the way state universities taught classes and recruited students. Taking all these factors into consideration, it is not surprising that all ETOs in my study were located in proximate areas of one or multiple state universities.

All three models also drew organizational repertoires from the second economy. According to previous studies (e.g., Rona-Tas, 1994; Stark, 1989, 2009), the second economy has several key organizational features: a) part-time employment and part-time entrepreneurship; b) informal, not-legally-regulated employment, with piecework-based, cash wages and no health insurance or pension plan; and c) informal structure and procedures, such as a lack of managerial hierarchy and due process under professional standards. For a), all three models started by employing state university teachers on part-time basis. Underdog ETO founders who were still working in the state education system were part-time entrepreneurs. This is also true for State

ETOs where administrators and faculty members were moonlighting in order to make extra money. This situation is what Stark (2012, p. 46) calls “bringing the second economy inside socialist firms.” There were a handful of full-time entrepreneurs, especially among retired professors and marginal entrepreneurs who were unemployed. However, the general idea was that working in the ETI at its early phase was not a formal job. For b) and c), although virtually no ETO started with a formal structure or a managerial team, the influence of second economy organizational repertoires was most visible among Underdog ETOs. Underdog ETOs and their entrepreneurs went farthest in deviating from formal and professional processes in teaching and operation, as I shall elaborate in the next section.

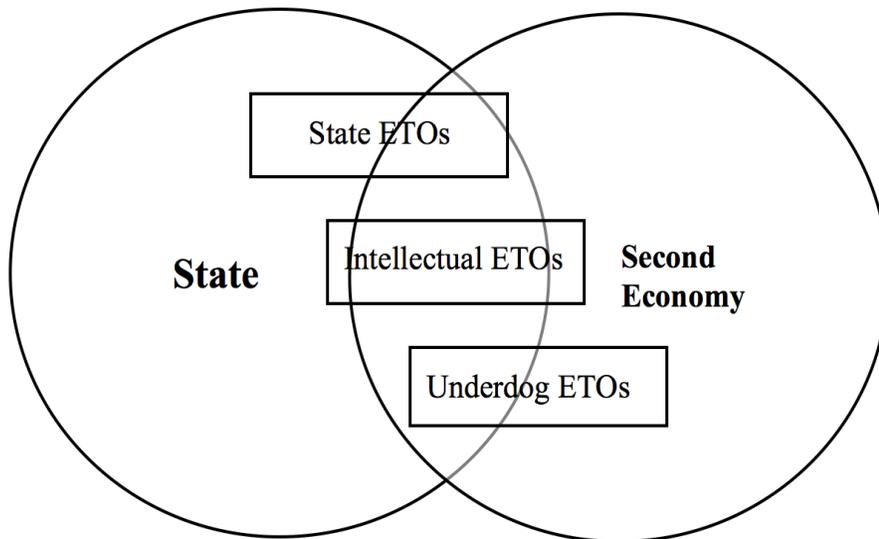
With regard to resources, Underdog ETOs were pioneers in drawing on the informal labor of the second economy for non-teaching staff. In other words, while all three models operated partially *as part of* the second economy, Underdog ETOs formed the earliest and for a long time the only model that introduced tangible elements *from* the second economy. Before the emergence of Underdog ETOs, State and Intellectual ETOs could only rely on junior faculty members and family members as administration and marketing personnel. Underdog ETOs brought in those who were informally employed and associated with the second economy. Cornerstone, for example, used college students who were often working part-time elsewhere as flyer-distributors (Informants No. 21, No. 61). Supernova used laid-off workers as classroom janitors (Informants No. 4, No. 9).<sup>5</sup> Multiple Underdog ETOs involved local gangs, an essential

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<sup>5</sup> According to literature that derived primarily from East Europe, only those students who are working part-time are parts of the second economy. Technically, therefore, laid-off workers were not elements of the second economy. However, China’s trajectory to socialism and market capitalism differed from those of the Eastern Europe. Most notably, China experienced continuous social revolutions after communists took power. Consequently, the boundary that divided formal and informal economy was more blurred in China. There were a large number of people who did not work systematically on part-time basis but participated part-time economic activities from time to time. Among laid-off workers in the ETI, for example, many were not yet officially laid off and were maneuvering the fluid boundary. They should be considered part of the second economy.

part of the underground economy, for marketing. Underdog ETOs in the Graduate Exam market acted similarly. Blue Ocean, for example, used other industries' informal laborers, such as migrant workers in construction, as flyer distributors (Informant No. 8). One of the flyer distributors who came from a rural area even became the founder of Blue Wings, another Underdog ETO that is now one of Blue Ocean's strongest competitors.

Figure 3.2 Differential Relationship with the State and Second Economy among the Three Models



Although all ETOs were doubly ambiguous, the relationship with the state and second economy was different among the three models. We can visualize their differential relationship by positioning each model according to its proximity to the state and the second economy. In Figure 3.2, State ETOs are on the far left side because state influence was strongest among these ETOs. In comparison, Underdog ETOs are the closest to the second economy because the second economy shaped Underdog ETOs most heavily.

## UNDERDOG ETOS AS MORE NONCONFORMING

Under heavy influence of the second economy, Underdog ETO founders adopted practices that were more nonconforming compared to other models.

First, Underdog ETOs were more nonconforming with formal state laws and regulations regardless of industry. This includes both permissible violations and the more deviant and even illegal practices. During China's early market reform, wide ranges of violations were permissible to the state either because of weak law enforcement or lack of supportive social institutions. Most notably, marginal entrepreneurs entered the ETI by circumventing regulations on founders' profiles. Their common practices included subcontracting a division under an established ETO or using a qualified person's name and identification. These are similar to how ownership-ambiguous enterprises started as "red hat" organizations (e.g., Naughton, 2007; Tsai, 2007). In the TOEFL/GRE niche, all four Underdog ETOs entered the market first by contracting a division or using others' identification. These strategies were also widely used in other niche markets, such as the Graduate Exam. The founder of a leading Graduate Exam ETO described how he obtained the license:

*It took me eight months to register the school. Initially I talked to a retired teacher. I told him that I needed to register a school for the Graduate Exam. I had all the other requirements but the Adult Education Bureau also required the legal representative to be a retired professor with associate level or above and with Beijing's residence permit (hukou, 户口). The retired teacher agreed happily at first. Then when we were about to register and I asked for his identifications. He said his children opposed it. They told him being a legal representative would bear huge responsibility. So I had to find someone else. I used to rent classrooms from another university and I know one of their officials. I heard he had a relative who was qualified. So I used his name and identification to register. (Informant No. 8)*

Another example concerns pirating test materials.<sup>6</sup> Although the state and test administrators forbade pirating past test materials, most Underdog ETOs could get away with obtaining, pirating and using these materials. They obtained these materials either by buying from someone who had special access or sending someone directly to the test centers (Informant No. 17). The other two models were less involved in pirating *per se*, although they were also able to access these materials through the black market.

Nonconformity with laws and regulations also takes more deviant forms. For example, three of the four Underdog ETOs used gang members to fight for favorable advertisement space on bulletin boards in nearby universities (Informants No. 28, No. 61, No. 66). Gang members associated with Cornerstone stabbed people from other ETOs (*ibid*). In the Graduate Exam niche, the founder of Sea Dragon, also an Underdog ETO, even used violent means to monopolize advertisement space in colleges in six northern and northeastern provinces (*ibid*).

There were also a handful of cases where Underdog ETOs used nonconforming practices to obtain teacher resources. The Sea Dragon founder coerced teachers by kneeling before their doors, coaxing them into cooperation and beating uncooperative and competing teachers. We have every reason to expect such practice to be myopic and that such an organization would be short-lived. However, Sea Dragon's founder was not arrested until he murdered an uncooperative teacher in 2006, a decade after Sea Dragon dominated Northern China and physically hurt a number of teachers. Sea Dragon might be the most extreme case, but it is far from an uncommon one. The other two leading brands in the Graduate Exam, Blue Ocean and Blue Wings, even organized gang members to interfere with each other's lecturers (Yang, 2008). Regardless of

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<sup>6</sup> I should also note that obtaining past test questions is different from students-organized cheating that became popular after 2000 when the computer-based tests came out. Students-organized cheating was based on sharing test questions online and memorizing the same questions in advance.

how sustainable such practices were, these Underdog ETOs gained temporary market leader positions with these practices.

Second, Underdog ETOs were more nonconforming with the legitimate forms of schools and teaching specific to this industry. A clear example is their adoption of performative pedagogy. To be sure, this pedagogy later became popular among students. We also see similar pedagogies in Korea, Hong Kong and Taiwan (e.g., Ng, 2009).<sup>7</sup> Nevertheless, given the clear expectations of the Chinese state and consumers about what an ETO should look like, performative pedagogy was clearly a nonconforming teaching style in this context.

Third, Underdog ETOs were also more nonconforming with cooperation norms among business partners. A common practice was called “pulling students away (*la xuesheng*, 拉学生).” In this situation, a founder secretly recruits or transfers students who are supposed to be shared with business partners. These students are often put into another school under the founder’s control, so this founder could reap all of the economic benefits.

Below is an example of “pulling students away.” This case concerns Su Leidong, who later founded Supernova. It goes back to how Su entered the market. Since he was not qualified to establish his own ETO, he had to subcontract a division under Nova Academy, an Intellectual ETO co-founded by several retired professors. In return, Su had to pay them 15 percent of his revenue as a “management fee.” Later, Su found paying the fee narrowed his profit margin, and he started to secretly recruit students to the school under his control. In the meantime, however,

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<sup>7</sup> Their popularity, however, should not be interpreted as being more effective. This is not to say that this pedagogy is not effective. As the lawsuit of Kaplan versus ETS (1997) shows, the key to determine if a test-preparation is effective is to measure the education gain before and after the preparation classes, holding other factors constant. However, Chinese ETOs in the 1980s and 1990s neither conducted tests to measure education gains nor used any statistical techniques to hold other factors constant. Their common way of proving effectiveness, such as publicly granting awards to students with high test scores, does not at all attempt to eliminate the selection bias (e.g., these students might be predominantly students from elite schools).

two teachers working for Su found in this situation a good chance to take over the division from Su. Just as they were colluding with a competing ETO, Su found out about their plan and bought them back over to his side.

*Su was thinking, why do I have to stay here? .... Su started pulling students away to another school of his. Two teachers working at Su's Division were not happy about this. Later they realized that this could be their opportunity. These two teachers went to see a competitor's founder one evening. The idea was that they would work together, keep running the Division and stop Su from pulling students. I heard they talked for a long time that night. They wanted to take over the Division from Su, or ask the competitor's boss to lead the Division.... But what happened next, according to one of the two teachers, was that Su went to talk to this teacher before dawn. And this teacher changed his mind (and chose to side with Su again). Su made some good promises to these two teachers. I think this is why they changed their minds. (Informant No. 61)*

In comparison, retired professors at Nova Academy did not take effective action to stop Su from pulling students away. Su was even able to buy the exclusive use of the title “Nova Academy Training Division” for three years with a price of less than three thousand US dollars after he left Nova Academy (Supernova Archive No. 5, p. 44). This case is suggestive because it shows how an Underdog entrepreneur easily defected from his business partners and how Intellectual ETO founders were incapable of defending themselves against the defection. Moreover, it demonstrates how capable Underdog entrepreneurs were in terms of defending, preventing and even preempting defections by teachers. On average, Underdog ETOs were much more nonconforming than Intellectual ETOs.

Table 3.2 below indicates that Underdog ETOs were also more nonconforming than State ETOs with formal state regulations and informal norms. Several caveats should be added. First, the claim about Underdog ETOs being nonconforming is comparative and relative: it does not mean Underdog ETOs do not conform to cooperation norms. The question is which model is *more* nonconforming, not whether a model *is* nonconforming. Second, this claim is based on

comparing models, not individual ETOs. Third, although this seems to be a dramatic case with both the founder and teachers “pulling students away,” five founders of the eight ETO I studied agreed that “pulling students away” was a common practice among Underdog ETOs.

Table 3.2 A Comparison of Nonconformity Levels across the Three Models

	State ETOs	Intellectual ETOs	Underdog ETOs
Nonconformity with formal state regulations regardless of industry	Medium: a) Using pirated test-prep materials or past authentic test questions without permission	Medium: a) Using pirated test-prep materials or past authentic test questions without permission	High: a) Registration (using others’ credentials for registration or subcontracting under a registered ETO) b) Cross-region expansion c) Violent control of advertisement space d) Using pirated test-prep materials or past authentic test questions without permission
Nonconformity with the legitimate forms of schools and teaching	Low: Adopting pedagogy and teacher management of the state universities, featuring professionally-trained teachers, teachers responsible for comprehensive language skills	Low: Adopting pedagogy and teacher management of the state universities, featuring professionally-trained teachers, teachers responsible for comprehensive language skills	High: Adopting mass teaching model. This model features a large class size, non-professionally-trained teachers, teachers responsible for a specialized language skill (e.g., listening, reading) and performative pedagogy
Nonconformity with cooperation norms	Low: Rarely defecting business partners or preventing others’ defection	Low: Rarely defecting business partners or preventing others’ defection	High: Defecting business partners and preventing others’ defection

Sources: Author’s compilation based on Lu (2002) and multiple informants

Nonconforming practices were effective in overcoming the legitimacy discount associated with Chinese private economy in the 1980s and early 1990s, regardless of industry. Here, legitimacy discount refers broadly to the stigma associated with private enterprises (e.g., Tsai, 2007, p. 51; Huang, 2008). The suffering of the legitimacy discount was especially true in

doubly ambiguous industries where state-affiliated organizations were equipped with rich resources and good reputations. Underdog ETO entrepreneurs started with regular practices, but soon realized that they would not be able to secure the basic resources needed for survival in the competition with State ETOs. They then shifted to nonconforming practices, and these practices proved to be effective. Below I use one case to show how Supernova, an Underdog ETO suffering from the legitimacy discount and in direct competition with the then dominant Northern ETO, shifted from regular practices to nonconforming practices in recruiting students.

*I rented a small office room in a state primary school in Zhongguancun but they did not allow me to recruit students and collect money within that room. I was only allowed to do these on a primary student's desk and chair outside the office room. Recruiting students in that way was difficult because prospective students would think, what if this guy ran away with my money at night if I hand my money to him now? .... Finally there came three students on one morning, and I spent half an hour to persuade them to stay, and they registered, paid tuition and left. But before their money turned warm in my pocket, two of the three came back and took their money back.... I later found out that these students all acted alike, and they would take a look at the registration form in order to find out how many people have registered. Once they found out no one or very few people registered, they were afraid and became hesitant. I knew the first dozen of students would be critical. So I was thinking, why not just fill out the registration form by myself first. So I filled out the form with about thirty fabricated names. After that, students were much more likely to pay tuition and register. (Supernova Archive No. 5, pp. 52–53)*

Using fabricated names to attract consumers is, of course, a minor trick. No matter how minor or how common it is, such a practice deviates from cooperation norms in that it favors one's interest at the expense of others' access to undistorted information.

## **EXPLAINING THE DOMINANCE OF UNDERDOG ETOS**

Nonconforming practices helped Underdog ETOs survive and overcome stigma. But these practices alone were not sufficient to gain market dominance. Underdog ETOs came to

dominance not only because they benefited from the structural condition of double ambiguity, but their nonconforming practices were also made more effective and less likely to be sanctioned under such condition. Below I provide four specific mechanisms. The first one concerns the structural advantages associated with double ambiguity, whereas the other three are related to the interaction between the structural condition and the nonconforming practices.

### **Low Risk of State Take-Over**

First, double ambiguity prevents Underdog ETOs from being taken over by the state. State take-over, also known as state predation, refers to the situation where local governments drive away private entrepreneurs and take over as owners (Che and Qian, 1998). Che and Qian (1998) claimed that one benefit of township and village enterprises' ambiguous ownership was that local governments could limit predation of the central government. However, a number of prosperous township and village enterprises, such as the leading home appliance manufacturer Kelon, have been taken over by local governments (e.g., Huang, 2008). Township and village enterprises had ambiguous ownership because different stakeholders could not agree on who the owners were, but at least the state had a clear perception. To the state, these were clearly collective enterprises. As the proxy owners of collective properties, local governments had the legal right to take them over.

Such take-over incidents never happened in the ETI. Under double ambiguity, there are not only competing and conflictual interpretations among multiple stakeholders, but the state perception was also only half clear. The state stipulated that ETOs were *not* private, but it did not specify what they were. Only when the confusion regarding ownership transfer and rampant distribution of *de facto* profits became widely known did the state attempt to clarify ownership.

Without a clear legal foundation, even the so-called authoritarian regime could not easily take over private enterprises or their prototypes. Although this low risk of state take-over does not guarantee which prototype would win out, it provides the necessary condition for the survival of private prototypes.

### **Taxation Benefits**

Double ambiguity interacted with nonconforming practices, providing Underdog ETOs with greater capital accumulation through lighter taxation. Since the state classified the ETI as an education instead of a commercial sector, ETOs did not have to pay any tax in the 1980s and early 1990s. In the mid-1990s, when other industries were paying tax from 30-35 percent (Zhang, 2005, p. 110), ETOs only needed to pay three percent (Informant No. 20). Indeed, the Chinese state had a weak capacity to levy taxes for years. But the lower tax rate here was primarily due to the state's classification associated with double ambiguity.

Even the three percent tax was often not collected because of the jurisdictional overlap of multiple state agencies and their conflictual interpretations. A founding member of Blue Ocean, a leading Graduate Exam ETO, commented on this situation:

*The laws in our country often fight against each other.... The Tax Bureau came to us and said, "You have money-making activities and you need to pay tax.".... So we went to the Education Bureau and asked them what we could do. The Education Bureau said, "We studied the laws, and they were conflictual. If the Tax Bureau comes to you, you can try to evade them if you can".... So I figured out that we could go to the Tax Bureau and keep pestering them. We tried to not pay the tax if possible. If we indeed need to pay, we wanted to bargain for less. (Informant No. 8)*

Although all three models could have benefited from the lower tax rate, Underdog ETOs benefited the most. As the last sentence of the above quote suggests, the possibility to realize the

taxation benefits hinges upon negotiating with government officials. However, not every founder was familiar or comfortable with negotiating. Among my informants, the three Underdog ETO founders said they negotiated before, but the two Intellectual ETO founders said they never did so. Of course, negotiation was very common in China's black market and is arguably characteristic of any black market (Geertz, [1978] 2011). But negotiating a tax rate that was formally written on state regulations was considered a serious deviant practice by those professors and university administrators (Informants No. 10, No. 11, No. 6). In other words, nonconformity became Underdog ETOs' comparative advantage to realize the benefits of double ambiguity.

Furthermore, other ETOs and especially State ETOs depended more on state assets and thus did not rely on retained earnings for survival and development. In comparison, Underdog ETOs had much less access to state assets. Like most Chinese private enterprises (Lardy, 2014), they also had very limited access to bank loans. They depended heavily upon retained earnings as a source of capital. Retaining more earning provided greater benefits to Underdog ETOs.

### **Low Sanction Risk in Blind Spot**

Double ambiguity also facilitated the transformation of nonconformity into ingenuity, first by making nonconforming practices less likely to be sanctioned. Sanction is critical because new institutionalism argues that ambiguous organizations would face harsh sanctions from the state and normative systems (e.g., Zuckerman, 1999). In face of this critique, studies on China's township and village enterprises have responded with a "below the radar" or "blind spot" logic (Nee and Opper, 2012). According to them, the state turned a blind eye to the private operation of these enterprises for two reasons: first, the state did not have the infrastructural capacity to

monitor far away rural areas that were below the radar; second, the state did not care about the specific means of running these enterprises as long as they served the goal of economic development.

Apparently, this blind spot logic falls short in the ETI. First of all, ETOs flourished right under the state's nose in metropolitan centers, so the state had relatively good capacity to monitor and sanction them; second, the state did show genuine care about the educational goals ETOs should serve.

I would propose that fewer sanctions under double ambiguity are due to two different types of blind spots. First, blind spots arise because the ETI was initially considered an extension of the state education system, so all state agencies were under the impression that ETOs were very well regulated. This situation means that the state needs much longer time to detect nonconforming practices. It also precludes higher-level agencies to monitor changes. Let me provide an example. In the year 2000, a senior consultant asked a high official in the Ministry of Education about his opinion on Supernova. By that time, Supernova had long defied the local Education Bureau's ban on cross-region expansion and each year recruited thousands of students from all over China. When being told about Supernova's annual enrollment of over 300,000 students, this official was skeptical. He was under the impression that all ETOs were local organizations and under close supervision of local Education Bureaus. Not having received any report from local Bureaus, he considered Supernova a "special and unsustainable phenomenon in a special period of time" (Li, 2009, p. 331). What is striking here is that by the year 2000, Supernova had been active in the same city where the Ministry was located for nearly a decade. So under double ambiguity, there are spots that are adjacent, but they could still remain invisible.

Apparently, these blind spots were crucial for Underdog ETO's cross-regional expansion. Since all local Education Bureaus were under the impression that ETOs were operating locally, Education Bureaus took little action to change the previous registration procedures that only examined the legal person's identification. By using local people's identifications, Underdog ETOs were able to establish branch schools in other cities. As a branch school president of Supernova explained the details of doing so:

*There were lots of difficulties at the beginning. It was absolutely forbidden to open up branch schools in other cities. So you would break the law if you open up one.... But people at the Education Bureau only checked once at the beginning about if the founder was local and had the right identification.... So we had to find some local guy within our school. We let him to be the "first president" when we were there to register. Then after we registered successfully, we could change the name to other people easily. (Informant No. 37)*

The second type of blind spot is associated with jurisdictional overlap and conflict, as already shown in the taxation situation. Non-state ETOs were initially solely supervised by the Education Bureaus. ETOs did not have to register with the Administration of Industry and Commerce, which was supposed to regulate all revenue-generating organizations. This is because the state considered ETOs to be educational organizations. Educational organizations were expected to collect tuition, but not to generate revenues. Education Bureaus focused primarily on educational matters as well as safety and qualifications, such as founders' profiles (Informants No. 20, No. 37). Therefore, information regarding ETOs' performance and operation and the ETI's size became blind spots. This information was included in neither the education nor the economy system statistics until 2010 (China Statistical Year Book, 1980–2015). For a long time, therefore, few people knew the size or profitability of this industry. This is why no previous study of China's private economy has ever included the ETI. Of course, it is common

for new industries to encounter jurisdictional blind spots. However, blind spots of this type are particularly associated with the ETI's double ambiguity. Being supervised by and proximate to the state's education system precluded jurisdiction or sanction by the state's economic regulatory agencies. This is not because the state deliberately turned a blind eye or because the ETI was outside of the state systems, as Nee and Opper (2012) suggest. Rather, the blindness is exactly because the ETI was right under the state's nose.

### **Innovation Advantages**

Except for being rarely sanctioned, Underdog ETOs were able to recombine divergent resources and repertoires into innovation advantages. These innovations solved a variety of problems. In the 1980s and early 1990s, the challenge facing ETOs was not recruiting students. The demand was abundant and students did not have clear consciousness about education quality. The real threat came from within.

The ETI started as an informal and non-capital-intensive industry. Therefore, it was easy for teachers to establish their own schools. In a business environment without a non-compete clause, a teacher could literally quit an ETO one day and open up a competing ETO across the street the next day. Most importantly, given poor marketing and operations, teachers were the most important asset and the key to attracting students. As an observer put it, "That was a time of individual heroes. Students followed good teachers as if these teachers were superstars. Students followed the names of teachers, not the brands" (Informant No.17). In other words, although ETO teachers were mostly hired on a part-time basis, individual teachers had formidable bargaining power and were different from those precarious informal laborers in the automobile and construction industries (Swider, 2015; Zhang, 2015).

Given this situation, teachers' exit and founding of their own ETOs were common. It was extremely difficult for entrepreneurs to retain good teachers within their organizations for sustainable development. Leading Intellectual ETOs, such as Quest and Nova Academy, for example, witnessed plummeting enrollment right after their well-performing teachers left. Teachers' exits and entrepreneurships were often accompanied by defection. In addition to "pulling students away," there were two additional forms of defections: hold-up and dumping classes. Williamson (1981) noticed inter-organizational holdup. A hold-up within an organization concerns using one's bargaining power to ask for higher wages accompanied by a threat to leave; dumping classes refers to standing-up students without notice in order to ruin the employer's tuition revenue and reputation. These defections were common to Intellectual and Underdog ETOs. Compared with Intellectual ETOs, Underdog ETOs had a greater chance of surviving defections because their entrepreneurs were often better prepared to defend and prevent defections. This was most evident in the Supernova example showed earlier.

For all three models, therefore, the question was how to cage teachers within organizations and how to make them more replaceable. Although all three models made attempted to solve these problems, only Underdog ETOs succeeded. Underdog ETOs brought in new groups of people as teachers. They started with graduate students who majored in English, then undergraduate students in other majors, and later even high school drops-outs and street vendors. Underdog ETOs' access to the second economy played an important role in bringing these new people into the ETI.

Bringing in new teachers weakened the bargaining power of old teachers. But it also created a new problem: how to evaluate the performances of these teachers with various backgrounds and teaching styles. Different Underdog ETOs adopted different solutions, but a

common theme was giving greater weight to the market mechanism: students' impressions of teachers' performances. In most State and Intellectual ETOs, teachers enjoyed professional power, and they were the ones to evaluate the performances of students. Students had no power to judge or influence teachers' teaching practices. But Underdog ETOs decided to change this situation. Some Underdog ETO founders allowed students to boo teachers, whereas others initially allowed students to shift to the same classes taught by a different teacher. These practices only constituted the elementary forms of mass teaching. I will introduce how mass teaching evolved into advanced forms in the next chapter. Despite its elementary stage by the early 1990s, mass teaching had provided Underdog ETOs advantages over other two models in caging teachers.

This chapter investigates the surprising dominance of Underdog ETOs. I found that all three models relied on both the state and the second economy for resources and organizational repertoires. Underdog ETOs not only benefited from the structural condition of double ambiguity, but they also gained from the interaction effects between nonconforming practices and double ambiguity. Underdog ETOs thrived and started to set the rules of the game, laying the groundwork for the ETI to turn into a for-profit sector led by private enterprises.

## Chapter Four

### One Step Ahead among Underdogs: Deepened Privatization and Marketization

*There are three characteristics of Supernova's teachers: knowledgeable, righteous and patriotic. Teachers at Supernova not only need to convey knowledge to, and answer questions of, students. They also need to instill in students patriotism and self-motivation. They need to use their sublime personal quality to touch students. (They should do these) by sharing their self-reflections and experiences, by advocating our national integrity and patriotism, by evoking the confidence of students in being Chinese, by spurring students' learning interest, and by guiding students out of perplexity and running toward success along the right track. These are the essential components of the Supernova Spirits.*

—Supernova Archive No. 3, Video 11'26''

*Let me ask you a question: what on earth is our purpose of learning English? All of you speak after me: to conquer the three biggest markets—U.S., Japan and Europe. Making money around the world! Speak louder: making money around the world.... Now open your mouth wide and speak after me: I enjoy losing face! Follow my gestures! I enjoy losing face! Have you learnt this sentence: I want to be a successful person. Now shout it out after me: I want to be somebody! Something!*

—Roaring English Archive No. 1

Underdog ETOs had become the dominant model across niche markets by the early-1990s. The fight for dominance turned into a competition among Underdog ETOs. Some Underdogs were able to rise to the top market leader position and sustain it, while others lost competitiveness and even became defunct. Although the winning ETOs only had locations within the city they started, some of them were able to attract students from all over the country.

This chapter aims primarily at understanding why some Underdog ETOs rose to the top while others failed. Again, this chapter draws primarily on Beijing's TOEFL/GRE niche and Supernova's rise to dominance. I will show that the success of Supernova was closely associated with its teaching form. Supernova developed mass teaching into an advanced form. The advanced form of mass teaching played an integral role in its triumph over other ETOs. To disentangle Supernova's dominance, therefore, I also inquire into how it innovated the advanced form. To the extent that its advanced form of mass teaching was widely accepted but only partially diffused, this chapter will also provide a new angle into the relationship between legitimation and diffusion of organizational form.

I begin with the context for, and competition dynamics of, the four Underdog ETOs in Beijing's TOEFL/GRE niche market during the 1990s. My explanation for Supernova's innovation of mass teaching centers on two aspects: the founder's distinct social embeddedness and the innovation as a non-incremental locking-in process.<sup>1</sup> Whereas founders who were exclusively embedded in the second economy were more likely to deviate from laws and cooperation norms, founders who were exclusively embedded in the state education system were bounded by the legitimate forms of schools and teaching. Only founders who were crossly embedded in both systems focused their nonconforming practices on teaching, setting the initial direction of innovation.

Despite the clear initial direction, the specific configuration of the advanced form of mass teaching only took shape after a non-incremental locking-in process. By locking-in process, I

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<sup>1</sup> For now, we can understand embeddedness in the way Granovetter (1985) defines it: economic activities are inseparable from the structures of social relations. Locking-in can also be interpreted as the situation where organizations are precluded from innovation (Stark, 2009). However, I will elaborate in the empirical sections that embeddedness here is relevant to being situated in historical specific social systems, such as China's dominant state education system and the second economy during the early market transition. I will also propose the idea that locking-in is long, contingent and processual, especially in doubly ambiguous social space.

mean that innovation in doubly ambiguous industries involves more than being flexible and exploring divergent resource and organizational repertoires (e.g., March, 1991; Stark, 2009). It also entails the process of exploiting and locking-in existing organizational elements into a stable combination.<sup>2</sup> Under double ambiguity, this exploiting process tends to be non-incremental, long and contingent because it is difficult to reach a stable combination for a social space with highly heterogeneous actors and ambiguous product standards.

As heightened institutional pressures made overly deviant practices obsolete and as Supernova locked in organizational elements into an advanced form of mass teaching, Supernova gained dominance in Beijing's TOEFL/GRE market. This spatially concentrated niche market filled with the nation's elite students further led to Supernova's local monopoly, nationwide dominance and legitimation of mass teaching. The advanced form of mass teaching was taken for granted. Numerous competitors explicitly attempted to imitate this mass teaching. Although competitors adopted some elements of the mass teaching, few of them were able to lock-in all elements of the advanced form. A field-wide legitimation was only associated with limited diffusion. Finally, I use the case of Roaring English, the leading ETO in the Spoken English market in the 1990s and early 2000s, to show the generalizability of the patterns found in the TOEFL/GRE market.

## **CONTEXT, DYNAMICS AND ALTERNATIVE EXPLANATIONS**

Market leaders in Beijing's TOEFL/GRE market in the 1990s—all Underdog ETOs—faced a different environment than the 1980s. To begin with, the competition among these nonconforming organizations intensified. As Figure 3.1 shows, the early 1990s witnessed, for the

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<sup>2</sup> In my dissertation, exploitation and locking-in are two interchangeable social processes.

first time, the decline of both the number of TOEFL test-takers and new Chinese students studying in the U.S. This is a result of China's economic recovery in the early 1990s (Xia, 1993). With increasingly better job prospects within China, Chinese students became reluctant to study abroad. The "study-abroad fever" temporarily cooled down. For the first time, therefore, ETOs felt the pressure of decreasing demand. In addition, the founding of new ETOs also made the niche increasingly crowded.

The institutional environment also changed. The Chinese state imposed stricter policies aimed at constraining the marketization and privatization of the ETI. In response to the dominance of the nonconforming Underdog ETOs, the mid- and late 1990s saw the further tightening of state regulations. In 1995 and 1997, the Chinese state passed two new laws. Both laws were aimed at clarifying the non-private and not-for-profit nature of the ETI.

In the early 1990s when the competition among Underdog ETOs just began, there were marked commonalities among them. First, they adopted nonconforming practices in order to obtain licenses. As mentioned in the previous chapter, they most often subcontracted a division under another registered ETO or used another person's name for registration. Second, these ETOs were largely based on part-time employment and entrepreneurship. The majority of teachers were employed on a part-time basis. With regard to entrepreneurs, there was a difference between the first and the second type of marginal entrepreneurs. Whereas the first type of marginal entrepreneurs often started with part-time entrepreneurship and later shifted to full-time within a short period of time, the second type often spent a much longer time as part-time entrepreneurs. This is understandable because the second-type marginal entrepreneurs were most likely still in their junior or peripheral positions within the state education system.

Associated with part-time entrepreneurship were the highly informal, minimalist and most often family-based structures.

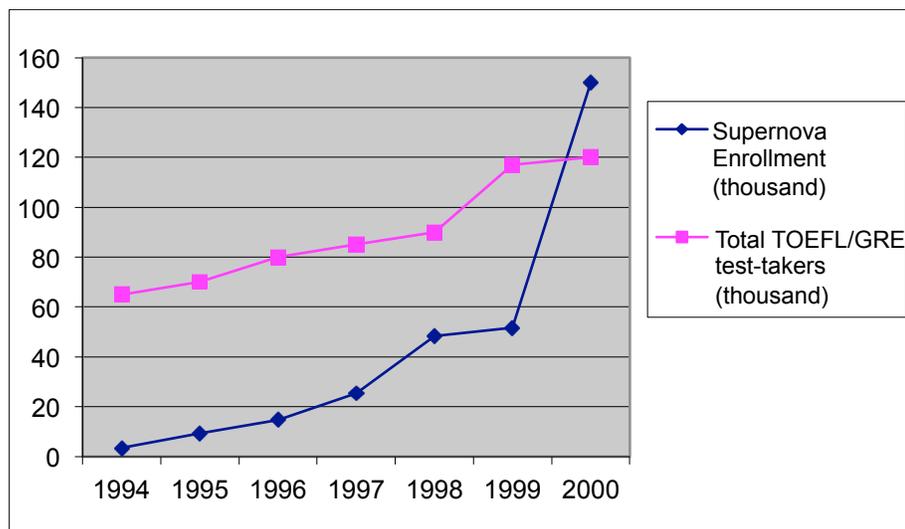
Despite their similar starting point, their trajectories and destinies diverged. Seven Swords first collapsed as two of its most famous teachers left, one to found Pioneers and the other to join Cornerstone. Pioneers, Cornerstone and Su's Division under Nova Academy were widely known as the "Big Three" in Beijing. As the competition among these three intensified, they launched aggressive price wars as well as gang control of poster spaces in nearby universities. Among these three, Cornerstone was the one that most often resorted to violent means.

In 1993, Su quit cooperating with Nova Academy and registered his own Supernova. Just as Pioneers and Cornerstone founders did, Su brought his wife, mother, brother-in-law and other relatives into Supernova. In the meantime, Su's low price, high wage and upgraded mass teaching put greater pressure on its competitors. By 1995, Supernova had become Beijing's No. 1 brand with an annual enrollment of 9,247 students (Lu, 2002). To keep up with and go beyond his initial success, Su invited his former fellow university students, friends and teachers to come back from North America and join his cause.

In the late 1990s, Su and his friends entered into an informal partnership, while Pioneers and Cornerstone were retaining their previous family structure. The informal partnership of Supernova encouraged each partner to expand into new territories. The partnership and the maturation of its mass teaching left less room for its competitors. By 1999, both Pioneers and Cornerstone had found it extremely difficult to recruit students (Informants No. 9, No. 61). In the year 2000, Supernova enrolled 150,000 students (Lu, 2002, p. 210). It occupied 80 percent of the TOEFL/GRE market share in Beijing and over 50 percent for all of China (Pang, 2004). Figure

4.1 substantiates Supernova’s local monopoly and nationwide dominance. It shows that Supernova was able to recruit nearly half of China’s TOEFL and GRE test-takers in 1999, though it had locations only in Beijing. In 2000, its annual enrollment even surpassed the total number of test-takers when it established two branch schools in Shanghai and Guangzhou.

Figure 4.1 Annual Enrollment in Supernova Compared with Total TOEFL and GRE Test-takers in China



Note: The number of GRE test-takers is unknown, so I doubled the number of TOEFL test-takers. This means that the red line is greater than the real number. However, it is not a problem because this greater number is still dwarfed by the enrollment of Supernova. This proves my point.

Sources: Lu (2002) and Qian, David. 2010. *English Language Assessment and the Chinese Learners*. p. 101. Routledge.

This was made possible by the advanced form of mass teaching. This advanced form won popularity among students. Through word-of-mouth, thousands of students shared their class experiences and legendary stories heard from Supernova classes with friends. After hearing these stories, students came from all over China to Supernova classes simply to admire a certain teacher, feel the exciting atmosphere or to “make their lives complete” (Lu, 2002, p. 111). Mass

teaching turned Supernova into a cult. Supernova conquered a nationwide market without conducting a nationwide marketing campaign. Since a large number of students only came to feel the atmosphere, they did not take the tests after the classes. This is why the number of Supernova students could go beyond the number of test-takers.

Various economic explanations are inadequate for understanding Supernova's rise to dominance. With regards to the demand, all the organizations I am studying in this chapter were facing the same niche market in the same location. Neither does the efficiency perspective that is associated with economics help explain my question. Not only is the idea of efficiency socially constructed, but the question of why some organizations, not others, can build a more efficient form also needs to be answered in the first place. In this case, even when Supernova's old and new competitors were aware of the high efficiency of mass teaching and imitated it, they were not able to lock in all organizational elements.

Currently dominant theories in organizational sociology are less interested in individual organizations than the change of organizational forms. New institutionalism, population ecology and recent studies on organizational forms and institutional logics, for example, center on the role of selection in the change of dominant organizational forms. An exception is the institutional entrepreneur approach. It focuses on the role of individual organizations in framing and institutionalizing an idea or model (DiMaggio, 1988; Fligstein, 1997; Thornton, Ocasio and Lounsbury, 2012). Some scholars have complemented this approach with institutional logic perspectives, highlighting the role of hybrid organizations as institutional entrepreneurs because these organizations face multiple and even contradictory institutional logics (Rao and Giorgi, 2006; Battilana and Dorado, 2010). According to them, these institutional entrepreneurs could facilitate the change because of their advantageous position in decoupling, blending, segregating

and selecting institutional elements (Binder, 2007; Pache and Santos, 2013). From these perspectives, Supernova's innovation so critical to its dominance can be attributed to its role as an institutional entrepreneur.

Despite the insight of these studies, they cannot answer the question of why, among a group of organizations that face contradictory institutional logic and thus enjoy candidacy as institutional entrepreneurs, some are able to push the innovation forward while others are not. Neither can it answer the question about how and why the innovator and winner could “successfully resist other actors' powers” (Fligstein and McAdam, 2012, p. 7). Moreover, these and other studies on the innovation of individual organization (e.g., Padgett and Ansell, 1993; Johnson, 2007) all share one important assumption: innovators are nothing but blenders of multiple options.

This assumption is in line with existing theories of ambiguity. Organizational theorists in this tradition have found that exploiting existing elements until locking-in tend to benefit innovation in the short term, whereas exploring divergent elements is associated with long-term flexibility (e.g., March, 1991; Greve, 2007). Later studies, especially those that emphasize the advantages of ambiguous social spaces, narrow the understanding of locking-in as a situation that constrains organizations from innovation (Page, 2007; Stark, 2009, p. 177). Although locking-in can refer to a static or ultimate situation, it also entails the process of exploiting and locking-in into a stable combination of given organizational repertoires.

Locking-in under double ambiguity is a long, non-incremental and contingent process. To be sure, any social process is non-incremental and contingent according to the historical and

processual view (Sewell, 1996a, 1996b; Abbott, 2001, pp. 261–279; Zhao, 2015, pp. 377–380).<sup>3</sup>

Under ambiguous social space, however, locking-in as a social process tends to be highly non-incremental and contingent. I will show in the empirical section that the double ambiguity is associated with heterogeneous actors and ambiguous product standards, all of which tend to delay and obstruct the evolution of existing organizational elements.

## **EXPLAINING THE DOMINANCE OF SUPERNOVA**

### **Social Embeddedness of Founders**

The social embeddedness of Supernova's founder is a crucial factor for its rise to dominance.

Being embedded between both the state education system and the second economy allowed Su to be less constrained by teachers' defections. It also narrowed the initial direction of innovation on teaching rather than other areas.

I have shown in the last chapter that Underdog ETOs were all under the heavier influence of the second economy compared to the other two models. This, however, does not mean that all Underdog ETOs had equal access to the resources and repertoires of the state education system. On average, the second type of marginal entrepreneurs had better access than the first type. In Beijing's TOEFL/GRE market, founders of Cornerstone and Seven Swords fell into the first type of marginal entrepreneurs because they were not associated with the state education system prior to their entrepreneurship. In comparison, founders of Supernova and Pioneers were

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<sup>3</sup> A non-incremental and contingent social process has the following characteristics: a) it is non-linear and non-incremental, in the sense that subsequent structures and meanings are conditioned upon fundamental changes brought by turning-point or watershed events; b) it is non-intentional, in the sense that the ultimate locked-in situation is hardly an intended outcome planned by actors; c) although the social process might start with actors' intention in solving functional problems, the extent to which actors can push forward their actions is governed by trial-and-error. In other words, actors react to the feedback from the environment as well as the actors' prior actions.

representative of the second type because they used to hold junior positions within the state education system.

Table 4.1 The Social Embeddedness of Founders

	Type of Marginal Entrepreneurs	Education Level	Conduct Teaching?	Social Status within State Education System
Seven Swords	First Type	Low	No	
Cornerstone	First Type	Low	No	
Pioneers	Second Type	High	Yes	Medium
Supernova	Second Type	High	Yes	Low

Sources: Multiple informants.

Table 4.1 provides a systematic comparison of the social embeddedness of the four founders. The founders of Seven Swords and Cornerstone were labeled as having low levels of education because they did not have college education. Informants also recalled that at least one of them was unemployed prior to their entrepreneurship (Informants No. 17, No. 18, No. 61). They acted as full-time entrepreneurs but did not teach classes by themselves. In contrast, founders of Pioneers and Supernova were junior faculty members of English prior to entrepreneurship. There were also marked differences between the two founders in terms of their social embeddedness. Ma Tiannan of Pioneers had a relatively smooth academic record and graduated from the most elite foreign language college. His father was a retired scholar in English literature and translation. He operated Pioneers on a part-time basis, which was the mainstream approach among faculty entrepreneurs in the ETI. Since he could not devote all his time and efforts into the ETI, his family members were deeply involved. His mother and sister

were in charge of administration, finance and marketing, while Ma and his father were the major teaching forces at Pioneers.

Su of Supernova was also a second-type marginal entrepreneur: he used to be an undergraduate and then a lecturer of English at Capital University. Of course, Capital University was an elite state university in China. But Su had low social status at Capital (see the right column on Table 4.1), partly because he had a rural accent and had two failed attempts in the College Exam, a widely used benchmark for peer comparison. He was even publicly humiliated for operating his ETO on campus and finally had to quit from Capital University. In the early 1990s when private entrepreneurs were still socially stigmatized, Su was one of the earliest full-time faculty entrepreneurs in the ETI (Informant No. 61). For the first two years, Su worked as a solo entrepreneur: he was the only full-time manager and teacher. His family members had not joined Supernova.

Despite Su's low social status at Capital, he had rich access to the second economy. Whereas Ma was born to an intellectual family, Su was brought up by his mother who was a first-generation rural entrepreneur in a coastal province. An informant recalled that Su's mother frequently participated in commercial activities in the second economy. When Su's mother came to visit Su while he was still in college, his mother brought clothes from their hometown and started selling them inside the university, just as street vendors did (Informant No. 9).

The divergent social embeddedness among Underdog ETO founders had significant impact on their teaching management. First of all, greater access to the state education system provided founders of Pioneers and Supernova with more reliable teacher and facility resources. Indeed, Seven Swords and Cornerstone also started with faculty members from state universities' English departments, but they lacked access to reliable and sustainable teacher and facility

resources in elite state universities. Ma and his father were initially conducting the majority of the classes, so Pioneers enjoyed a stable teaching force. Supernova's first group of teachers came exclusively from Capital University's English Department (Supernova Archive No. 5). Due to his connection with English Department at Capital, Su brought in a group of his former colleagues. Although these teachers left Supernova soon, their presence left consumers with the impression that Supernova's teachers were all faculty members of the most elite state university. In addition to teachers, Su also used his connections to access Capital University's language lab for listening training (Informants No. 9, No. 73).

Second, the fact that founders could teach themselves gave Pioneers and Supernova greater control over the teaching process. Since the founders of Seven Swords and Cornerstone did not teach themselves, they had to rely on other people as leaders in teaching. Dependence on other teachers greatly weakened the founders' bargaining power and internal control. The founder of Seven Swords, for example, was mocked by other veteran teachers as the person "through which teachers obtained the government stamp" (Informant No. 17), because he had to give teachers full autonomy in teaching. The internal control was so loose that "every teacher could use the school title in the poster they printed by themselves (ibid)." Moreover, founders of Seven Swords and Cornerstone could not teach themselves, so these ETOs could not reduce the negative impact of teachers' holding-up. I have mentioned that Seven Swords collapsed quickly after one teacher left to establish Pioneers and the other joined Cornerstone (Informant No. 61). This latter teacher, who was in charge of Cornerstone's teaching management, quit again and founded his own ETO later (ibid).

Founders of Pioneers and Supernova had greater control over the teaching process from the beginning. Ma and his father were responsible for the majority of courses, so they did not

have to depend on other faculty members. Su prepared himself for teaching most of the courses, with the clear intention of replacing teachers when they exited or held him up (Supernova Archive No. 5). In short, these second-type marginal entrepreneurs had the initial upper hand in caging teachers compared to the first type.

In addition to teaching management, the disparity in social embeddedness among the four Underdog ETOs also led to divergent directions in initial innovation. Since the founders of Seven Swords and Cornerstone could not control their ETOs through teaching, they dedicated their time and attention to oppressive internal control and violent control of the market (Informants No. 21, No. 61). In other words, their nonconformity was concentrated in deviating from laws, state regulations and cooperation norms. As the institutional pressure heightened, nonconformity in these areas became increasingly unsustainable.

Indeed, Supernova was reported as also participating in violent control of poster space. I will also show in the next section that Supernova initiated the price war. Su conducted these approaches with his resources and repertoires from the second economy. However, Su had much greater exposure and access to the state education system than founders of Seven Swords and Cornerstone. Although he conducted practices that were nonconforming with formal state regulations and cooperation norms, his primary focus was on developing an iconoclast form of teaching.

Su's low social status within an elite state education institution led him to pursue a distinct pedagogy from the beginning. When he was an undergraduate student at Capital University, he was laughed at because of his rural accent and narrow knowledge scope. He started to build his competence in memorizing English vocabulary through the use of mnemonics. After he became a lecturer at Capital partly because majority of his classmates went abroad for

further education, he initially struggled in teaching. When teaching the same level class as his colleague did, his students preferred to join the class of his colleagues (Supernova Archive No. 5). He decided to introduce some elements that were not considered appropriate in the mainstream pedagogy at that time, such as motivational stories and popular English songs. Regardless of the educational effectiveness of these elements, students welcomed Su's approach. According to a teacher in Capital University's English Department, in the last two years during his stay Su was already a model for new teachers. The department's director asked new teachers to shadow Su's classes in order to learn some teaching techniques (Informant No. 39).

Su brought his own unique pedagogical style to Supernova. Of course, at that time this pedagogy was hardly a systematic performative pedagogy. Only Su himself employed this style and it was often improvised. Moreover, Supernova's marketing, teacher management and operation had not been coupled with his pedagogy yet. However rudimentary his pedagogy was, it started to differ from the mainstream pedagogy Pioneers adopted. This divergence had its root in the disparate social status within the elite state education system. As Table 4.1 illustrates, Su had a low social status within this system, whereas Ma and his father obtained relatively medium positions. Compared to Su, therefore, Ma was much more restrained in breaking from taken-for-granted pedagogy in universities. He was also considered the founder that rarely engaged in violent control of poster spaces (Informants No. 66). As I will show later, Ma was even reluctant in conducting price wars.

To sum up this section, the divergent social embeddedness of these founders not only provided Supernova and Pioneers advantages in teaching management, but it also shaped the initial direction of innovation in these ETOs. To be sure, sociologists have long been attempting to go beyond personal attributes to build a network theory of entrepreneurship (e.g., Aldrich and

Zimmer, 1986, pp. 3–23). These efforts, however, do not specify the condition under which founders' embeddedness matters. I contend that, among organizations that share the same niche market, social embeddedness plays an integral in shaping the initial direction of innovation. Just as entrepreneurship is a social process (e.g., Johnson, 2007), innovation also entails a social process.

### **Innovation as a Lock-In Process**

Social embeddedness of founders is crucial for the initial *direction* of innovation. It does not, however, determine the *extent* to which an organization can push forward its innovation.

Supernova's innovation of the advanced form is not only a result of exploring and recombining divergent resources and repertoires. It is also the fruit of a non-incremental social process in which Supernova exploited and locked-in existing organizational elements.

*Three Generations of Teachers.* Supernova's locking-in is non-incremental and contingent because double ambiguity instills in ETOs a heterogeneous group of actors and ambiguous product standards. When Su first brought his own style to Supernova, this style directly clashed with the styles of other Capital University faculty members who were working part-time at Supernova. Su described these faculty members as incompetent to teach the TOEFL and GRE. He commented:

*These “academic school (xue yuan pai, 学院派)” teachers taught TOEFL Reading classes the same way they taught English at universities. They just pedantically analyzed one sentence after another, and they analyzed grammar and vocabulary. As a result, they often couldn't finish one long paragraph of reading in a single class, while I could finish seven to eight paragraphs. When they taught listening, they could only cover about ten dialogues, but I covered more than a hundred dialogues. Then students started to give me feedback. Their first complaint was that they did not get enough information from these*

*“academic school” teachers. The second complaint was that these teachers’ classes were entirely academic and pedantic. Their teaching was not specifically designed for test-preparation, and these teachers had not even taken the TOEFL test themselves. The third complaint was that, these teachers could not teach in a passionate and lively manner. They did not teach with charming language or a sense of humor or anything pertaining to the characteristics of our time. (Supernova Archive No. 5, pp. 64–65)*

It is clear from this description that Su did not consider educational gains as an essential criterion for evaluating teachers and their classes. Instead, he was more interested in how much information teachers delivered and their class performance. To be sure, education services are known for ambiguous quality standards (e.g., Firestone, Schorr and Monfils, 2004). This is even truer in the ETI where neither ownership nor commerciality is clear. The way to evaluate teachers, therefore, kept changing along with teachers’ profiles.

Similar to all the other ETOs, Supernova initially borrowed the standard of teaching English and teacher evaluation criteria from the state education system. These standards and criteria were carried out by the first generation of teachers at Supernova.<sup>4</sup> All of them were Su’s former colleagues, mid-level faculty members in the English Department of Capital University at that time. Accordingly, these teachers enjoyed high bargaining power. They evaluated student performance, but not the other way around. They taught TOEFL in the way they taught English: one teacher covered all sections (e.g., listening, grammar and writing) of the TOEFL test. In Table 4.2 below, therefore, I did not specify the section for which these teachers were responsible.

I mentioned in the last chapter that double ambiguity allowed the introduction of new teachers. Underdog ETOs all tried to limit the bargaining power of professionally trained teachers by introducing new groups of teachers. In Supernova, the evolution of teachers and

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<sup>4</sup> To be consistent, Su is not counted among any generation of teachers, although he was teaching the most.

evaluation methods went hand-in-hand. Su first allowed students to boo a teacher and shift to other classes at the same level (Informant No. 5, Supernova Archive No. 5). Students left other teachers' classes and rushed to Su's classes. The first generation of teachers was unhappy about these new evaluation methods. In less than a year, all the first-generation teachers left Supernova.

The second generation of teachers came from different backgrounds. As Table 4.2 shows, three out of four also came from Capital University's English Department. However, none of them was a mid-level faculty member. They were senior graduate students or junior faculty members (Supernova Archives No. 2).

Table 4.2 Three Generations of Early Teachers at Supernova

Generation	Name	Background	Major	Full-time or Part-time	Course taught
First Generation (1991)	Unknown	Mid-level faculty member at Capital University (CU)	English	Full-Time	TOEFL
Second Generation (1992/1993 to 2000)	Gu	Junior faculty member at CU	English	Part-Time	TOEFL Listening
	Shen	Junior administrator at CU	English	Part-Time	TOEFL Vocabulary
	Kun	PhD Student at CU	English	Part-Time	TOEFL Grammar
	Dong	PhD Student at Central Academy of Sciences	Automation	Part-Time	GRE Logic and Quantitative
Third Generation (1994/1995 to 2000)	Xie	College student at a provincial Industrial University	Automation	Part-Time to Full-Time	GRE Logic and Quantitative
	Deng	Master student at Central Academy of Science (undergraduate at a provincial Normal University)	Biology	Part-Time to Full-Time	GRE Vocabulary
	Liang	Undergraduate at Capital University	German	Part-Time to Full-Time	GRE Reading

Sources: Supernova Archive No. 2; Lu, 2002; multiple informants.

One of them shadowed Su's class just after she joined Capital University. The fourth teacher, who was responsible for GRE Quantitative, did not major in English, although he also came from an elite academic institution. Since Su had considerable influence on these teachers, he was able to ask them to imitate his way of teaching. These teachers started to put more focus on class performance. However, since most of them were only familiar with the professional ways of teaching, they did not contribute much to the development of performative pedagogy.

During the mid-1990s, Su recruited the third generation of teachers to Supernova. Their profiles differed dramatically from those of the first two generations. According to Table 4.2, none of them majored in English and only one attended an elite undergraduate college.<sup>5</sup> They all came to teach at Supernova while still graduate students. Despite having less elite academic profiles, this group became the bedrock of Supernova's superstar teachers and key proponents of performative pedagogy. They were Supernova's most famous teachers in the 1990s, as well as Supernova's earliest shareholders because of their teaching contribution. They were recruited not because they were proficient in English or because they held the highest test scores, standards Su specified were essential for satisfactory teaching in the last quote. Instead, these teachers impressed Su by circumventing Su's formal recruiting criteria. They stopped Su's car in the middle of the road or called Su's cellphone using names of Su's friends. As an extreme example, a high school dropout joined Supernova and later became one of the most famous GRE teachers (Lu, 2002). He impressed Su with a long letter decrying the formal requirements listed in Supernova's recruitment posters (*ibid*). Teachers of the third generation demonstrated a different

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<sup>5</sup> I include the undergraduate college because Chinese people all know that undergraduate institutions, compared to graduate institutions, are a better indicator of one's excellence in academic works. This is because the most competent undergraduate students often choose to study abroad or go to work rather than undertaking graduate studies in China.

motivational structure than teachers of the first two generations. They were recruited because they showed potential to deliver performative classes. Although the second and the third generations of teachers were able to co-exist during the 1990s, the rise of the third generation and their greater alignment with Su's teaching styles marginalized the second generation. As Table 4.2 illustrates, while all second-generation teachers remained full-time faculty members and administrators in state universities and worked at Supernova on part-time basis, third-generation teachers were the first group who made the transition from part-time teachers to full-time teachers and managers at Supernova.

*Locking-In of Performative Pedagogy.* Performative pedagogy puts priority on elements that are not directly related to educational materials—motivational stories, mnemonics banter, nationalist comments and entertaining jokes. Locking-in these elements was crucial for Supernova's sustained dominance and especially for cross-region expansion. I have mentioned that student word-of-mouth was the primary medium through which students outside of Beijing knew Supernova. Performative elements were one of the key messages students circulated in their networks.

Locking-in performative pedagogy at Supernova was a highly contingent social process. The possibility of the locking-in and the specific configuration of the pedagogy were based on two conditions: Su conducted a large volume of teaching from the beginning, and this locking-in process unfolded simultaneously with the succession of teachers. Su's own teaching style led him to put more emphasis on qualities, such as public-speaking skills and boldness in making dangerous or inappropriate remarks rather than on English proficiency. Newly recruited teachers, such as those of the third generation, increasingly demonstrated these qualities. The fact that

these teachers, many of whom did not even pronounce English correctly, were able to teach at Supernova sent encouraging messages to others. Teachers with profiles similar to the third generation joined Supernova and became the major teaching force.

The entrance and burgeoning number of the third-generation teachers expanded the original scope of performative elements Su created. Whereas Su initially focused on motivational stories, other teachers brought in nationalist comments, entertaining jokes and a variety of seemingly irrelevant knowledge. To many students, the fact that Supernova teachers could blurt out a large quantity of extracurricular knowledge was impressive. A faculty member at an elite state university depicted the most unforgettable class he had at Supernova while he was still a student. He mentioned that a Supernova teacher's firm grasp of a particular set of novels blew him away. He said that:

*This Teacher Deng was quite a character. He taught GRE Vocabulary. If he showed superb capacity in English vocabulary, that was natural. But his class was filled with all the detailed and insightful analysis of Jin Yong's Wuxia Novels.<sup>6</sup> I considered myself sort of an expert in this field, you know. But that a teacher of GRE Vocabulary could know Jin Yong so well really blew me away. (Informant No. 21)*

To students, performative elements seemed to be improvised. Although Su and the first three generations of teachers had a sense of what students wanted, a large portion of their performative elements started as spontaneous elements. It took a long trial-and-error process for these elements to reach a fixed combination and become the trademark of a teacher. As this Teacher Deng himself recalled:

*At the very beginning those irrelevant asides (xianpian, 闲篇) were somewhat spontaneous.... But if you say something in a class and you find it welcomed by students, you will continue talking about it in the next class. If you say something and students*

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<sup>6</sup> The Wuxia novel is a genre that has been popular among Chinese since the 1990s. As its name shows, this type of novel features people with superb kung-fu (*wu*, 武) skills and heroes (*xia*, 侠). Jin Yong's Wuxia novels are considered the best.

*have no response, you will stop talking about it. So after numerous rounds of trial-and-error, every sentence you say becomes of interest to students.... (Informant No. 5)*

Since crafting of a performative element is a trial-and-error process, it takes intensive practice and requires a long time for a piece of such pedagogy to mature. Veteran teachers, who have more classes to teach, have more opportunities to practice. Inventing classic pieces was a formidable task for new teachers because they were often assigned fewer classes. Teacher Deng commented on this situation:

*In such a situation, new teachers found it difficult to survive because they did not have enough classes to make a living and for practice. At that time, Su did not care whether he could train new teachers. He was more concerned about making students happy. His priority was to “nail students down (gaoding xuesheng, 搞定学生),” to make them stay and put their money into his pocket first. (Informant No.5)*

No matter how difficult it was for new teachers to invent performative pedagogy, they were evaluated in comparison with veteran teachers, as I will elaborate in the next section. In some cases, new teachers needed to prepare performative elements for a newly assigned class in a short period of time. Under these circumstances, teachers had to rely on the patterned approaches of manufacturing performative pedagogy. Moreover, since teachers exchanged experiences regarding how to create these elements, they adapted by slightly modifying existing motivational stories or nationalist comments. The key components of performative elements persisted, although they were open to modification by individual teachers. Below, I provide two variants of a classic piece of performative pedagogy.

*Example 1: A girl got on a bus to attend a Supernova class. On this crowded bus, a boy’s T-shirt caught the girl’s attention. There was a line on the T-shirt—“GRE AT WALL.” The girl could not understand it and murmured, “Why was GRE at the wall?” When she got to the class and asked another student about this, the other student laughed and told her to put the letters together. It was “GREAT WALL.” (Lu, 2002, p. 109)*

*Example 2: A boy was about to take the GRE. He put great effort into it and recited Su's Vocabulary Bible even when he was walking. One day, this boy saw a girl who was wearing a T-shirt that had some English letters. He came closer and found that the letters were "GRE AT WALL." The boy was thinking, "What does 'GRE AT WALL' mean? Why is GRE at a wall?" The boy followed the girl to her apartment. The girl saw him and asked, "Why are you following me?" The boy told her about the strange words on her back, and the girl said, "My T-shirt says GREAT WALL." (Lu, 2002, p. 110)*

Apparently, these two pieces were created with similar logic. This logic combines both motivational and entertaining elements. They intend to show that some students were so hardworking that they became obsessed with the GRE. Once the patterns for manufacturing performative contents became clear to teachers, some teachers used highly opportunistic approaches to manipulate students' impressions. For example, some teachers bragged about their capacity to recite a brick-like dictionary while others alluded to their astronomical wages. Still others made up stories about taking care of disabled people (Luo, 2010, pp. 40–42). The key, according to a veteran teacher, was "to use whatever means to make students like you" (Informant No. 31).

In 1997–1999, the fast expansion of Supernova required an even faster pace to reproduce performative pedagogy. In the meantime, performative elements had become so mature that new teachers only needed to copy veteran teachers' stories and comments. Su recorded a massive number of class audios by superstar teachers. New teachers could learn performative content by simply listening to the cassettes. Although veteran teachers criticized this practice as copying (ibid), Su did not have to worry about copyright given the absence of intellectual property protection. Tape recorders helped Supernova rapidly train new teachers in the "Supernova way."

*From Performative Pedagogy to Mass Teaching.* Mass teaching not only locked in people and performative contents, but also involved additional organizational arrangements. These arrangements included a market-based evaluation system, a specialist teacher/co-teach model, large class size, high wage and low price/aggressive marketing. These elements started coupling with each other by accident. They only constituted a stable configuration after they interacted with and reinforced each other.

Teacher evaluations went hand-in-hand with the succession of teachers. Su's introduction of rudimentary market-based evaluation at the time of founding, such as booing teachers and shifting classes, facilitated recruitment and the rise of the third generation of teachers. These teachers tended not to be professionally trained in English, so they were less restrained by or concerned about professional standards of teaching. In turn, the succession of teachers catalyzed the evolution of evaluation methods.

State and Intellectual ETOs in Beijing's TOEFL/GRE market in the 1980s and early 1990s did not evaluate teachers' performance at all (Informants No. 61, No. 23). Supernova was among the first group of Underdog ETOs to introduce rudimentary market-based teacher evaluations, such as booing teachers and allowing students to shift to other classes. The recruitment and rise of the third-generation teachers pushed evaluations toward a greater reliance on market mechanisms. Between 1993 and 1995, Supernova's teacher evaluation shifted to rely entirely upon students' impressions of teachers' class performances: how well a teacher was doing was based on students' numerical judgment on a scale from one to five on the evaluation sheet. In a ten-class course, for example, an administrative staff person distributed questionnaires to students—often in the ninth class—and asked students to provide an evaluation for all their teachers (Luo, 2010, p. 41).

The succession of teachers and the rise of the market-based evaluation created new conditions under which Su further experimented on the teaching model. Now that students evaluated all teachers, teachers' performance evaluations were only comparable if they were teaching the same group of students. Under the previous model of generalist teacher model, each teacher covered all test sections. A class only had one teacher. Now different teachers were teaching different classes of students. As a consequence, teachers' performances were hardly comparable. As a veteran teacher recalled, Su devised the specialist teacher model in order to make teachers compare and compete with each other.

*At that time Supernova had 40 classes for one course. So if students had the same teacher (40 times), this teacher would become a boring guy no matter how funny he was. Another issue was that it would not be comparable (if a course was taught by one teacher). This teacher would think he was doing a pretty good job. Students would have no one to compare to, and they would not know whether this teacher is good or not. But if you ask four teachers to go into the same classroom, students will immediately find out who does not teach well and this guy will be under a lot of pressure. It is actually a competitive system in a benign way. It is about making teachers check, balance and compete with each other. And if we have a teacher specialize in one section, that teacher is more likely to excel in this section. (Informant No. 4)*

In the specialist teacher model coupled with the co-teaching model, each class was required to be taught by multiple teachers. Each teacher had to specialize in one particular section such as TOEFL Listening or GRE Vocabulary, so a class often required a team of four teachers. Facing the same group of students, teacher performance became more comparable. Competing for students' high evaluation turned into a Burawoyian game,<sup>7</sup> a tournament among teachers.

Although Su's original intention was to make teacher performance more comparable, an unintentional consequence was the limiting of teachers' bargaining power. As the specialist

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<sup>7</sup> See Burawoy (1979), pp. 77–94.

teacher model emerged, all teachers were limited to narrower subjects. They were no longer able to grasp the comprehensive knowledge about the ETI business. They became much more dependent on each other and on Su. Their entrepreneurial capacity was crippled. The specialist teacher and co-teach models had made Supernova much more capable of caging teachers by the mid-1990s. In comparison, even the top market leader in Shanghai in the early 2000s—Shining—was still using the generalist model (Informant No. 23).

The maturation of the market-based evaluation and the specialist teacher/co-teaching model intensified stratification among teachers. As mentioned earlier, the succession of teachers facilitated the evolution of evaluation methods. In turn, the market-based evaluation and the specialist teacher/co-teaching model tended to attract teachers who were good at performative pedagogy. Moreover, these new organizational arrangements tended to widen the gap between winners and losers in the teaching game. Supernova increasingly used the evaluation score of a teacher to determine his/her bonus and how many classes would be assigned to him/her in the next season.

Since the ETI was based on piecework wages, the number of classes and bonus determined the wage of a teacher. Consequently, teachers who received high scores tended to have more classes, more practice opportunities and higher wages. Those who did not receive high scores would receive lower wages and fewer opportunities, which made it even harder for them to obtain high scores. This system meant that only a small portion of new teachers could stand out. Most new teachers soon left because they could “not feed themselves” (Informant No. 31). In this situation, firing a person did not incur much cost: a teacher who could not obtain a high score would not receive classes to teach in the future, so the teacher left voluntarily.

With market-based evaluations and the specialist teacher/co-teaching model in place, Supernova's systematic large classes took shape. Of course, almost all ETOs in the 1980s and early 1990s in Beijing's Haidian District were of large size and provided a high profit rate, partly because of the abundant demand and the concentration of over thirty elite universities in this region. However, a systematic model of large classes is different. It required only renting or building large classrooms with over one hundred seats. It presupposed little attention or service to individual students. Accordingly, a systematic model of large classes tends to be low priced. Admittedly, the prices for all ETO classes were low in the 1980s and 1990s.<sup>8</sup> As competition intensified in the mid-1990s, Su used a price war for initial survival and to weaken competitors. In a local niche where all competitors fight for the same group of students as resources, "having one more student in my class means one less in competitors'" (Informant No. 17). Su adopted a low price that was about half that of his competitors' while paying significantly higher wages (Informants No. 4, No. 17). In the mid-1990s, Supernova teachers' wages rose steadily; the average wage was comparable to that of the average Harvard professors (Lu, 2002). Su's low price pulled students from his competitors, while his high wages turned competitors into teacher training schools for Supernova. Despite these advantages, the low price coupled with high wage was not sustainable in the long run.

The co-existence of the low price and high wage was initially possible because Su carried out a large portion of the teaching and marketing himself. In a typical TOEFL class consisting of 40 classes, Su typically taught 20 classes without pay, so the tuition revenue could cover the wages of other teachers (Informant No. 4). Su also conducted his own marketing, such as putting up posters and distributing flyers. His original intentions were to cut costs and to prevent teacher

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<sup>8</sup> An informant estimated that the average hourly rate among Beijing ETOs was about 3–5 RMB per student (Informant No. 4).

defections. These practices led to an unintended consequence: the low price and high wages became compatible in the short run.

In the long run, large class size, low price and high wages were sustained by supporting and reinforcing each other. Large classes provided an experience of collective exuberance. As a veteran teacher recalled, “Students’ laughter would lift the roof and storm you in waves when you told a joke in a class of five hundred people” (Informant No. 31). This special type of class was dependent on a special type of teacher, a special pedagogy and special teacher management. In Supernova, the third-generation teachers, pedagogy elements, market-based evaluation and specialist teacher/co-teaching model were in place to sustain the large class size in the long run. The evaluation and competition promoted teachers who were most suitable for a large crowd. Performative elements that were only suitable for a large classroom were reproduced. Eventually, only teachers who could perform in large classes were retained. Large classes were so taken-for-granted that Supernova required all of its classrooms to be built with a large number of seats. With all elements locked-in, mass teaching crystallized.

Although Supernova’s teaching model had crystallized, the entire organization was only partially locked-in. First, from 1995 to 2000, the ownership structure was still rapidly changing. Supernova was a family business before 1995, an informal partnership from 1996 to 1999 and started to incorporate in 2000. In short, only the teaching elements were locked-in. Locking-in the teaching model provided a stabilized base for the radical change in ownership and turn to the financial markets. Second, even on the teaching dimension, the locking-in was only partial. For example, although performative pedagogy, the third-generation teachers and market-based evaluation were locked-in, the second-generation teachers survived for a long time. Su placed the highest priority on teachers’ performance, but he still treasured the professional training of

teachers. Therefore, he still assigned classes to second-generation teachers, especially those who had full-time jobs in elite state universities. Third, performative pedagogy was a platform where a variety of “schools” co-existed. A number of studies have identified the existence of a “motivational school”, an “academic school” and others among Supernova teachers (Lu, 2001). Most dramatically, nationalist discourse and anti-nationalist discourse co-existed. Although a large number of teachers promoted anti-Japanese slogans, a few encouraged critical thinking about the nationalist messages behind these anti-Japanese slogans (Supernova Archives No. 8, No. 9).

### **Legitimation and Monopoly**

Supernova’s 80 percent market share in Beijing and 50 percent share in the entire nation indicate that its mass teaching and performative pedagogy were well received by consumers. In fact, they were so warmly welcomed throughout the entire ETI that these practices have become standard. How and why were these performative elements irrelevant of test-prep materials institutionalized? This is especially puzzling given that this is a field where students come with specific aims for educational gains in test scores.

Supernova’s legitimation strategies did not go beyond what we know from past literature on legitimation (e.g., Aldrich and Fiol, 1994; David, Sine and Haveman, 2013). For example, Su showed his authority by constantly referring to his former connection with Capital University. Su also legitimated performative pedagogy by depicting mainstream pedagogy in the state education system as a problem of the *status quo* (David, Sine and Haveman, 2013, p. 365). As he once said:

*I think there are numerous things that elite state universities cannot offer. For example, a large number of faculty members in state universities do not talk with students about how*

*to design a life. They do not talk about how to reach a goal or execute a plan. They do not tell motivational stories.... (Supernova Archive No. 5, p. 73)*

Supernova also staged cultural and ritualistic events to show the high scores of its students. As previously mentioned, it is true that a large number of Supernova students obtained high scores on the TOEFL and GRE, and they did so without cheating. However, Supernova was never able to show the extent to which these high scores should be credited to its classes.

Regardless of how much Supernova contributed to actual student gain, Supernova was able to legitimize performative pedagogy and mass teaching with the help of its location. Since Supernova was located in the heartland of Haidian, its initial students primarily came from elite state universities. These students were pioneers in obtaining high scores. This made it even harder to tease out educational gains from students' baselines. Even so, the high scores of Supernova's students sent a strong signal to other students: Supernova's fun classes were believed to be effective. Students believed that fun classes were the cause of the high scores. It is important to note that I am not claiming that students' test scores did not benefit from Supernova's classes. Teachers' motivational speeches could also spur students to study harder, even when these speeches did not concern the TOEFL/GRE. Moreover, Supernova outcompeted its competitors not because of its location. Its competitors were also located in Haidian District. I am suggesting that the spatial location was an important element through which Supernova could lead students to believe that its fun classes could also help them increase their test scores.

Another benefit of the Haidian District location is the presence of a large number of students from all over China. These tended to be elite students back in their hometowns. They had a huge influence over other students who lived outside Beijing. Their word of mouth about

the legends of Supernova constituted invaluable, free advertising. The location of Supernova conditioned its local monopoly and national dominance in the TOEFL/GRE market.

### **Non-Diffusion of Mass Teaching**

It is puzzling, in view of its clear success, that mass teaching was not diffused and imitated by Supernova's competitors, especially since this model was welcomed by students. Two possibilities can easily be ruled out. The first is that Supernova's competitors did not even want to imitate mass teaching. There is ample evidence showing how its competitors attempted to adopt various forms of performative content. It is also possible that Supernova's monopoly already left no opportunity for competitors to imitate this model. Even though Supernova had wiped out the other three ETOs in Beijing by 1999, it had not yet established any branch school in other cities. Major cities such as Shanghai and Guangzhou were still dominated by local brands. These local brands had sufficient time to imitate mass teaching. Although many of them showed a willingness to imitate this model and even picked up some elements, such as motivational stories, they were never able to put together integral mass teaching as Supernova did. In sum, we observe here an industry-level institutionalization without inter-organizational diffusion. This new question begs a new perspective.

It is tempting to think that performative pedagogy and mass teaching were easy to imitate. The market-based evaluation system, for example, did not seem to present technical difficulties. Seven Swords and Cornerstone, however, were restrained from reforming their pedagogy due to their founders' dependence on other teachers. As for Pioneers, Ma Tianna's affiliation with the state university and intellectual family background precluded him from considering the ETI as a full-time career. When Supernova was offering a wage of 600–700 RMB per 2.5 hours to

teachers, Pioneers was still offering 300–400 RMB. This is because “Ma’s rationale was that 300–400 was already ten times as much as the wage for private tutoring”, but “Su was thinking how to use the low tuition and high wage to get one more student or good teacher from his competitors” (Informant No. 17). Even if Ma was also trying to use a similar market-based evaluation, “he could not fire his own father when his father failed the students’ evaluation form” (ibid). Eventually, Pioneers became the teacher training school for Supernova.

Moreover, ETOs in other cities were not able to imitate Supernova even if they desired to do so. Supernova’s locking-in of mass teaching was a long and contingent process. It was impossible for a competitor to incorporate all elements at the same time. Neither was it easy for a competitor to start with one or a few elements and put these elements together in an incremental manner. A senior manager who used to be a branch school president at Supernova mentioned,

*When we were there to found the new branch school, we designed the school layout to have many large classrooms. So basically we were copying the super star teacher model in Beijing. We trained about thirty or forty new teachers. You know, we recruited the best teachers from local ETOs, we asked them to listen to our tapes and keep practicing. On the first day of our grand opening, there came four thousand students. In the first two months of our opening, about thirty competing ETOs died. On that first day, the founder of a big competitor came to take a look at our classes but was identified by a student’s parent. Our front desk informed me so I went to greet him. This President Li told me, “There is no way I could copy your model. I cannot afford such expensive teachers, and this is related to the fact that I do not have so many students!” (Informant No. 36)*

This section shows a case where there is legitimation without diffusion. In a doubly ambiguous space, locking-in an innovation is processual and contingent. Therefore, even a legitimated model might not be widely diffused.

## **GENERALIZABILITY OF THE TOEFL/GRE PATTERN: THE CASE OF ROARING ENGLISH**

In this section, I use the case of Roaring English to show that the pattern I found in Beijing's TOEFL/GRE is generalizable to another niche in another city. I will show that, not only is the founder's social embeddedness an important indicator of the initial innovation direction, but Roaring English's exploitation and locking-in of an alternative version of mass teaching were also highly processual.

That Roaring English stands out corroborates the significance of the founder's social embeddedness. Roaring English rose as an Underdog ETO in Guangzhou's Spoken English niche in 1995. Its founder, Duan Ping, was a marginal entrepreneur. He was not qualified to be a founder according to the state requirements, so he circumvented state regulations and registered his ETO as a cultural and consulting firm. He fell into the second type of marginal entrepreneurs since he had rich access to the state media system. Duan's full-time job was anchoring an English program at Guangdong Broadcasting Group, a state-owned media agency. His familiarity with the media shaped Roaring English's subsequent changes.

As a marginal entrepreneur, Duan conducted a wide variety of nonconforming practices. The name Roaring English, for example, was pirated from another successful media content company (Informant No. 49). At that time, the top market leader in Guangzhou's Spoken English was Scholastic Times, founded by an intellectual who had returned from the United States. Compared to the founder of Scholastic Times, Duan employed far more nonconforming practices. However, it should be pointed out that Duan did not go so far as to use violence or break laws. He focused on his pedagogy and marketing strategies. In short, Duan's social embeddedness also shaped the initial direction of innovation at Roaring English.

Innovation in teaching was only possible because Duan had full control in that area. As the first teacher of his ETO, he carried out most of the teaching. He designed a solo model for himself: all students recruited to Roaring English were supposed to learn Spoken English directly from Duan. Other teachers, often with the title of teaching assistants, had to teach English exactly the same way Duan did. Even their gestures had to be same as Duan's (Informants No. 49, No. 55). Duan's solo model meant that all other teachers at Roaring English were replaceable. Even though it was partly taken for granted that Spoken English classes should involve native speaker teachers, Duan came up with a strategy to reduce dependence on foreign teachers. He only used a specific type of foreign teachers in a specific kind of class. In 1998, Duan held his first "training camp" in a tourist town in southern China, where students had to pay a high tuition for seven days of English immersion. To recruit a large number of native speakers as teachers and limit them to short-term classes, Duan contacted a group of Baha'i believers from the U.S. (Informant No. 55). These teachers willingly came to teach English free of charge.

Duan developed an alternative version of mass teaching. The success in locking-in divergent elements for this version was also a social process. Duan's version of mass teaching is similar to Su's in the sense that they both relied on large class size, non-professionally trained teachers and performative pedagogy. Even so, there are also marked differences between the two. Duan's mass teaching was based on his solo teaching in front of a large crowd. As already stated, teachers at Roaring English had to teach exactly the same way Duan did, whereas teachers at Supernova could improvise and even develop an alternative approach under performative pedagogy. Moreover, Duan's performative pedagogy delivered motivational and nationalist messages in a more direct, emotional and sometimes hysterical way (Zhang, 2002). As the second quote at the beginning of the chapter shows, Duan often taught the class by asking

students to shout slogan-like phrases such as “I enjoy losing face” and “I will never let my country down” (ibid).

Duan followed a protracted process when linking his solo model with selling media content in rural areas. Duan initially generated all his revenue from his classes (Informant No. 49). He soon expanded in Guangzhou and other cities with the franchise model. However, he realized that there was no way for him to control the quality of franchise schools, especially under the institutional environment in the 1990s. In addition, although his “training camps” could recruit a large number of students from all over China, these short-term but full-time camps could only take place in summer or winter vacations. Coincidentally, Duan had rich experience and resources in editing media content. He easily put together English sentences in cassettes and books, so students could imitate what he said. He gradually realized that he could generate revenue by selling these cassettes and books, and began to use free classes as a marketing strategy. This model was a perfect match with his solo teaching: he only needed to appear in a city one time, and students could still learn from him by buying his books and cassettes.

Duan also realized that rural areas were more suitable for his model. He initially attempted to promote his teaching in colleges and other urban institutions. However, after receiving lukewarm feedback, he and his managers began to explore rural areas. He found that it was easier to mobilize a large crowd in rural areas simply by working with local governments and education departments. Local officials would consider Duan’s free classes in front of primary and secondary school students a political achievement (Informant No. 49). After lecturing and speaking English with students, it was natural for Duan to promote his books and cassettes. Duan expanded his business by “conquering one village after another” (Roaring

English Archive No. 1). As Roaring English locked in mass teaching, free classes, media content and rural markets, it became the most well known brand in the Spoken English market.

This chapter probes why some Underdog ETOs, but not others, became dominant. I revealed that founders' social embeddedness was an important indicator for the initial trajectory of an ETO. Whereas founders who had no connection with the state systems tended to use overly deviant practices, founders who were tightly coupled with the state system could be constrained from innovation. I also discovered that innovation under double ambiguity, as a locking-in process, tended to be highly processual and non-incremental.

## Chapter Five

### From Classrooms to Trading Rooms: Financialization and Institutionalization

*Our company started before I came. It started with the angel investment from two founding partners of Supernova.... In terms of the A-round investment, we might have been one of the earliest among ETOs. You know, capital became interested in education and online education. Before 2012, if you had a concept that could go “viral,” you could get tons of money from venture capital.... Now, the tide has shifted. People ask you if you can do “onsite promotion (ditui, 地推).” This is how we got to the D-round and got a good valuation (guzhi, 估值).*

—Informant No. 64

*I think Supernova’s IPO in 2006 was a watershed event in the ETI. Domestic and international capital all rushed in.... They totally messed up this industry. All they cared about was preparing ETOs for IPOs (baozhuang shangshi, 包装上市) and expansion (paoma quandi, 跑马圈地).... This used to be a profitable industry. It required solid and rigorous (work). Now all the profits are gone, along with their fast expansion. These people have made this industry into a bubble just like blowing up a balloon. Everyone, every underdog, wants to go IPO. Once the investment is in, the salaries for executives and staff can double. But where do you get the revenue? So they have to expand rapidly. Their management and quality control cannot adapt to the expansion. They run deficits. They lose what they made. They also lose investors’ money. You know, without Supernova, no one ever would have thought about going IPO. Neither did investors think about investing in Chinese ETOs. This industry has been doomed since Supernova’s IPO. The vitality of this industry has still not recovered.*

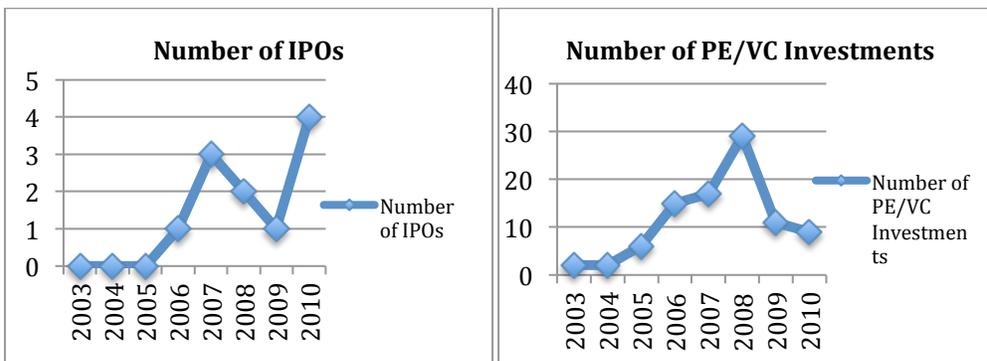
—Informant No. 8

The quotes above provide clues about the shift in ETOs’ primary capital sources. From the birth of the ETI in the 1980s up until the early 2000s, all ETOs relied on family savings to start their businesses in shabby classrooms as back-alley mom-and-pop businesses. Capital from external sources was minimum. The state also strictly forbade ETOs’ from being listed on domestic stock

markets. All this changed within a decade. Figure 5.1 documents the changes from 2003 to 2010 in the form of IPOs and investment from venture capital (VC) and private equity firms (PE).

By 2010, eleven ETOs had been publicly listed on overseas stock markets. The total number of VC and PE investments was in single-digits before 2005, but increased to 87 between 2005 and 2010 (Deloitte, 2011). The primary capital source to start an ETO has shifted to PE/VC firms in both China and Silicon Valley. To the extent that PE/VC firms' investments in the ETI are oriented toward profiting from ETOs' IPOs on the stock markets, their involvement also indicates that the ETI has become tied to global financial markets. As the first quote indicates, the taken-for-granted way of starting an ETO has shifted to first contacting a VC/PE. Along with these changes has occurred a shift in state policy. In 2010, the Chinese state permitted the first IPO by an ETO on the domestic stock market.

Figure 5.1 Growth of IPOs and PE/VC Investments in the ETI, 2003-2010



Source: Deloitte China Auditing Firm, 2011, 2012.

This chapter investigates how and why the ETI turned to financial markets. Specifically, how and why did the ETI and ETOs that had previously been disconnected from financial

markets become embedded therein?<sup>1</sup> The ETI's embedding in financial markets is puzzling. The ETI in the early 2000s did not seem to need extra capital from financial markets. It had historically been, and still was, a typically non-capital-intensive industry. There was no fancy technology, nor were there costly advertisements. All ETOs I studied relied on family capital and started their businesses by renting dilapidated houses near state universities. It was customary for students to pay their tuition before the classes began and for the ETOs to pay teachers a piecework rate. Therefore ETOs, and especially the leading ETOs, enjoyed high cash flows.

This embedding process is more surprising when we consider that it commenced and developed while the state was still forbidding ETOs from being listed on stock markets. Embedding in financial markets therefore incurred the risk of state sanctions. Moreover, the majority of the ETOs did not register as corporations, and accordingly their infrastructural readiness for financial markets (e.g., corporate governance) was underdeveloped. Given the state's restrictions and the poor infrastructural readiness, the rapid embedding within a decade is surprising. Therefore, an explanation has to be able to answer two related questions: 1) Why was the turn so rapid? 2) Why, among market leaders with intentions to go public, did some ETOs succeed while others failed? And 3) To the extent that this embedding process is an institutionalization process, how does it change the way ETOs act?

This chapter documents a two-stage embedding process that started with the market leader Supernova's IPO. I illustrate that, although the second stage was a case of isomorphic institutionalization, structurally conditioned internal conflicts were a contributory factor in Supernova's IPO. Specifically, Supernova's internal conflicts among shareholders led to its IPO in two ways: a) conflicts and the exhaustion of alternative solutions to conflicts led to an

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<sup>1</sup> Embedding therefore can be defined as the process by which an industry or firm unconnected to financial markets becomes connected for the sake of capital.

organizational lock-up, with IPO emerging as the only way out; and b) conflicts upgraded Supernova's infrastructural readiness for financial markets because the absence of trust in the wake of conflicts pushed stakeholders to turn to formal and professional financial structures for securing financial gains. In the second stage, the mimetic isomorphism of Supernova's competitors formed a cascade of IPOs and PE/VC investments. This isomorphic process, and the market competition structure of the ETI, hastened the industry's embedding process.

My conclusion that structurally conditioned internal conflicts facilitated the embedding in financial markets bridges two literatures. My study shows that double ambiguity in particular, and ambiguity in general, contribute to widespread structurally conditioned internal conflicts among business partners regarding profit distribution, ownership transfer and share distribution (Francis, 1999; Su et al., 2008). I also expound upon previous research that shows embedding in financial markets is a functional solution to internal struggle (Graebner and Eisenhardt, 2004; Wasserman, 2012, pp. 378–379; Denton, 2016).

This chapter starts with ruling out alternative explanations. I show that the existing efficiency, new institutional and macro-political accounts are indispensable for understanding the embedding of the ETI, but that they leave important questions unanswered. I offer my explanation with a narrative of Supernova's IPO and its impact on the embedding of its competitors. In the second half of this chapter, I conduct a comparison of ETOs in terms of their success and failures in connecting with financial markets, as well as a discussion about the relationship between institutionalization and nonconforming practices.

## **CONTEXT, DYNAMICS AND ALTERNATIVE EXPLANATIONS**

The turn to financial markets in the 2000s was conditioned upon two favorable contexts. The first was the further development of China's private economy and financial markets. During this period, the productivity of China's private sector had been twice as high as that of the state-sector (Lardy, 2014, p. 95), and corporate governance and the idea of shareholders' value had been taken for granted in private sectors outside of the ETI. Although China's stock market took off only in the 1990s, by 2000 it had become the second largest in Asia (Naughton, 2007, p. 468). Chinese firms had even figured out how to be listed on U.S. stock markets. The connection between the Chinese economy and global capitalism was tightening. The second favorable context was the shift in state policy toward much more tolerance of, and even support for, market-based education. The passing of the Non-State Education Promotion Act in 2002 laid the legal foundation for ETOs to practice in more of a for-profit manner, and for managers and resources to enter the ETI from other industries.

During this time, the competition structure of the ETI also changed. Supernova evolved into a nationally operating generalist organization. It was dominant in TOEFL/GRE and also competitive in other niches. Furthermore, it competed with leading specialists in each niche market—Doo & Cool and Duvell (K–12), United IELTS (IELTS), Roaring English (Spoken English) and Blue Ocean (Graduate Exam).

The efficiency, new institutional and macro-political accounts are all indispensable for understanding the embedding of the ETI. Efficiency accounts claim that financial markets are efficient channels for allocating resources (Jensen and Meckling, 1976; Fama and Jensen, 1983). Therefore, embedding can bring in developmental resources for the organization or cash-out opportunities for the entrepreneurs (e.g., Brau and Fawcett, 2006; Certo et al., 2009). All

founders and shareholders I interviewed admitted that part of their rationale for going IPO was to become rich. This is especially true for those minor shareholders who did not worry about losing control of their enterprises. The efficiency account also matters because ETOs need extra capital sources for further development and expansion, even though past business models did not seem to require much capital.

The new institutional account considers the embedding in financial markets as a legitimation process, as new ideologies such as shareholder value become taken for granted (Lazonick and O'Sullivan, 2000; Fligstein, 2001; Dobbin and Zorn, 2005). This is useful in explaining the ETI case for multiple reasons. First, the escalation of Supernova's IPO to the industry's cascade of IPOs and PE/VC investments is an example of a typical institutionalization process—mimetic isomorphism. Ample evidence shows that after Supernova's IPO, its competitors imitated its actions, both because they considered Supernova's growing financial capacity a threat, and also because they observed Supernova's reputational gain from its IPO. Second, various institutional agents, such as foreign PE/VC and consulting firms, introduced the initial normative and cultural-cognitive frameworks of IPO, and even bridged ETOs to global financial markets.

The macro-political account places emphasis on the role of the state in pushing the economy toward financialized forms under the global capitalistic system (e.g., Arrighi, 1994; Magdoff and Sweezy, 1997; Krippner, 2011). It is also relevant because the expansion of the global financial system and the developmental Chinese state provided social conditions favorable to the embedding of the ETI. However, I will show that the roles of the Chinese state in my case are more indirect than what the macro-political account describes.

Despite their explanatory power, these existing accounts leave important questions unanswered. None can explain how and why heavy regulations and poor infrastructural readiness were overcome. Neither can they explain three related questions: First, why did major shareholders of ETOs—who could have enjoyed equal financial returns without going IPO, and might have suffered from a loss of control after IPO—still give the green light to embedding? Second, why did the ETI turn to financial markets so rapidly? Third, why did it turn to global instead of domestic financial markets?

## **THE EMBEDDING OF THE ETI IN GLOBAL FINANCIAL MARKETS**

This section explains the ETI's embedding process beginning with the Supernova's IPO. This IPO had roots in its early development and subsequent internal conflicts.

### **Prelude to Supernova's IPO**

*Supernova: From Founding to Dominance.* Recall that Su Leidong founded Supernova School (the School) in Beijing in 1993. Focusing on TOEFL and GRE classes, he started with part-time teachers and was the only full-time teacher and administrator (Supernova Archive No. 4). As his businesses grew, his wife, mother and in-laws also joined. Using an innovative mass teaching model, Supernova grew rapidly with high profits. By 1995, it had become Beijing's No. 1 educational brand, with an annual enrollment of 9,247 students (Lu, 2002). During 1995 and 1996, three of Su's former teachers and friends from college—Wei, Dai and Kang—returned from North America and joined Su's business. In the absence of a corporate structure, Su devised a verbal agreement of informal partnership with each of them. According to the partnership, each would start a new business under the Supernova brand, and they would not tap into Su's original

territory, TOEFL/GRE training. Each partner could retain 85 percent of the revenue of his business, but had to give 15 percent to Su as a management fee. Under this informal partnership, Su was pleased with his control and expansion of the Supernova brand, while his partners benefited financially. Under the request of Wei and Dai, Su also forced his family members, with the exception of his mother, to quit Supernova.

From 1996 to 1999, Supernova became increasingly popular, and even achieved a sacred place among young students. Thousands of students from all over China rushed to its classes in Beijing after hearing legendary stories of Supernova from fellow students. In 2000, it enrolled 150,000 students (Lu, 2002). It also outcompeted all major competitors in Beijing, occupying 80 percent of Beijing's TOEFL/GRE training market share and 50 percent of that of China as a whole (Pang, 2004). More surprisingly, Supernova achieved such success without any nationwide marketing, instead relying entirely on word of mouth. These factors contributed to its positive cash flow. As business expanded, the division of territories under the partnership gradually became unequal, as some territories expanded faster than others. Furthermore, the informality of the partnership raised a serious problem: without a formal contract and legal protection, Su could "put an end to the agreement anytime he wanted" (Informant No. 17).

*Supernova's Incorporation and Its Unintended Consequences.* In 2000, representatives from Supernova contacted a domestic consulting firm for solutions. The consulting firm prescribed incorporation as a formalization solution. Consultants further suggested that Supernova was worth five billion RMB on the stock market, and that going IPO would "make everyone a billionaire" (Li, 2009; Informant No. 35). Su and his partners were all pleased with these ideas. Of course, they knew that these consultants were "brainwashing," given the state's restrictive regulations and Supernova's underdeveloped corporate governance (ibid). However,

they still decided to follow the consultants' advice and register as a corporation. Su and his partners terminated their partnership and established Supernova Inc. (hereafter the Corporation). Since the state forbade ETOs to register as firms, Su and his partners had to keep the School, and tried to link it to the Corporation financially. The incorporation entailed the formal distribution of shares and the establishment of board rules. Su was the board director, president and major shareholder with 45 percent ownership. Ten minor shareholders held a total of 45 percent. Ten percent was left aside for future executives.

This incorporation process reveals three points. Firstly, incorporation was intended to mitigate the growing sense of insecurity among minor partners. The state's positioning of ETOs as educational entities paved the way for Supernova's informal partnership, and the informality in turn conditioned minor partners' sense of insecurity. Secondly, Supernova's founders and shareholders also had the idea of becoming rich and making Supernova a more successful and respected firm through an IPO. In other words, efficiency and new institutional rationales were considered during the decision-making process for IPO. However, these considerations were secondary, compared to the rationale to solve the insecurity problem. Supernova's founders and shareholders did not launch a systematic plan to go IPO at that time because they had anticipated that there would be formidable barriers and restrictions. Thirdly, institutional agents such as consultants played an integral role in providing the initial normative and cultural-cognitive frameworks for the IPO. Supernova's embedding in financial markets would have been impossible had multiple groups of institutional agents not been thriving in China since the late 1990s.

Surprisingly, incorporation intensified conflicts. To begin, there were immediate unfavorable changes in social status and financial payoffs to minor shareholders. Wei, Dai and

Kang considered it intolerable that their identities had changed from founding partners to Su's subordinates. They previously had had full autonomy and decision-making power on issues within their own territories. Now, they had to go through a lengthy, formalized process that often required Su's signature.

Table 5.1 The Distribution of Shares in Supernova and Its Multiple Criteria

Name	Shares	Former role at Supernova	Financial Contribution	Seniority (year of entering)	Relation to Su and Other Shareholders Prior to Joining
Su	45%	Founder, Partner	60-65%	Founder	
Wei	10%	Partner	30%	1995	Teacher of Su at Capital University
Dai	10%	Partner		1996	Classmate of Su at Capital University
Kang	4%	Partner		1997	Classmate of Su at Capital University
Chu	6%	Partner	<6%	1994	None
Guan	2%-4% (Su gave Guan additional 6% in 2001)	Partner	<8%	1995	None
Lian	1%-2%	Teacher	N/A	1993	None
Ren	2%	Manager	N/A	1997	Colleague of Su at Capital
Sang	2%	None	N/A	1997	Friend of Kang in Canada
Lei	0.5%	Teacher	N/A	1994	None
Chen	0.5%	Teacher	N/A	1997	None

Sources: Lu (2001), Supernova Archive No. 5; Informants No. 5, No. 17, No. 28.

In addition, minor shareholders' financial returns decreased after incorporation. When they terminated the partnership in 2000, former partners could no longer receive their 85 percent

share of revenues. Although they were still enjoying six-figure salaries as managers of the Corporation, their income was not as high as before. With only non-circulating shares, and without a clear timetable to go IPO, no one knew how much his or her shares might be worth.

Furthermore, the way the initial equity was distributed among the eleven earliest shareholders exacerbated the conflict. As Table 5.1 shows, the initial equity was distributed according to multiple criteria. First, the percentage was determined according to previous contributions, and particularly the financial contributions of former partners. In 2000, Supernova had total revenue of about 15 million USD. Approximately 60-65 percent of it came from Su's business (Informants No. 73, No. 28). The business of Wei, Dai and Kang combined accounted for approximately 30 percent. If the shares were to be distributed solely based on such criteria, Su would have been awarded the largest percentage—over 60 percent. The consulting firm also recommended 55 percent for Su to secure an advantageous position in the case of voting. Nevertheless, Su only took 45 percent. Wei, Dai and Kang took ten, ten and four percent respectively. Besides honoring former partners' financial contributions, Su also gave shares to the three teachers who had added the most value to the development of mass teaching.

The second major criterion was seniority. Chu, for example, led a partner division whose financial contribution was less than six percent, but he joined Supernova as the first partner in 1994. Therefore, he obtained six percent. Other criteria included the individual's relationship with Su or other shareholders, and his/her potential future contribution. Wei, Dai and Kang, for example, obtained greater percentages than their proportions of financial contribution under the partnership, partly due to their close relation with Su. Sang obtained two percent with little financial contribution, most because he was a friend of Kang and was a lawyer from Canada, and thus had potential future value for legal issues. This complex way of determining share

distribution added fuel to the fire. For example, the two teachers who had only obtained 0.5 percent bickered with Su because they thought even Sang, a newcomer with little contribution, had obtained a larger share than they had (Supernova Archive No. 5). A veteran manager from Supernova commented, “Now I do a lot of investing, and I know that distributing equity is often either based on past or future contribution. No one considers both at the same time. That is why it was total mess. Of course, Su was still a genius. He did not receive any business education and took care of the equity issue relatively well” (Informant No. 17).

Conflict erupted on the issue of dividend distribution. Su had decided not to distribute dividends. His rationale was that the revenue of the Corporation was supposed to come from tuition payments made to the School, but state restrictions on for-profit education meant that tuition payments could not be used to pay the dividends of a corporation (Supernova Archive No. 5, p. 124). With the initial hope of higher financial returns under the corporate structure, minor shareholders found that their gains would be less than they had anticipated. Some felt that terminating the partnership and transferring to a corporate structure had been a scam perpetrated by Su (Lu, 2002). Among the five shareholders I interviewed, two had thought that distributing dividends was feasible, even though the state had forbidden it. They said:

*It is not a problem to distribute dividends. Many others were doing so...A few years later, there was an occasion when Su was drunk and he said he just did not want to give us the money. (Informant No. 19)*

*He surely did not want to distribute the dividends. It used to be his family business. If I were Su, I would not have wanted to distribute the dividends either. (Informant No. 5)*

Their story emphasized Su’s unwillingness to distribute a dividend. However, a veteran financial manager noted otherwise:

*Only three or four years after the Corporation was established did we figure out that the Corporation could get money from the School by providing training, branding and consulting to the latter, and thus charging the latter for revenues.... It was called "affiliated transaction (guanlian jiaoyi, 关联交易)." But back then (in 2001), there were many legal and technical barriers...we had a few branch schools that were using various forms of accounting systems.... We did not even have professional financial managers who could provide financial statements.... It was a long process until we found out how to sign specific deals and get the affiliated transactions done. It could not have happened overnight. (Informant No. 41)*

In this version, the issue had not been Su's willingness, but the legal and technical barriers. The financial manager emphasized the formal policies, whereas the minor shareholders stressed how common it was for other firms to distribute dividends.

As conflict intensified, Supernova looked increasingly like a political coalition comprised of multiple infighting sub-coalitions (March, 1962; Cyert and March, 1963). Although shareholders sided with different parties on different issues and also fought against each other, they formed two general factions: Su on one side and minor shareholders under the leadership of Wei and Dai on the other. In the aftermath of incorporation, the conflict was so intense that between 2000 and 2004 shareholders often flipped tables, smashed objects and broke down in tears in the middle of meetings. Upon seeing the bitter arguments, several shareholders and top managers recalled that they had felt Supernova was on the verge of collapse. Similar conflicts were rampant among ETOs. However, other ETOs experienced conflict later than Supernova because they grew out of the family business model after 2000. Moreover, other major IPO candidates, such as Blue Ocean and Roaring English, had such intensified conflicts that their founders or co-founders were driven out of their firms and their IPO processes were delayed accordingly.

*Exhaustion of Alternative Solutions and the Lock-up.* One way internal conflicts can lead to IPO is as follows: conflicts and the exhaustion of alternative solutions lead to an organizational lock-up, and IPO emerges as the only solution. What happened after Supernova's incorporation is a case in point. In the face of the entrenched problems and conflicts after incorporation, Supernova's founders and shareholders first resorted to solutions borrowed from the institutional framework, but these solutions were unsatisfactory. First of all, they relied on solutions offered by consulting firms. They first consulted with their original consulting firm, and then also hired a U.S. consulting firm. These consulting firms prescribed solutions toward better corporate governance and formal structures, but these solutions all failed. Both consulting firms had to terminate their services before their contracts ended.

Second, the dominant market status of Supernova precluded divestiture and other forms of withdrawal for minor shareholders. For example, Supernova's prosperity discouraged minor shareholders from joining competitors. In the early 2000s, Supernova's high profits meant that even its ordinary teachers could earn as much as average Chinese private entrepreneurs, therefore it would be illogical to join less competitive firms and accept a pay cut (Lu, 2002; Informant No. 13). Supernova's unique pedagogy also made it difficult for minor shareholders to found other successful schools through imitation (Informant No. 28). Minor shareholders were also aware of Supernova's rapid growth, and held out for the possibility that their shares could skyrocket in value someday (Lu, 2002).

Third, minor shareholders along with Su proposed a series of financial solutions. The first financial solution involved distributing dividends informally in the name of expenses at the school level. A shareholder noted:

*People started to propose that we could perhaps have some sort of “dividend” at the school level. But to make distributions in the name of a dividend presented a legal problem, plus a high tax rate. It was something like 40 percent, if I remember correctly. People wanted the money, but they did not want to pay the tax. If the sum was not large, we could find receipts from other expenses to deduct the tax. But the sum was large! Where could we find so many receipts? So they asked Su to figure it out. Su made the financial manager ask officials at the Tax Bureau. Some officials said we could pay another type of tax that had a lower rate and obtain enough receipts. But that financial manager did not bring the money to the Tax Bureau. Instead, he went to street vendors to buy receipts at a low cost and embezzled the money that should have gone to the Bureau. Su found out and said we should stop this. So he called it off. (Informant No. 73)*

This incident shows that dividends could have been distributed in a legal grey area, at least at the School’s level. In fact, Su and other ETOs had frequently distributed tuition payments before the incorporation. However, Su was now concerned because it was more risky to ignore formal policies once famous and incorporated. The corruption of the financial manager validated Su’s concerns, and he decided to halt dividend distribution. This first financial solution had failed.

Since another focal point of conflicts was doubt over the value of the shares, in May 2001 Su turned to the internal pricing of shares as a second financial solution. As he recalled:

*I thought it might help if I connected the shares to a cash price. I said to them, “Perhaps you guys can sell your shares to me. I will buy them from you at the price of one million RMB for one percent.” Our meeting was at nine in the morning, and my deadline was five that afternoon. I agreed to pay them cash if they wanted to sell their shares.... At the same time, I made it clear to them that I would only wait until five. So they went back to consider the offer. On that day, some of them thought it would be better to stay and work together. They were happy then because they felt that their shares were worth good money. We also went to a temple to have tea together. At four thirty, I asked if they would like to sell their shares to me. They said, “No, we won’t sell shares to you.... And we now know you did not have leadership through all these matters, so let one of us lead.” Although I was still the major shareholder and able to stay on the Board, I was no longer allowed to attend the top executives’ meeting. (Supernova Archive No. 5, p. 128)*

Su's proposal and the high pricing astonished minor shareholders. The pricing made them reluctant to sell their shares because Su's confidence had made them aspire to a greater future return from the shares (Lu, 2002). This financial solution had also failed. The failure of these solutions created turmoil at the shareholder and top leadership levels. For example, the position of president rotated between several minor shareholders from 2002 to 2004. Despite the conflict and turmoil, Supernova did not collapse. One of the reasons, as I have mentioned, was that minor shareholders were aware of the potential for greater future financial returns, and therefore refused to leave. In addition, the conflicts between shareholders tacitly unfolded "with the door closed" (Supernova Archive No. 5, p. 129). The educational services were not hampered, and most teachers did not even know shareholders were in fighting. The technical core of educational services had thus been buffered from the conflict (Thompson, 1967). In comparison, the internal conflicts in Blue Ocean, when growing out of control, made the original founder quit and delayed its IPO plan. In the discussion section, I will elaborate on the conditions under which internal conflicts are likely to lead to IPOs instead of collapse.

Although Supernova did not collapse, solutions to internal conflicts had been exhausted. Minor shareholders no longer trusted Su, but they could not replace him either. Neither could they abandon their shares and leave Supernova. As for Su, he also felt that he could not implement his strategic decisions, since minor shareholders were opposing him. In addition, Su did not want to be blamed for forcing friends out of the game, unless they left with decent financial compensation. At the shareholder level, the organization was stuck in a lock-up situation.

*The Infrastructural Readiness of Supernova and Other ETOs.* Another way internal conflicts can impact IPOs is through elevating infrastructural readiness: the absence of trust in

the wake of conflicts pushes stakeholders to turn to formal and professional financial structures for securing financial gains. In the early 2000s, neither Supernova nor its competitors possessed the infrastructural readiness for financial markets. Supernova did not have a professional financial manager, not to mention functioning corporate governance. In fact, the entire ETI was unprepared in multiple respects. First, the state forbade ETOs from registering as corporations, and accordingly, professional financial managers whose expertise had been partly corporate governance seemed unnecessary to ETOs (Informant No. 19). Second, replacing previous financial managers who had been exclusively family members was a formidable task for all ETOs. Third, the loyalty and frugality of family members were their treasures. Since the state had forbidden the distribution of ETOs' profits, ETOs had relied on family members to conduct shady accounting and bookkeeping practices so that they could reap financial gain.

All cases I studied followed this pattern. In all four Underdog TOEFL/GRE ETOs, their financial managers had been founders' family members. These financial managers lacked professional training in finance and business. Three leading ETOs in other niche markets (Blue Ocean, Roaring English and United IELTS) that were founded before the early 2000s were in the same situation. At that time, even United IELTS, founded in 1999, still had its founder's wife as its financial manager.

Indeed, Supernova did not have a professional manager in the early 2000s. However, the intensified internal conflicts unintentionally professionalized Supernova's financial system in a short time. During the partnership period, the financial manager had been a family member of Su with no professional training. Other partners had not cared who had been the School's financial manager because the financial payoff for each partner had been only associated with his own business. However, as the incorporation had amalgamated everyone's business, and as conflict

had escalated, minor shareholders no longer trusted this financial manager. They felt that this manager had helped Su hide extra revenue of which they had been unaware. In 2000, they pushed to replace this financial manager and demanded a professional one. A veteran manager from that era described how distrust and conflict drove the succession of the first two managers:

*The oldest financial manager only knew how to keep a record of the expenses. People called him “Lao San (the Old Third).” He was Su’s relative and whatever he said about how much we made, that was it. When you are just starting a business, it’s most reliable to go with your family members, right? You cannot trust other people. This is very common for those who start with their bare hands. But because you’re not operating professionally, other shareholders get suspicious: are the numbers you give us reliable? You say that I should be given this amount of money, is that all that I should be given? Are there any other revenues that you did not reveal to us? .... The old manager did not even have a channel to present financial data, or he simply did not even have accurate numbers or financial statements. So minor shareholders felt unsafe and they demanded a new financial manager. (Informant No. 41)*

This newly hired manager was the one who embezzled the money in the second financial solution previously mentioned. He lost the trust of the top leadership and finally had to leave. Afterwards, there was an accelerated succession of professional managers and the professionalization process went deeper. The third and fourth managers were professionally trained and the fourth even had experience in a major technology firm. As professionalization penetrated deeper, the financial records were formalized and made transparent to all shareholders.

### **Supernova’s Road to the Financial Market: From VC Investment to IPO**

As the financial system somehow became professionalized, the prospect of IPO seemed a possibility. However, since the Chinese state did not allow ETOs to IPO on domestic financial markets, Su and other shareholders had to consider going public on overseas financial markets. Therefore, the most important reason for looking overseas was to circumvent state regulation.

Choosing an overseas stock market was also potentially related to the economic characteristics of the industry (Blass and Yafeh, 2001), but these are secondary considerations in the ETI case. In 2004, Su and other shareholders learned that several state-owned enterprises had gone public on the New York Stock Exchange. However, there was no precedent for Chinese private corporations. Without a precedent, they also worried about overseas investors' lack of trust and familiarity with the ETI.

In late 2004, Supernova contacted the U.S. based VC firm Taurus Global. The idea was to use Taurus to ease the doubt of overseas investors, and to continue with the unfamiliar IPO procedures. Even then, Supernova's founders and shareholders were unsure whether their financial reports could pass Taurus' inspection. However, accountants and analysts from Taurus found that Supernova's financial reports from the previous three years, as a result of the conflicts and succession of managers, were surprisingly complete and organized (Supernova Archive No. 5). In December 2004, two weeks after the inspection, Taurus invested thirty million U.S. dollars in a ten percent stake in Supernova. This was no less surprising to Supernova's founders and shareholders (Li, 2009, p. 338): their informal business appeared to indeed be valuable and an IPO was within reach. Moreover, Taurus brought in a board member and two senior financial managers.

The investment from an overseas VC played an important role in Supernova being accepted by global financial markets. The entrance of the VC not only eased the cultural and legitimacy barriers, but also changed the equilibrium of internal power relations. With a U.S. VC firm as an endorsement to overseas investors, minor shareholders felt the prospect of an IPO was their best, and only, chance to escape. They built an alliance with Taurus to push hard for an IPO. In contrast, Su became increasingly uneasy about the idea of an IPO (Supernova Archive No. 5,

p. 139). He felt that an IPO would mean his loss of autonomy and control. With his control of the firm and his shares, he could have fared equally well financially as the owner of a private firm. However, the momentum to go IPO had become unstoppable. It finally became clear to Su that IPO was the only way out of the lock-up, and that “anyone blocking the way to IPO would be doomed” (ibid). He decided to proceed with the IPO. On September 7, Supernova went public on the New York Stock Exchange. After the IPO, all shareholders except for Su relinquished their board and executive positions. Supernova’s internal conflicts had been resolved. The giant corporate machine was now lubricated, and ready to move on.

### **The Impact of Supernova’s IPO on Its Competitors and the ETI**

Before Supernova’s IPO, few ETOs knew how to go public. With positive cash flows, most ETOs did not even know why they should go public. Several major brands started to incorporate, but even these leading brands did not have corporate governance or professional financial systems, not to mention the other ETOs.

Supernova’s IPO was a watershed event for the ETI. It first showed other ETOs that the legal and institutional barriers were surmountable, and revealed every necessary step. It also demonstrated the lucrative material benefits and reputational gains associated with the IPO. In the meantime, it seemed that there had been limited state sanctions on ETOs’ going public on overseas stock markets. Furthermore, it showed Wall Street and the investment world that the ETI was a goldmine. Domestic and foreign VCs and PEs rushed in. Thus, an individual organization’s IPO changed the institutional environment of the entire organizational field.

As a result, there came a cascade of PE/VC investment and IPOs. This cascade began with Supernova’s competitors. Among the ten ETOs that had IPOs between 2006 and 2010, six

were major competitors of Supernova. There is ample evidence showing that these competitors launched IPOs in order to imitate Supernova. One example was United IELTS, Supernova's primary competitor in the IELTS niche market. Wang Liguo, founder and CEO of United IELTS, said that "Supernova's IPO means a great leap in advancement for United IELTS in terms of reputation and capital, which might cause the loss of good teachers" (Li et al., 2014, pp. 66–67). Wang decided to turn to the financial market, so that their "accounts could have some money, and could store some spare food to go through the winter" (ibid). Consequently, United IELTS launched its plan for PE/VC investment and IPO, even though it did not even have a professional financial manager at the time. United IELTS went public on the Nasdaq in 2010.

Another example was Doo & Cool, Supernova's primary competitor in the K-12 niche market. As a senior manager of Doo & Cool said, "Supernova's IPO changed everything. We heard that another competitor had started considering IPO. Our boss got nervous. You know, in K-12, we started earlier than Supernova and the other brands, but their IPO might put them on the fast track. Their IPO would turn the situation around completely. So our boss made us ask around, and (he) wanted to find the same VC firm that Supernova used. He said that it had to be this firm because they would know how to get us on the stock market" (Informant No. 67). Doo & Cool went public on the New York Stock Exchange in 2010.

The first IPO of the ETI on China's domestic stock market was also a response to Supernova's IPO. In 2010, Supernova's competitor in Shanghai, Spotlight, went public on the Shanghai Stock Exchange. When commenting on their rationale for going public, its founder said, "Seeing Supernova's IPO made us anxious. We started to think about going public too" (Li et al., 2014, p. 129).

The ETI's embedding in this second stage was an institutionalization process. Institutional theories predict that when there is uncertainty in the effectiveness of a practice, actors in the field imitate the leading actor, regarding it as evidence of effectiveness (Scott, 2014). In the ETI case, Supernova's competitors imitated Supernova not because they thought IPO would be more effective, but because they felt the threat and uncertainty associated with Supernova's IPO. To defend themselves against these real or imagined threats, and to mitigate the uncertainty, they decided to imitate Supernova and go public. Consequently, IPOs and PE/VC investments rippled across the industry.

Nevertheless, institutionalization cannot fully explain the rapidity of embedding in this case. This rapidity is contingent upon the ETI's market competition structure—that of Supernova as the only generalist market leader competing with a dozen specialists in their respective niches. Given this structure, the single case of Supernova's IPO triggered simultaneous responses from a dozen other ETOs. These ETOs, in turn, translated IPOs and PE/VC investment into fads in every niche market in a short period of time.

## **COMPARISON OF MARKET LEADERS' SUCCESS AND FAILURE**

Thus far, I have used a successful case to show the connection between internal conflicts and embedding in financial markets. In this section, I conduct a comparison of the six market leaders—Supernova, Roaring English, Blue Ocean, United IELTS, Duvell and Doo & Cool—in order to test this connection more systematically. Each of the six ETOs was a top one or two leading brand in their niche, and therefore they are comparable as equal candidates for

financialization.<sup>2</sup> Each either launched plans for IPO or made explicit attempts to attract PE/VC investment. In Table 5.2, I code ETOs that had IPOs by the end of 2010 as financialized and those that did not as non-financialized. I further code those ETOs whose entrepreneurial networks were based on kinship networks as “kinship”, and those with a partnership by fellow students or colleagues as “partnership.” I show the comparison below.

Table 5.2 A Comparison of Entrepreneurial Networks and Financialization among Five ETOs

	Year Founded	Entrepreneurial Network	Financialized or Non-Financialized
Supernova	1993	Kinship + Partnership	Financialized
Roaring English	1995	Kinship	Non-Financialized
Blue Ocean	1993	Kinship	Non-Financialized
United IELTS	1999	Kinship	Financialized
Duvell	2001	Partnership	Financialized
Doo & Cool	2003	Partnership	Financialized

Sources: Author’s compilation based on various sources.

This table shows a clear imprinting effect: with the exception of Supernova, ETOs that were founded after the mid 1990s succeeded in financialization, while early comers failed. To be sure, this pattern is not surprising. Latecomers, such as Duvell and Doo & Cool, were founded in an era when corporate governance and financial experts were much more readily available than

<sup>2</sup> Like many concepts in the social sciences, the definition of financialization is messy. While some scholars refer to financialization as the rise of the rentier class (e.g., Epstein and Jaradev, 2005), others discuss it as the increase of finance in everyday life (van der Zwan, 2014). The general consensus is that financialization concerns the shift of capital sources from banks to financial markets, and profit sources from productive activities to financial activities (Krippner, 2011; Davis and Kim, 2015). According to this definition, IPOs and PE/VC investments are activities only tangential toward financialization. However, these definitions are based on empirical studies of U.S. markets where the economy is already embedded in financial markets. When studying Chinese enterprises, we need to broaden the scope and include the embedding of private and state-owned enterprises as part of the financialization.

they were in the early 1990s. Moreover, establishing a corporate structure on top of a school entity was already a practice with which insiders were familiar, although formal state regulations still restricted such practices. In the early 2000s, state policies also started to show more support for the ETI to move toward becoming a for-profit industry. In 2002, China passed the Non-State Education Promotion Act. For the first time, this act suggested that ETO founders could receive “reasonable financial rewards” (Tao and Wang, 2010). Although the state did not clarify what “reasonable” meant and restated the nature of the “public goods” of all non-state education, the new law was interpreted as being more favorable to the ETI’s connection with business and financial institutions (Li et al., 2014). Latecomers, therefore, enjoyed a more favorable institutional environment than had previously been the case.

It was difficult for early comers to embed themselves in the financial markets. Both Roaring English and Blue Ocean had been operated as family businesses. Their financial managers had been family members who had not received any professional training. For example, Roaring English was Supernova’s strongest competitor in the Spoken English niche in the early 2000s. Its founder had sought VC/PE investment, and had once closed a deal with a Chinese firm. Nevertheless, the partnership soon came to an end, and each party accused the other of not fulfilling its obligations. Part of the reason, as a senior manager at Roaring English put it, was because “the founder quickly squandered the money and no one could monitor him. The company did not have a shareholding structure and the founder had full control. There was no corporate governance or financial system. The financial managers were the founder’s ex-girlfriend’s parents who had been expecting the founder to marry their daughter one day” (Informant No. 49). With regard to Blue Ocean, this had been the heritage of the previous decade when entrepreneurship in the ETI had been primarily a part-time job. In the late 2000s, the

founder was still a full-time administrative employee at a state university and only worked on the ETI business part-time.

The unique case of United IELTS further substantiates the imprinting effect. Founded in the late 1990s, it was neither a young nor an old ETO in the late 2000s compared to the early comers and newly established brands. As we would expect from the imprinting effect, its financialization was more successful than the early comers, but was less so than the latecomers. It received VC/PE investment and went IPO on the Nasdaq in 2010. However, it had to withdraw from the stock market in 2012 due to the poor performance of its stock (Li et al., 2014). The founder and observers of the ETI attributed the firm's incompatibility with the financial market to family control and a lack of financial professionalism: the founder had taken charge of all operations and his wife had been in charge of finance. As the founder later recalled, "United IELTS was basically shouldered by me and my wife. We did not have any partners, not to mention a board. Soon our capacity had reached the limit." He also said, "I did not have much experience in distributing stocks and futures. Since the futures were distributed too late (and therefore with a high price), people did not make much money after going public" (Li et al., 2014, p. 79). This demonstrates that, United IELTS had a corporate structure and financial professionalism that was in between the early and latecomers. Such a structure led to its success and rapid fall in the global financial markets.

While it appears as if success in financialization is a function of the founding date, it is also important to note that Supernova and all the latecomers that succeeded in IPOs started with partnership structures. Doo & Cool, for example, was based on the partnership of two graduate students from Capital University. Therefore, the imprinting effect of time might be the difference between a partnership and a kinship structure. To the extent that Supernova's partnership was the

precondition for its internal conflict and IPO, it is worth investigating why Supernova was able to build and sustain its partnership in the 1990s while other ETOs were still based on family control.

Let me rewind the story back to Supernova and its early partnership. I will show that although double ambiguity determined the informality of the partnership, the nuanced balanced powers among partners unintentionally created a resilient partnership structure.

First, partners had different authority bases. Su's power came from his status as founder, the largest financial contribution of his territory, and his control over teachers, family members and a few managers. Wei and Dai, on the other hand, based their power not only on their financial contributions as partners, but also on their overseas experience. Although the stigma associated with the private economy had started to dissipate by the mid-1990s, it was still rare to see people with such overseas backgrounds to join the ETI. According to an informant, the mid 1990s was still an era dominated by "hillbilly turtles (*tubie*, 土鳖)." Wei, Dai and Kang were the first group of "returning (over) sea turtles (*haigui*, 海龟)" in the ETI.

Second, the fact that different founders had different power bases is rooted in their relative social status dating back to their college years. To outsiders, Supernova was an ETO where the "hillbilly turtle" was leading a group of "returning sea turtles." However, Wei and Dai enjoyed greater power and superior social status over Su within their own networks. Their superiority in relative social status over Su extended back to their college years. During those years, Wei and Kang were in the same department and cohort as Su. A popular student leader, Wei was also the student president of Capital University's art troupe where Dai was the supervising faculty member. Su, on the other hand, earned little respect from his fellow students on the account of his rural accent, two failed College Exam experiences and unimpressive GPA.

Not surprisingly, Wei and Dai had more influence over Su, and thus higher status within their network ever since college. This is why, when Wei and Dai returned from North America, neither they nor Su felt that they had come to work for Su as subordinates. Their relative social status since college time persisted into the entrepreneurial stage.

Su's weak position in the partner network brought resilience to Supernova through a nuanced balance of power and a unique financial arrangement. In the previous chapter, I discussed Su's advantageous position in being situated within both the network of the state education system and the second economy. In addition, Su had previously been a marginal figure at an elite state university—a little fish in a big pond. This unique positioning meant that there was a unique starting point for their partnership. Wei, Dai and Kang had come back not because they had thought Su was a capable leader. Neither did they come back because they thought Su was more capable than them. On the contrary, their agreement to follow Su was based on the assumption that they were more capable than him: "If even a 'little fish' like Su could become somebody in China through the ETI business, we could definitely fare better" (Supernova Archive No. 5). Su's weak position, in combination with the auspicious prospects of the ETI business, became the starting point for attracting "big fish" from the elite state education system into the ETI.

Su's weak position helped him balance the power between partners and his family members. Wei and Dai were the key proponents of Supernova's shift away from family control. Su also had the intention to move away from family control, but it was Wei and Dai who had given him the strongest push. Su's wife and brothers-in-law left, but Su kept his mother to balance to his partners. His mother continued running the logistics department, even though Wei and Dai had openly opposed her. Dai once threatened to quit, telling Su that, "I do not want to

sacrifice for the sake of his family members. Su is not able to go beyond his mother. This is an important reason why I have to leave” (Lu, 2002, p. 370). In addition to their balanced power, Su’s inferior position within their network led to a financial arrangement that initially favored Wei and Dai. This seems to be the only way that an entrepreneur in a weaker position could maintain higher status partners.

Third, the resilience of Supernova’s partnership was also based on the shared experiences of key partners (Su, Wei, Dai and Kang) and their multiple communication channels. As I mentioned before, one of the reasons why the conflict did not lead to collapse was that teachers were all kept out of the conflict. No partners escalated the problem by mobilizing teachers. Key partners frequently relied on other senior leaders and common friends as channels of communication. Such shared experiences and communication channels added resilience to their network. They broke up but could soon unite again. When they broke up with other partners, however, the damage was often not salvageable. The ousting of Guan was a most illustrative case. Guan was widely believed to have been Su’s strongest ally and to have been used by Su to balance Wei and Dai during the intense conflict in the early 2000s. However, when Guan encountered problems in delivering financial performance as CEO in the mid-2000s, Wei and Dai easily obtained Su’s approval to remove him and force him to leave Supernova. Guan was not even entitled to the financial gains of the IPO.

In sum, Supernova’s capacity to establish and sustain a partnership in the mid-1990s was based on its unique social network among founders. It was difficult for other ETOs of the 1990s to establish and sustain such partnerships. One of the greatest obstacles was the animosity between family members and partners. An informant mentioned that part of the reason why Roaring English had five general managers in the span of a few years was because these

managers could not get along with the founder's sister or his girlfriend's parents (Informant No. 55). In such cases, the founder often sided with family members, causing the high attrition rate among partners and executives.

Another difficulty was building trust with new partners. The ubiquitous nonconformity in the 1980s and 1990s meant that only family members were reliable. The old nonconforming practices became less visible in the late 1990s and 2000s. However, the entrance of investors led to new nonconforming practices. A common practice was collusion between executives and investors in taking over an organization from its founder. An informant described how Blue Ocean's senior executive had worked secretly with an investor to take over the ETO:

*In 2007, Blue Ocean's founder Wen went to the U.S. to continue his education. He signed a one-year opt-out agreement with his CEO Ding who had a Ph.D. in Management. Basically, this agreement said how much money Ding was to give Wen. Wen gave Ding all the teachers, staff and everything.... But one year later, Ding somehow changed the clauses into a company transfer contract. Wen was restricted from using the name Blue Ocean and was even forbidden from entering into the Graduate Exam business. What happened was that an investor wanted to invest some money in Blue Ocean. Wen asked Ding to talk with the investor. Wen knew that Ding was very good at telling stories. So Ding came up with an idea. He registered another company to hold shares of Blue Ocean. Then he hooked up with the investor to pump money into his own company. You know, some people from that investment company knew about this and they said, "Hey, we were investing in Blue Ocean, not this unknown company." So Ding used the opportunity of Wen's studying-abroad to change the clause and gain control of Blue Ocean. What I heard was that Wen filed a lawsuit against Ding and Ding paid him some 1.5 million USD.... I can tell you what Wen told me. He said, "I've always wanted to get rid of my family control. But there is no professional manager in China. Ding totally gave me a lesson." (Informant No. 8)*

In sum, an observable determinant of the success of financialization was the existence of a resilient partnership. Whereas ETOs with resilient partnerships successfully landed on overseas stock markets, those that did not invariably failed. Despite the importance of partnerships,

building a sustainable partnership was a formidable task for ETOs founded in the 1980s and 1990s, not to mention controlling internal conflict and using it to turn to financial markets.

Despite the clear results of the comparison, this relationship is more heuristic than definitive for three reasons. First, I only compare those ETOs that actually launched financialization. Ideally, I would have industry-level data covering ETOs that did and did not launch financialization. This would have enabled me to observe the effect of partnerships on whether or not an ETO had launched financialization. This would have been the most accurate test of partnerships as a driving force. However, due to data limitations in this emerging and less institutionalized field, I only compare the six ETOs that launched financialization, but ended up as cases of either success or failure. In other words, I am testing the effect of partnerships on the success rate of financialization as a proxy of the driving force. In doing so, I have to accept the imperfect assumption that those ETOs that succeeded in financialization had the most powerful driving force.

Second, the comparison is about six ETOs that grew from different segments and launched financialization in different time periods. Unlike controlled and randomized experiments, cases selected from the real world have multiple variables that cannot be perfectly controlled. The proposition that comes out of the comparison, therefore, is subject to spurious causations. For a comparison of real world cases, there is no way to eliminate such spurious causation. Third, this comparison is based on a small sample. Future research that could utilize larger datasets with more comprehensive data on entrepreneurial networks and financialization is necessary to reach a more definitive conclusion.

## **INSTITUTIONALIZATION IN A DOUBLY AMBIGUOUS INDUSTRY**

Turning to the financial markets is, at least partly, an institutionalization process. As the quote at the beginning of the chapter shows, the taken-for-granted approach for starting an ETO has now shifted to contacting a VC/PE. Managers are accustomed to obtaining equity and aiming at IPO, rather than receiving salary for making a living. This trend deepened after 2010 when the so-called online education technology diffused to China from Silicon Valley.

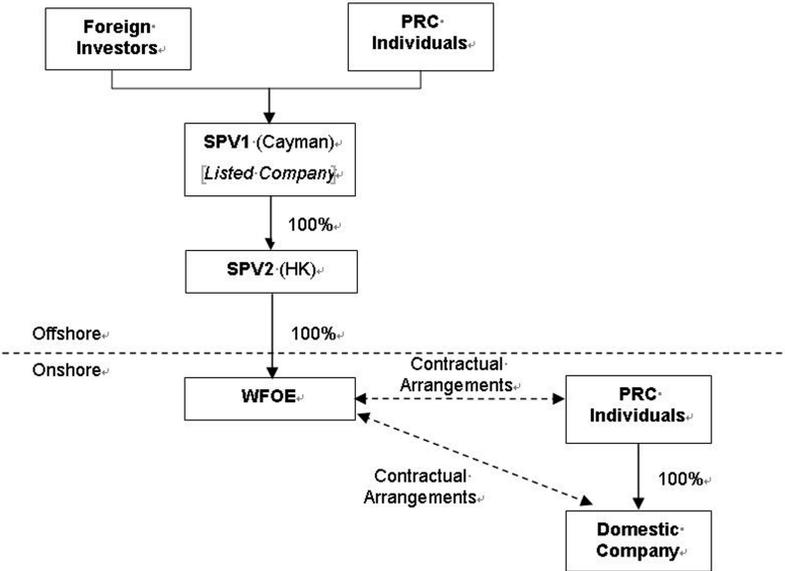
This institutionalization process formalized the structure and procedures of ETOs. Newly founded ETOs now start with corporate governance and professional managers. This institutionalization process also exerted impact on existing ETOs. As Su put it, “Now every transaction needs to be audited and I cannot just do whatever I want” (Supernova Archive No. 5, p. 159). In comparison, ETOs such as Roaring English that refused to comply with the formalized rules lost their competitiveness. By 2010, the ETI had disembedded from the black market and become embedded in global financial markets as well as other more formal social institutions.

However, this rapid institutionalization of a formerly doubly ambiguous social space also brought about new areas of uncertainty and unpredictability. In addition to being subject to the volatility and opportunism of the stock market (Abolafia, 1996; Zuckerman, 1999), publicly listed Chinese ETOs also face the potential risk of a state crackdown on the Variable Interest Entity (VIE) structure—a set of financial transactions and arrangements that link the domestic schools to offshore companies and stock markets. All ETOs that went public did so with the help of the VIE structure.

As Figure 5.2 shows, the actual corporate body that went public was an offshore company and this offshore company was linked to ETOs in China through complex transactions.

In 2012, however, the Chinese state issued a policy that declared the VIE structure illegal. With that said, the state has not yet taken any serious measure to crack down on VIE corporations, partly because a large number of state-owned enterprises and influential technology companies, such as Alibaba, also rely on the VIE structure. Although the Chinese state has not taken systematic measures to crack down on the VIE structure, it has nullified two deals that were associated with VIE—one in 2011 and one in 2012. ETOs publicly listed on overseas stock markets, therefore, have to bear the additional uncertainty of state intervention. Although their economic transactions have become more predictable, their political fate is now even more open to unpredictability.

Figure 5.2 Variable Interest Entity (VIE) Structure



Note: WFOE stands for Wholly Foreign Owned Enterprises, and SPV means Special Purpose Vehicle.

Source: Zeng, Xianwu and Lihui Bai. Variable Interest Entity Structure in China. *Foreign Investment*. King & Wood’s Foreign Direct Investment Group (<http://www.chinalawinsight.com/2012/02/articles/corporate/foreign-investment/variable-interest-entity-structure-in-china/>).

Furthermore, this institutionalization process has created new areas for nonconforming practices. In the previous section, I already show how Blue Ocean executives and investors used nonconforming practices to drive away founders and take over the ETO. In fact, being embedded in the financial markets substantially enlarged the range of nonconforming practices. New nonconforming practices revolved around obtaining huge sums of capital. Being sanctioned by the state or informal cooperation norms seemed to many like a price worth paying in order to secure wealth.

The rapid rise and fall of Arrows were a typical example. Founded in the early 2000s, Arrows acquired a large number of local ETOs and schools in a short period of time and went public on a U.S. stock market. It accomplished this with two kinds of nonconforming practices. First, the management team used more promises than capital to acquire ETOs. Multiple sources confirmed that Arrows' leadership would promise to use half cash and half equity when acquiring a school (Peng, 2013; Informant No. 31). However, Arrows requested that ETOs send the cash back to Headquarters in exchange for the brand service it provided. In other words, the equity, whose value was clear until the IPO, became the only capital they used for purchasing other organizations. They also promised the original founders of ETOs that their stock price would soon surpass Supernova's, once the IPO was successful (ibid). The other nonconforming practice was using all means to increase tuition, so that short-term financial performance would be more impressive.

Despite Arrows' successful IPO in 2010, its stock price soon plummeted. The promise to the original founders of local ETOs that they would become billionaires fell flat. These founders started to file complaints and lawsuits against the leadership of Arrows. In 2012, an employee

even reported Arrow's financial fraud to the U.S. Securities and Exchange Commission, and Arrows was ultimately removed from the stock market. The example of Arrows is dramatic, but the nonconforming practices it adopted were common among ETOs that sought a fast track to financial markets.

This chapter investigates how and why China's ETI became embedded in global financial markets from the early 2000s to the early 2010s. I have documented a two-stage process of the ETI's embedding. I found that structurally conditioned internal conflicts played an integral role in the first IPO in the ETI. Despite the catalytic role of internal conflicts, enterprises with internal conflicts do not necessarily succeed in IPOs. Severe internal conflicts most often result in organizational collapse instead of IPOs. In addition, enterprises without internal conflict can have IPOs. With this said, I have identified four conditions under which internal conflicts can lead to IPOs: a) When conflicts are severe enough that stakeholders seek to address them with multiple solutions, including IPOs; b) when conflicts are not fatal, or at least when the technical core is buffered from conflicts; c) when there are constraints, such as close networks and prospects about the future, so stakeholders do not easily relinquish their ties to the organization; and d) when non-financial and non-IPO solutions do not seem to alleviate internal conflicts. When these conditions are met, the connections between internal conflicts and IPOs are more likely to occur and to be observed. In the second half of this chapter, I also tested the relationship between internal conflicts and financialization by comparing six ETOs. I further showed the importance of partnerships in financialization and why it was rare for ETOs to build resilient partnerships.

## Chapter Six

### **From Chalkboard Hands to Visible Hands: Formalization, Bureaucratization and the Rise of the Managerial Class**

*I have not done anything over the last ten years but build 40 branch schools. Each branch school has at least ten learning centers. So right now Supernova has at least 400 learning centers all over China.*

—Su Leidong (Founder), *Supernova Archive No. 5, p. 158*

*There was no control problem (for branch schools at Doo & Cool). The human resources and finances of the branch schools were all under the control of the headquarters. The headquarters hired financial managers for the branch schools. Branch school presidents had little evaluation power over these financial managers. Otherwise, wouldn't they have become independent kingdoms?*

—Informant No. 67

To the extent that Chandler (1977) considers full-time and salaried managers as the “visible hands,” ETOs before 2000 were all handicapped. Most ETOs relied on founders and their family members for daily administration and coordination. A few other organizations, such as Supernova, had barely walked out of family control but were still trapped in informal partnership. There were few layers between top leaders and ordinary teachers, not to mention other formal structures or procedures. Moreover, the mass teaching model as the dominant model in the ETI reduced the necessity of managers because a small number of teachers could deliver classes directly to a large number of students. This model required little internal coordination or non-teaching services such as counseling.

A managerial revolution took place in the ETI between 2000 and 2010. A new class of full-time, salaried and non-kinship-based educational managers had taken shape by 2010. They had not only occupied increasingly more mid-level and high-level positions, but their powers in shaping strategic ETO decisions as well as the landscape of the ETI had also expanded. For example, at new market leaders such as Doo & Cool and Duvell, educational managers had become the indispensable and stable links between founders and teachers. Even at Supernova that was founded in the 1990s, the number of senior and mid-level managers had ballooned. Managerial layers also grew increasingly complex. New ranks and titles mushroomed. Associated with these changes were the bureaucratization and formalization of ETOs. These broad processes deepened the institutionalization of the ETI.

This chapter investigates the managerial revolution in the ETI. Specifically, I ask four interrelated questions. First, why did a managerial class suddenly emerge in a field that needed little coordination? Second, who became managers and how did they manage, given the absence of educational managers or accumulated managerial repertoires in the ETI? Third, why were some ETOs able to build large, powerful managerial teams, while others were not? Fourth, what can these processes tell us about bureaucratization, formalization and institutionalization in general, and about institutionalization in doubly ambiguous field in particular?

After laying out the social context and ruling out alternative explanations, I will show that the rise of the managerial class in the ETI was largely governed by a selection mechanism: new niches such as K–12 required additional coordination; after new organizational repertoires and models diffused into the ETI, new ETOs with organizational elements associated with managerial capitalism emerged. Most ETOs that had survived the 1990s, however, had a difficult time building managerial teams. Imprinted with features of the double ambiguity, these ETOs

were filled with informal and nonconforming practices, staffed with powerful family members or inflicted by the uncontrollable conflicts between family members and managers. Supernova was an exception that developed a large and powerful team of educational managers. Its partnership and weakened family influence diminished the difficulty of adapting to managerial capitalism. Furthermore, Supernova unintentionally developed a decentralized model for cross-region expansion, which amounted to bottom-up pressure toward managerial capitalism. Although Supernova's turn to managerial capitalism was also an institutionalization process, there was a simultaneous growth of branch school presidents' nonconforming practices and Su's control over these far away branches. The increased personal influence went hand in hand with the bureaucratization and formalization processes.

## **CONTEXT, DYNAMICS AND ALTERNATIVE EXPLANATIONS**

In the previous chapter, I mentioned the favorable conditions for capitalistic development during the 2000s. Another favorable condition was China's embracing of the WTO. Following China's entrance, leading foreign ETO brands rushed to the goldmine of China's ETI market. Once there, they introduced the Western model of operating ETOs—small classes, interactive, service-intensive—into China.

This was also the time when there was a spike in the demand for K–12 training. As mentioned in Chapter One, the state's change of policy triggered the rising demand for K–12 ETOs. Facing younger students who needed to attend nearby supplementary programs, K–12 training was inherently different from the other niche markets. First, it required more services, such as counseling, homework follow-up and communication with parents, than it did educational services for college students and adults. Second, it was an inherently fragmented and

local niche. Whereas the TOEFL/GRE and Graduate Exam niche markets were spatially concentrated in major metropolitan centers, the K–12 niche was larger, but more fragmented. This was not only because K–12 schools were more dispersed, but also because K–12 students were less mobile. Attracting K–12 students from other cities into the headquarters' large classes was more difficult. K–12 ETOs had to open a vast number of branches in local neighborhoods.

As mentioned before, the competition structure of the ETI now took the form of one generalist—Supernova—competing with leading specialists in each niche market. In addition, the burgeoning K–12 niche was associated with the enhanced status of the leading specialist in K–12, relative to other leading specialists. Doo & Cool and Duvell became the nationally dominant ETOs, although they still trailed Supernova.

Supernova, Doo & Cool and Duvell were also successful in building managerial teams, although the pathways to managerial capitalism were not the same among the three. In comparison, Roaring English, Blue Ocean and United IELTS each showed signs of adversity in building their managerial teams. Whereas Supernova adopted a decentralized model, Doo & Cool and Duvell used more centralized approaches. However, none of the existing accounts can explain the pattern identified above. With this in mind, we can identify three approaches for studying the rise of managers and their effects on the bureaucratization and formalization of organizations.

The efficiency accounts, represented by Chandler (1977), attribute the rise of the managerial class to greater demand, more advanced technology and an enhanced volume of economic activities. This enhanced volume, also known as increased throughput, led to a managerial hierarchy and lower administrative coordination costs. Small traditional enterprise was replaced by modern multi-unit business enterprise, and the invisible hands of market

mechanisms were replaced by internalized visible hands of managers. The consequences, then, are the hierarchy itself becoming a source of power and endurance, and more importantly, the separation of enterprise management from its ownership.

If the efficiency accounts were correct, we would predict a business model that produces greater throughput would lead to more layers of hierarchy. Nevertheless, the ETI case shows that mass teaching was associated with a high level of throughput, but produced few managers. Even among newly founded ETOs that used small class sizes and enjoyed similar levels of throughput, some ETOs had more elaborate managerial structures than others. Behind the inadequacy of the efficiency account is its ahistorical and functional logic: it observes the function of the modern managerial class in enhancing economic efficiency; therefore it uses this function as the cause for the rise of the managerial class. Neither do the efficiency accounts consider the fact that efficiency is socially constructed and is open to different interpretation by different managerial groups (Fligstein, 1990).

The political-institutional accounts of Fligstein (1990) go beyond the efficiency accounts. He brings power and the state back in and considers the rise of a particular kind of managers as a political battle. His thesis is that American corporations, and particularly what constitutes the ideal conception of corporate control, are transformed in an interactive process. This process involves the corporations themselves, the managers and the state. Facing crises and state policy shifts, managers acting as social actors redefine the standards of ideal control and efficiency. The standards evolve from direct control to manufacturing control, to marketing control and finally to financial control. His theory challenges the economically rigid idea of efficiency, and sees it as constantly redefined by managers. For Fligstein, corporate groups are not formed and capitalized

with the inherent goal of efficiency. Instead, they avoid competition and strive to construct a stable world.

Despite the insight of the political-institutional accounts, this approach does not answer my question. If Fligstein's prediction were true, we would observe that large ETOs with elaborate managerial structures are more interested in forming trust or other competition-constraining arrangements. In China's ETI, however, the largest ETOs such as Supernova showed little interest in organizing trust, association or other forms of industry-level institutions. This is related to the second problem—Fligstein (1990) assumes that the risk-averse motivational structure is dominant in any spatial, temporal or cultural context. As mentioned earlier, a well-institutionalized social space may indeed only welcome individuals with risk-averse motivational structure. In a doubly ambiguous social space such as the ETI, however, there is a higher level of heterogeneity of social actors. Whereas risk-averse and law-abiding actors tend to push innovation by institutionalizing the field, adventurers tend to revolutionize the field by destabilizing it. Furthermore, even if the succession of one group of managers by another might be due to the selection of a particular management ideology arising at a particular time, the succession of other managerial groups and the rise of the managerial class do not necessarily follow the same institutionalization process in every case.

To the extent that the rise of the managerial class is associated with formalization and rationalization, Guthrie's (1999) study of formalization represents a third approach. He applies new institutionalism's isomorphism argument to China and argues that the formalization of the structure and procedures of Chinese corporations is due to mimetic activities of the more legitimate Western model through joint ventures. In other words, formalization, bureaucratization and the rise of the managerial class in the ETI are signs of convergence to the

Western models. To be sure, this prediction has its merit because there was isomorphism both in terms of business models and formal structures across ETOs during the 2000s.

However, this isomorphism argument still falls short. In the next section, I will show that there are clear signs of imitating the Western small class model as well as other formal structures among newly founded ETOs. Yet, older ETOs such as Supernova did not build managerial teams by imitating the West. Supernova started with a managerial structure that emphasized neither centralized coordination nor the Western franchise model (Aurini and Davies, 2006). Even newly founded Doo & Cool and Duvell, though imitating the Western small class model, did not employ the franchise approach for cross-region expansion.

## **THE RISE OF MANAGERS IN CHINA'S ETI**

In this section, I offer my explanations for the rise of the managerial class in the ETI. I will show that the rise of the managerial class was largely attributed to a legitimacy-oriented selection mechanism. With this mechanism in place, it was difficult for surviving ETOs to develop managerial structures. That said, I use the case of Supernova to illustrate the unique path of adaptation.

### **Building a Managerial Class as a Legitimacy-Oriented Selection Process**

The rise of the managerial class in the upper echelon of the ETI was largely a legitimacy-oriented selection process. In other words, the newly founded ETOs were imprinted with more elaborate managerial structures. Not only did the characteristics of the new niches lay the foundation for managerial structure, but the entrance of domestic and foreign managerial resources and models into the ETI also allowed these ETOs to emerge with greater potential for

managerial capitalism. Furthermore, the rising market status of these ETOs enhanced the legitimacy of educational managers.

Newly established ETOs, especially those in the K–12 niche market such as Doo & Cool and Duvell, emerged with the characteristics of the niche market. For example, the K–12 niche presupposed greater standardization of teaching materials. This standardization was based on the fact that formal education has a clearer classification of what is to be taught on each level. Whereas for TOEFL/GRE “a student with the score of 600 and another with the score of 200 had no problem in attending the same class” (Supernova Archive No. 5), in K–12, a fifth grade teacher was not supposed to cover those materials a sixth grade teacher was expected to teach (Informant No. 67). The greater pressure toward standardization was also due to the fact that K–12 training is not limited to English. As a veteran Doo & Cool teacher mentioned, “Doing math, physics and chemistry is different from English. It is about working out specific questions and the right answers. We might teach in more colorful ways if we taught English. We cannot do that when we teach math. So the difference is in our genes” (Informant No. 58).

In accordance with its greater affinity for standardization, the K–12 niche also presupposes smaller class sizes. Since K–12 students are supposed to be taught only with students from their own cohort, mass teaching did not seem to be a suitable model. That said, Supernova started its K–12 classes in the early 2000s with the sole target of the College Exam. In other words, all K–12 students, regardless of their levels and scores, were expected to attend the same College Exam preparation course. The initial success of these classes demonstrated the appeal of mass teaching to students. However, new comers such as Doo & Cool were established with different blueprints. Since Doo & Cool followed the characteristics of the K–12 niche market and assigned students to the appropriate cohort, their long-term growth was dependent

upon moving lower grade students to higher-level classes. As a senior manager of Supernova put it, “When I asked Supernova branch school presidents where we should start with K–12 classes, without exception they told me we should start with the College Exam. However, when I asked Doo & Cool managers, they all told me we should start with the first grade” (Zhu, 2013).

Behind the characteristics of the K–12 niche was a group of consumers that were different from those in other niches. In the previous section, I mentioned that K–12 students tended to be local and immobile. Therefore, capturing the vast K–12 market required more capital investment to open learning centers near each neighborhood. In addition, K–12 students often depended on their parents for decision-making. In this regard, they were different from TOEFL/GRE students. As a founding member of Supernova said, “TOEFL/GRE students in the 1980s and early 1990s did not need homework checks, tests or counseling. They had clear objectives and were highly self-motivated” (Informant No. 4).

Given the characteristics of the K–12 niche market, K–12 ETOs were inherently more service- and capital-intensive. Under mass teaching, all students cared about were the teachers and their performances. In fact, poor service and environment were not only taken-for-granted, but also sought after by some students as the signs of authentic mass teaching (Informants No. 14, No. 40). Yet, Doo & Cool and Duvell started with teams in charge of guidance, counseling and monitoring. Since Duvell used a one-on-one model that demanded a higher unit-time price and longer class periods, it also strove to rent high-end offices with fancy interior design and invested cash in other projects (Informants No. 40, No. 62).

Newly established K–12 ETOs also emerged in a period when domestic and foreign managerial resources and models were readily available. As I mentioned before, foreign ETOs such as Nasdaq English rushed into the ETI after China’s embrace of the WTO. Their small class

model, together with technologies and management techniques such as sales discourse (*xiaoshou huashu*, 销售话术), became well-known to domestic brands. Managers of other sectors also found their ways into the ETI after the passing of the Non-State Education Promotion Act. As a veteran teacher at Doo & Cool mentioned, they had initially been inexperienced in the management of the front desk, customer service and classrooms, and their solution was hiring a senior manager from a pizza restaurant chain (Informant No. 67).

### **Existing ETOs' Difficulty in Adapting to the Managerial Structure**

ETOs that survived the 1990s faced difficulty in building managerial structures. The major obstacle was family control. Family control in market leaders tended to be solid. For example, at Roaring English and United IELTS, numerous leadership positions were under the control of the founders and their relatives. The highest title a non-kinship manager could obtain at Roaring English was General Manager of either the Editing Department (*Bianji Bu*, 编辑部) or the Speaker Team Department (*Yanjiang Tuan*, 演讲团). Firm-level strategic positions, such as those in finance and Beijing branch school presidents, however, were only open to family members (Informant No. 49). In the absence of a shareholding structure, managers only received salaries. With regard to United IELTS, I have mentioned that the founder and his wife shouldered all major decisions. They also held the vast majority of the equity shares. Non-kinship managers were allocated neither equity nor futures until the last minute before going public (Li et al., 2014).

Reliance on family members not only limited the status and financial well being of non-kinship managers, but it also had three additional negative effects on the rise of the managerial class. First, since all top, strategic and comprehensive managerial positions were under the

control of family members, non-kinship managers could not develop their managerial toolkits through trial-and-error. Second, reliance on family members narrowed the options for cross-region expansion, which in turn limited the development of the managerial class. Roaring English and United IELTS all relied on the franchise model for cross-region expansion. These market leaders adopted the franchise model not only because they wanted to rapidly occupy the market with nonconforming practices, but also because they had been historically dependent upon family members. Family members, however, were insufficient for cross-region expansion. The franchise model therefore became the only choice. In turn, even an efficient franchise model constituted weaker pressure toward bureaucratization and formalization than directly managed schools since franchise schools' management teams were trapped in local businesses. Malfunctioning franchise systems could even be detrimental to the reputation of the brand.

Although some leading ETOs attempted to elevate the power of managers, the enhancement of managers' power often resulted in an uncontrollable conflict between themselves and family members. I have already shown how the CEO of Blue Ocean took over the organization from the founder. Although this failed top leadership succession could be attributed to the nonconforming practices of the CEO, it began with the founder's decision to transform the ETO from a family-control model to a manager-control model. Moreover, the leadership succession devastated the organization because after the ousting of the founder, his family members engaged in prolonged conflict with the CEO (Informant No. 21).

### **Supernova's Elaborate Managerial Structure**

Supernova was, again, an exception among ETOs that survived the 1990s. It developed a managerial team and a managerial structure. In addition to the founder Su, the "top management

team” consisted of 50 people by 2010, and every one of them was a non-kinship manager. This top management team also included a clear division between educational and functional departments.<sup>1</sup> There were three hierarchical levels within the top management team. Below the top management team were an additional three layers. Supernova’s internal operation had become so formalized and laden with red tape that teachers often compared it to the Chinese government.

The rise in managerial power at Supernova was not only due to the move away from the family structure, but also because of the adoption of a decentralized model for cross-region expansion. In the previous chapter, I showed how the successful transition from family to partnership structure was realized through the network of founding members. This transition not only limited the power of family members, but the conflict among partners also led to the formalization of the financial arrangements. In this section, I focus on Supernova’s decentralized system of directly managed branch schools all over China.

Supernova’s decentralized system of directly managed branch schools paved the way for the formation of its managerial class. In the previous chapter, I showed that Supernova’s first senior managers consisted of partners, such as Wei, Dai and Kang. They transitioned from partners to senior managers during the incorporation and financialization processes, from 2000 to 2006. Feudal lords became bureaucrats, although their status and relations with the founder differed significantly from average managers from other non-family-based firms. Neither Su nor these senior managers of this first group considered themselves to be subordinates of Su. As the

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<sup>1</sup> Education departments are departments that are responsible for niche markets such as the Department of TOEFL/GRE and the Department of Spoken English. Functional departments are in charge of regular business functions such as human resources.

internal conflict intensified and after they cashed out through the IPO, each of these senior managers left Supernova.

Table 6.1 Non-Kinship and Non-Partner Senior Managers at Supernova by 2010

Manager's Number And Names	Highest Rank (Year: the year first promoted to be senior manager)	Was a branch school president	Was a teacher before becoming manager?	Taught at a branch school (outside Beijing) before becoming manager?	Was a department head at branch school?
1	Executive President (2003)	Y	Y		N
2	Senior Vice President (2006)	Y	Y		N
3	Senior Vice President (2006)	Y	Y		Y
4	Vice President (2006)	Y	Y		Y
5	Vice President (2008)	Y	Y		Y
6	Vice President (2010)	Y	N		N
Percentage of YES		100%	83.3%		50%
7	Branch School President (2000)		N	N	N
8	Branch School President (2002)		Y	N	N
9	Branch School President (2002)		Y	Y	N/A
10	Branch School President (2002)		Y	N	N
11	Branch School President (2002)		Y	N	N
12	Branch School President (2003)		Y	N	N
13	Branch School President (2003)		Y	N	Y
14	Branch School President (2004)*		Y	N	Y
15	Branch School President (2004)*		Y	Y	N
16	Branch School President (2005)		Y	Y	Y
17	Branch School President (2005)		Y	N	N
18	Branch School President (2005)		Y	Y	Y
19	Branch School President (2005)		Y	N	Y
20	Branch School President (2005)		Y	N	N
21	Branch School President (2005)		Y	N	N
22	Branch School President (2005)*		Y	Y	Y
23	Branch School President (2005)*		Y	Y	Y
24	Branch School President (2005)*		Y	Y	Y
Percentage of YES			94.4%	38.9%	47%
25	Branch School President (2006)*		Unknown	N	Y
26	Branch School President (2006)		Y	Y	Y
27	Branch School President (2006)*		Y	Y	Y
28	Branch School President (2006)		Y	Y	Y
29	Branch School President (2006)		Y	Y	Y
30	Branch School President (2006)		Y	Unknown	Y
31	Branch School President (2006)*		Y	Y	Y
32	Branch School President (2006)*		Unknown	Y	Y
33	Branch School President (2006)*		Y	Y	Unknown
34	Branch School President (2006)		Y	N	Unknown
35	Branch School President (2006)		Y	Y	Y
36	Branch School President (2007)*		N	N	N
37	Branch School President (2007)		Y	Y	Unknown
38	Branch School President (2007)		Y	N	Unknown
39	Branch School President (2007)*		Y	Y	Y
40	Branch School President (2007)*		Y	Y	Y
41	Branch School President (2007)*		Y	Y	Y
42	Branch School President (2008)*		Y	Y	Y
43	Branch School President (2008)		Y	N	Unknown
44	Branch School President (2008)*		Y	Y	Y
45	Branch School President (2008)		Y	Y	Y
46	Branch School President (2009)*		Y	N	Y
47	Branch School President (2009)*		Y	Y	Y
48	Branch School President (2009)*		Y	Y	Y
49	Branch School President (2009)*		Y	Y	Y
50	Branch School President (2010)*		Y	Y	Unknown
51	Branch School President (2010)		Y	Y	Y
Percentage of YES			96%	77%	95.2%

Note: \* Indicates that the branch school president is not the founding president.  
Sources: Supernova Archives No. 7–33

Table 6.1 presents the profiles of the second and third groups of senior managers. The second group (top) consists of managers who as of 2010 had titles of vice presidents or above, not including Su or other partner-like managers. The third group (middle and bottom) includes branch school presidents. There are two sub-groups under this category: those who became branch school presidents between 2000 and 2005, and those who did so between 2006 and 2010. Both the second and the third group were considered members of the “senior management team (*gaoji guanli ceng*, 高级管理层)” at Supernova in the 2000s.<sup>2</sup> The first striking pattern shown in Table 6.1 is that every individual in the second group (with the title of vice president or above) had previously been a branch school president. Compared to the other positions, such as senior managers of human resources, branch school presidents had a greater chance of being promoted to be vice president during the 2000s.<sup>3</sup>

There was a clear path from teacher to senior manager. As the left columns show, the vast majority of senior managers had previously been teachers. My informants characterized this by saying “those who can teach well shall become managers (*jiao er you ze shi*, 教而优则仕).” Few who worked in non-teaching areas, such as human resources or marketing, had the opportunity to become branch school presidents or vice presidents. In addition, a substantial portion of branch school presidents needed to first work as department heads at branch schools, as the right column shows. The managerial ladder that began with teachers—department heads, branch school presidents and then vice presidents—was taking shape.

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<sup>2</sup> These two groups also had differences. As I will show, former branch school presidents started with a financial arrangement under which they could retain a fixed portion of the profits. In other words, they retained characteristics of the feudal system. Current branch school presidents, on the other hand, were only entitled to salary and bonus.

<sup>3</sup> This pattern, however, changed after the late 2000s when Supernova strengthened its central control.

Another related pattern is the growing importance of positions at branch schools outside of Beijing. As the two right columns show, branch school presidents were increasingly chosen from teachers and department heads of non-Beijing schools. For example, 38.9 percent of branch school presidents between 2000 and 2005 had teaching experience at non-Beijing schools, but 77 percent of branch school presidents between 2006 and 2010 had such experience.

Supernova's decentralized system of branch schools not only provided managers with hands-on training, but also constituted pressure from below toward a more hierarchical structure. We cannot understand the rise of managerial power at Supernova without understanding its cross-region expansion. Below, I will describe how Supernova unintentionally developed the decentralized system and how this system contributed to the formation of an elaborate managerial structure.

*Supernova's Initial Expansion.* Supernova's cross-region expansion did not emerge from careful planning. Instead, it was an unintentional result in response to nonconforming practices and internal conflicts. For example, the idea of establishing the first branch school in Shanghai was suddenly brought up to Su when competitors' nonconforming practices in Shanghai had damaged the financial and reputational interests of Supernova. As a veteran teacher recalled:

*In 2000, a guy named Zhong who had no affiliation with Supernova recruited students in Shanghai in the name of Supernova. He easily recruited more than 1,600 students. He did nothing except pull out a banner advertisement. Su was really mad. He gave Zhong a bankcard and asked him to put money onto it. Su said his teachers could help teach classes if Zhong complied. Of course Zhong was reluctant. Had he complied, his efforts would have ended in vain. Zhong asked other people, some of who were from Supernova's competitors, to teach classes. After this incident, Su immediately started thinking about opening up a branch school in Shanghai. (Informant No. 61)*

As this quote shows, the institutional environment in the early 2000s was still too weak to protect Supernova from nonconforming practices in faraway places: other actors could easily use

Supernova's name to reap financial benefits and damage its reputation. To prevent these problems, Supernova had to expand to other cities. However, cross-region expansion poses two challenges. First, the state forbade the establishment of branch schools in other cities, and required legal representatives of an ETO to be locals. To circumvent these regulations, Supernova used locals as the earliest legal representatives. Later, these locals were all replaced.

The second challenge was how Supernova could find reliable yet non-kinship employees to take care of distant branch schools. Again, Su started with his fellow student network. He used two of his high school classmates to establish the first branch school outside of Beijing—the Shanghai Supernova School (Shanghai School). Unlike Wei and Dai who previously had superior status over Su, these two individuals previously admired Su as a leader back in high school. Su was able to gain control over Shanghai with their help. The Shanghai School was founded before incorporation, and therefore these two branch school presidents enjoyed a financial arrangement similar to the partnership system: the Shanghai School could retain 50 percent of the profit generated in Shanghai (Informants No. 37, No. 74). In fact, both the Shanghai and Guangzhou branch schools kept such financial arrangements until IPO preparation required all branch schools to send their revenues to Headquarters first, and then wait for Headquarters' allocation of expenses. The Guangzhou School, as the second branch school outside of Beijing, resembled the Shanghai School in its financial arrangement. It was also a contingent fruit of internal conflict. Since the turf war between partners in the late 1990s had resulted in the termination of one of Wei's managers' business, this manager needed a new position. In order to take care of him and to prevent what had happened in Shanghai, Su asked this manager to found the Guangzhou School and serve as the first president (*ibid*).

*Supernova's Decentralized Model.* Since these earliest branch schools had been established before the incorporation was complete, the Supernova Corporation as the headquarters provided little support or coordination. Branch schools evolved into a decentralized model of cross-region expansion. By decentralized model, I mean that branch school presidents enjoyed autonomy in hiring/firing, financials and other strategic decisions. The amount of resources a branch school could obtain and what managerial approach to adopt were both left to branch school presidents and their personal connections. A veteran Supernova branch school president mentioned that the only support he received for founding the school was a 300,000 RMB startup fund and teachers sent from headquarters. He recalled that,

*At that time, there was no Corporation (Headquarters), and they just let you live or die by yourself (zisheng zimie, 自生自灭). The only support we could get (from Headquarters) was the TOEFL/GRE teachers Su sent to us. This was the only support. At that time, IELTS was not part of Su's territory. It was part of Guan's territory. My personal connection with Guan was OK, so he sent some IELTS teachers to help us. It was because of our personal connections. You know, the president of Shanghai did not get along with Guan. So Guan never sent any teachers to support Shanghai. Even Shanghai's books were different from others'. (Informant No. 37)*

The quantity and quality of central support only improved to a limited extent between 2000 and 2005. Between 2002 and 2003 when Supernova launched the second wave of expansion to nine cities, all branch school presidents obtained from Headquarters was a two million RMB startup fund and a handful of teachers who could fly in to teach in their cities. In the absence of any auditing system, branch school presidents could do whatever they wanted with the startup funds (Informant No. 41). In addition, the management training was still limited. A former branch school president recalled that the only training he had received was a short recording on management made by an individual who became branch school president three years before (Informant No. 64). Given the limited central coordination and support, there was

much heterogeneity among branch schools in terms of strategies, procedures and even logos. Although the administration and financials were left to “local control,” Supernova’s performative pedagogy and mass teaching diffused to all branch schools. New teachers at each branch school imitated the pedagogy by listening to the recordings of other teachers. Supernova also started organizing training conferences for branch schools’ teachers.

This decentralized model made Supernova a fragmented system. A senior financial manager also recalled how fragmented the financial system was:

*At that time (in 2005), we already had over ten branch schools but each school ran on its own system (gezi weizheng, 各自为政). Each branch school used a different financial system.... I remember our financial managers spent three or four days on each branch school, auditing all the books and preparing for IPO. We had not even done a single internal audit yet. Auditing by external professionals would be unimaginable if branch schools couldn’t even pass our internal auditing.... The financials were a mess. Basically, a branch school president could do whatever he/she wanted. The accountant could not even balance the accounts. It was horrible to see that even an accountant could not balance the accounts. When we went to a major school in Southern China, we saw another astonishing thing. The branch school president had sold his used refrigerator to the school and brought the money back home. He just made up an excuse and did that. He sold lots of his own stuff to the school with a price he had decided. We were completely astonished. There were lots of things like this. No one knew and no one was responsible. Basically, how a school is doing is entirely up to the quality of its president. It won’t work. (Informant No. 41)*

This quote also means that establishing distant branch schools spawned new nonconforming practices. It was not difficult to embezzle money, and Headquarters had limited measures to uncover such practices (Informants No. 29, No. 41). For example, a branch school president used the name of Supernova to recruit students from a smaller nearby city, but did not report these enrollment figures to Headquarters. Therefore, he was able to put the revenue into his own pocket. In another example, a branch school president mobilized his subordinates—all department heads at his school—to recruit students in another city and keep the revenue to

themselves. He gave each one of these department heads a small portion of the revenue and kept the largest portion for himself. He also took kickbacks by choosing construction and facility management firms (ibid). Since he always shared the benefits with department heads, he could still achieve high scores in his evaluations from colleagues (ibid). In short, branch schools resembled independent kingdoms of branch school presidents.

The decentralized model proved beneficial to Supernova. First, it made cross-region expansion possible even though there were state restrictions, a lack of managerial and logistic preparation at Supernova, and a lack of institutional support (i.e., an effective legal framework for Chinese franchises). Under the decentralized system, Su and Headquarters did not even have to adapt to the diverse local situations. Second, the decentralized model instilled in Supernova a high level of internal competition among branch schools. This, in turn, spurred the expansion to new regions and new niche markets. Without adequate and well-planned central coordination, branch schools engaged in constant turf wars. Representatives from one branch school would often overstep boundaries to recruit students in the territories of others. The intense internal competition kept each branch school active in searching for new resources and markets.

Third, the decentralized model became a training mechanism for branch school presidents. It included formal and informal evaluations of one's performance in comparison to others', just like how they had been compared with each other when they had been teachers. Branch school presidents not only had to beat the market, but they also had to beat their fellow presidents. To excel in such a system and without adequate central support, branch school presidents had to pick up a whole gamut of managerial toolkits through self-learning and trial-and-error. They had to learn skills from basic people management to advanced finance.

An invaluable lesson for branch school presidents was how to deal with both the government and public officials. As Table 6.1 shows, the majority of current branch school presidents had previously been teachers. Additionally, some had previously served as department heads in branch schools. For the positions of teacher and department head, however, they had only dealt with teaching-related issues within their schools. They had had no experience in registration, taxation, public safety or any other issues related to external agencies. When they became branch school presidents, the first thing they had to learn was the complicated relationship with local governments: to the extent that the ETI had been a local business, the top local brands were most often operated by relatives or friends of local governments (Informants No. 33, No. 37, No. 64). The entrance of Supernova, therefore, was interpreted by local ETOs as an act of invasion. Multiple branch school presidents mentioned that they had had difficulty obtaining licenses because of conflicts of interest (ibid).

Of course, branch school presidents who had local connections tended to enjoy a smoother start. As a former branch school president said:

*I started operating without a license. I was brave because I knew nothing (wuzhizhe wuwe, 无知者无畏). I learned a lot about the Chinese government after operating the school. Government people would come to you right away and tell you that without a license you were operating illegally. They told me that this was serious. They said, "First, we would forfeit all illegal income; second, you would have to pay a fine equal to two to ten times the amount of the illegal income; third, for those who had directly participated in the decision-making and illegal activities, they would be transferred to the legal department if they had broken any criminal laws." Well, I told them that I did not know. Another thing was that I was not afraid. An important reason was that our school had been a cooperative venture with the local Party Committee's school (shiwei dangxiao, 市委党校). The head of the Party Committee's school was Vice Chief Secretary of the local Communist Party. So I had such a person as my collaborator. Was I afraid the Education Bureau was bluffing? Of course not. The second reason why I was not afraid was because I had majored in law. It hadn't been long since I had graduated, so I blurted out all the laws. The third thing was my family background. I was not from a family of high-ranking officials. But I had this confidence. As long as I was dealing with people in my own province, and as long as I was not conducting criminal activities, I could get things*

*done. If the brand of Supernova could not get things done, my relatives could. (Informant No. 32)*

As we can see from this quote, the branch school presidents' local connections were crucial to a school's smooth opening. Accordingly, Su preferred to appoint local people as branch school presidents in cities where there was strong local protectionism. With that said, most Supernova branch school presidents had neither local connections nor experience in dealing with local governments. They learned how to manage government-related issues through independent learning and trial-and-error. For branch school presidents who had previously been department heads, the first lesson was often a hard one. A former branch school president reflected on a hard lesson he learned shortly after becoming president:

*I only got to understand how the Chinese government works after this incident. So first of all, there was a big fire at a nearby bar. I heard almost 40 people died. The central government was mad. Local officials had to hurry up and check the fire safety of all institutions. They closed more than ten thousand institutions within a few days. You know, lots of these institutions were not meeting the fire safety standards. They had gotten away by giving money to the local officials, but this time the government was serious.... The director of the sub-district office (jiedao banshi chu, 街道办事处) was responsible for the checkup. I got to know that the sub-district office was a level of government at that time. It was the lowest level of government. It is like a comprehensive public safety agency that can command local police and firefighters. However, our case was even more complicated. We had a huge stairway that led to our classrooms. Of course we had all the licenses, including the one for fire safety, but after that big fire, every government agency was out to inspect us. There was a kindergarten, and the kindergarten was under the supervision of the sub-district office, not the Education Bureau. But the people at the Education Bureau had gone to inspect the fire safety of that kindergarten and had decided to close it because it did not meet the standards. So people from the sub-district office wanted revenge on the Education Bureau. They decided to put us under the knife. Well, part of the reason was that I did not take them seriously. I was not there when they came to inspect. You know, I did not give them enough respect. I did not know the internal strife between these government agencies. I thought we had all the paperwork. (Informant No. 33)*

Another major area of training for branch school presidents was dealing with political coalitions within branch schools. This could also be a hard lesson for presidents who were not founding presidents. They had to face local department heads, teachers, employees and their prolonged conflicts. The worst strategy, according to a former branch school president, was to act like a “pushover” (Informant No. 48). When a branch school president would agree with one party but also side with the other, these parties would use the president’s words to fight one another. Eventually they would press the president to show them his/her side. Regardless of the president’s decision, one party would interpret his/her siding with the other party as betrayal. When complaint emails were sent to Su, often the branch school president would be the first to be removed (ibid). Some branch school presidents learned the lessons of their predecessors, and would bring groups of their own men to the branch school. However, such acts were often interpreted as distrust of the locals. The locals could put aside their conflict and form a coalition against the new president and his/her own men. Once the local/non-local conflict had taken shape, it was almost impossible for the new president to turn the situation around (ibid).

In the absence of systematic training, branch school presidents learned from each other through informal channels. To be sure, there were formal meetings organized by Headquarters for branch school presidents. However, branch school presidents considered these meetings poorly organized (ibid). Headquarters also lacked the expertise and power to select and implement best practices. Therefore, branch school presidents met with each other and discovered who was doing well on what. For example, the new small class and four-season-retention model which was a revolution against the previous mass teaching, began from two Southern branch schools, and later diffused to all branch schools. As one of the former branch school presidents recalled:

*At Supernova, we learned from the best practices of other branch schools. The all-around K–12 model started in Guangzhou. The four-season-retention model that is now the most popular model started in another Southern branch school. Previously, teachers had taught the same stuff to students across seasons. Teachers were all teaching how to crack the College Exam. Everyone only knew how to deliver the teaching for eight hours. An old lady at a Southern branch school initiated the new four-season-retention model. We found that her classes were all small. You know, previously we had all thought the bigger the better, but this old lady told her president and us that a class with more than 40 people would negatively impact quality. At that time, we knew nothing about educational quality. We only needed to have star teachers who could deliver brilliant classes to large audiences. She told the president, “We wouldn’t be able to remember the names of the students in a class of over 40 people.” You know how her president replied? “Why do we have to remember their names?” And she said, “So how are we supposed to answer questions from their parents about how their kids are doing when we are having parent-teacher meetings?” These are problems we never had before. So this model attracted the attention of others the next year. This old lady’s K–12 department had revenue that was right behind Beijing’s. Presidents of other branch schools marveled. We all asked, “How could this branch school in a small city have grown so fast?” Then leaders from Beijing and other schools all went to study this model. After that, another branch school in Eastern China crystallized the model even further. They not only used different textbooks for different seasons, but they also deemphasized students’ evaluations of teachers. Now, retention had become the most important indicator. This completely changed how we evaluated teachers. Only then did people from Headquarters notice this new model. The K–12 department at headquarters basically just claimed that these two branch schools were doing really well and asked them to deliver speeches at Headquarters. Lots of new models emerged like this. Say one branch school did well on one issue. OK, please go ahead and share with us about how you did it, so we all can go study it. The informal word of mouth was the most important. This was better than the formal meetings organized by Headquarters because we would ask around by ourselves and we wanted to know how others were doing. We studied others voluntarily. (Informant No. 48)*

*Supernova’s Central Control under the Decentralized Model.* Despite the fact that there was little central coordination, Su imposed rigorous internal control over branch schools. To be sure, Supernova was in the process of building formal channels of internal control, such as explicitly written report lines. Under a decentralized system that had originated from a doubly ambiguous space, however, Su had to depend more on personal, informal and even nonconforming measures to control distant organizations. Using a personal approach to maintain control started with the selection of branch school presidents. Branch school presidents recalled

that despite the existence of the human resources department and their written standards, all that mattered was the one-on-one interview with Su (Informants No. 63, No. 64). He was the only person who decided who would become branch school presidents. More surprisingly, Su often reached a decision after drinking a large volume of alcohol with candidates (ibid). Using these approaches allowed Su to establish personal connections with candidates and rely on his “intuition in judging their reliability” (Informant No. 64).

Another notable measure to keep control was to tolerate and even encourage teachers and staff to snitch on branch school presidents. Since Su actively wrote emails to every teacher and staff member, these teachers and staff members knew how to reach him. Although teachers and staff were supposed to communicate with their local leaders, some reported directly to Su. They not only made suggestions on strategies, but also reported on and complained about their local leaders. More importantly, Su took these reports seriously. As a former branch school president said, “It often took Su a long time to reply to our emails, but if a staff member or teacher wrote an email to Su, Su would reply immediately” (Informant No. 29). To be sure, Su did not believe every complaint he received from staff and teachers. However, he could use these complaints to demonstrate his knowledge of each branch school and send reminders to branch school presidents. A former branch school president described an incident:

*At that time, our school was performing well. But there was still this one unhappy guy. Well, there might have more, but this is the one I knew about because Su forwarded his emails to me. Of course, Su did not disclose this guy's name. Su's message was: look, reform is difficult. Someone is pouring dirty water on you (po zang shui, 泼脏水). At that time, I did not understand Su's intentions. I was thinking, “Why would you forward this email to me if you did not believe what he wrote?” Now I understand. It was part of the big boss's techniques of taming people (yuren zhishu, 驭人之术). It was just too difficult for him to know what was going on in each of these schools. He would use these incidents to remind you that you should not do this or that. Basically, that letter was complaining about my corruption. This unhappy guy mentioned that we had rent a classroom at the rate of 60 RMB but other people could get it at 45 RMB. So my first reaction was that I*

*put this email on the table during our meeting and I said, "Look, people will say bad things about you no matter what you do." Do you know what happened then? That unhappy guy wrote another email to Su, asking him why he forwarded his letter to me. He told Su, "Don't you know I might get grilled?" Then Su called me and scolded me. Su was like, "How can you sell me out?" I couldn't understand him at that time. I thought he was crazy. Our school was doing really well. He could have checked all the data in the system. Why would he believe this crazy stuff? He should have deleted emails like this directly. (Informant No. 48)*

This case shows that Su used snitching in a cautious manner. He had to rely on teachers and staff members to know how a particular school was doing, but at the same time he tried not to be credulous or to openly encourage snitching.

Using snitching fell into a broader category of control that Su adopted—making use of the internal politics of branch schools. A branch school with internal conflict is a school that can be monitored. The most difficult situation was when there had been no internal conflict between the branch school president, teachers and staff. Lack of complaints might have been a sign of coalition among these groups to oppose Su and Headquarters. Once branch school presidents and their department heads had formed stable coalitions, they could conduct nonconforming practices without being exposed. When necessary, Su had to relocate presidents in order to prevent the formation of stable local coalitions.

Selecting, promoting and relocating branch school presidents were also essential for controlling Supernova as a giant political system. For example, promoting someone who is new can instill loyalty and gratitude in this person and, more importantly, can weaken the powers of veteran candidates. For example, a branch school president of a major Southern school was first promoted because several veteran teachers had been competing for the position and no one could tolerate the possibility of other veteran teachers being promoted. Promoting a new person in fact reduced grievances among veteran teachers.

*Building a Managerial Class from Below.* The decentralized model transformed into a hierarchical system through two mechanisms in two different periods. Between 2000 and 2005, the decentralized model generated bottom-up pressure toward managerial capitalism. After 2005, there was an accelerated top-down effort to strengthen the central authority.

When there was no systematic top-down attempt to build a managerial ladder and when the income gap between managers and teachers was small, bottom-up pressure played the key role. Specifically, the intense internal competition and constant comparisons prompted teachers and managers to leave their current “comfort zones” in order to stay one step ahead of their peers. A senior manager called this “blocking other’s move to the position (*ka wei*, 卡位)” (Informant No. 30). Between 2000 and 2005, teachers and department heads in older schools such as Beijing and Shanghai lived prosperous lives. Top teachers could earn as much as 0.5-1 million RMB a year. In comparison, a few branch school presidents were entitled to profit distribution, but on average, the gap between teachers and branch school presidents was small. In addition, it was unclear what the next level was after becoming a branch school president. Therefore, there were a number of cases where teachers and department heads of the Beijing or Shanghai school refused to go to a small city and found a new school from scratch (Informant No. 63).

The engine of mobility from branch schools to Headquarters was even weaker. Under the decentralized model, the power of Headquarters was weak. It had a variety of functional departments, such as human resources and finance, but these departments were supposed to guide and evaluate the functional departments of each branch school. In reality, however, the functional departments of branch schools only listened to their local bosses—the branch school presidents. Branch school presidents, therefore, had little incentive to work at Headquarters unless there was a significant increase in status and income (Informant No. 62). Instead, they

preferred to be lower-level generals with real power rather than higher-level bureaucrats with rubber stamps (ibid).

Constant comparisons and intense internal competition prompted teachers and managers to leave their current “comfort zones” in order to stay one step ahead of their peers. Since teachers and branch school presidents constantly faced the pressure of being compared to each other, veterans could not rest on their previous achievements. It was like a soccer game with no age limit: older people had to compete with younger people on the same field. Moreover, performative pedagogy that required numerous repetitions bored teachers. They complained that they would have to tell the same joke four times in one day (Informants No. 38, No. 45, No. 66).

In this climate, remaining in the same comfort zone was the equivalent of “waiting for death” in the long run (Informant No. 63). This was even truer for teachers and department heads in non-Beijing schools—their incomes were significantly lower than that of those working in the Beijing School. Therefore, teachers in non-Beijing schools were active in becoming department heads. Department heads in these schools were also active in applying for the positions of branch school presidents. They even hoped their local bosses could move up to Headquarters or to bigger schools, so that they would have the opportunity to be promoted. In the face of such bottom-up pressure toward managerial capitalism, Su only needed a gentle push. He provided implicit promises of more advantageous future positions to those willing to leave their current comfort zones. The whole system now had the engine to move up.

Between 2006 and 2010, a series of top-down attempts to build the managerial ladder came into play. The goal was to strengthen the central authority and to increase the economic and social status of senior managers at Headquarters. In early 2006, Supernova changed the organizational structure to a regional management model. Two branch school presidents became

Supernova's vice presidents. These two new vice presidents, together with a senior vice president promoted from another branch school in 2003, were designated as regional vice presidents. Each was responsible for one region: one for Northern China, one for Western China and one for Eastern and Southeastern China.

The evolution to the regional management model, which was undoubtedly a centralization movement, also provided a new impetus toward decentralization. Regional vice presidents pushed toward greater coordination across branch schools within the same region. They also represented Headquarters in monitoring the implementation of firm-wide strategies. On the other hand, they provided new sources for blocking headquarters' penetration into local schools. Regions had the tendency of becoming independent kingdoms. To address these problems, in 2007 Su abolished the regional management model and Supernova evolved into a more centralized structure. Under this multi-divisional structure (Li, 2010), a senior vice president led all branch schools along with several senior project managers, and the other senior vice president was in charge of the functional departments. The third vice president was in charge of the Beijing School which contributed over half of Supernova's revenue.

However, the functional departments in each branch school were still largely under local control. In 2009, Supernova further evolved into a matrix system (ibid). While a senior vice president led all branch schools "vertically," the other two senior vice presidents led teaching and functional departments "horizontally." Meanwhile, headquarters significantly strengthened its control over the functional departments of branch schools. All functional departments now had to follow the standard structures and procedures coordinated at Headquarters. By 2010, Supernova had not only formed a substantial managerial team, but it had also advanced along the direction of bureaucratization and formalization.

### **Doo & Cool's Centralized Model**

Supernova was a unique case of adaptation. It survived the doubly ambiguous environment and built an elaborate managerial structure from below. In contrast, Doo & Cool built its centralized system of branch schools and managerial structure from above.

Similar to Supernova, Doo & Cool also adopted a directly managed branch school system. However, the way Doo & Cool managed its branch schools contrasted from that of Supernova. Doo & Cool adopted a centralized model with the following features: a) strong control and coordination by its Headquarters in Beijing. Headquarters was responsible for hiring, training and evaluating functional department managers for the branch schools; b) branch school presidents' responsibilities and powers were limited. For example, public relations managers at headquarters, instead of branch school presidents, were responsible for public relations with local governments. In addition, branch school presidents were accountable for education-related performance, but not financial performance; and c) Headquarters prioritized a collective culture and long-term performance. Doo & Cool emphasized seniority when evaluating presidents. Individual heroism and short-term performance were deemphasized. It was not easy to fire an employee. They also did not compare the performances of branch school presidents during meetings or other public events (Informants No. 53, No. 58, No. 67).

This central model was partly driven by selection. Doo & Cool thrived in the mid-2000s when the state's tolerance for privatization and marketization was increasingly clear. Resources and repertoires from other private business sectors started flowing into the ETI. Registering an

ETO in a corporate structure was no longer a problem.<sup>4</sup> Given these institutional supports, it was easier for Headquarters to coordinate and control branch schools thousands of miles away. As mentioned earlier, this selection effect was also based on the fact that the K–12 niche presupposed more standardization of teaching materials. The fact that Doo & Cool had started from math and other natural science subjects also contributed to its initial departure from Supernova.

The way Doo & Cool managed its branch school was an extension and adaptation of its initial management style that had been applied to its Beijing school. At the outset, teachers were hired “with pacifiers in their mouths” (Informant No. 53). This meant that teachers who performed on the front stage only needed to follow the guidance that had been prepared on the backstage. Accordingly, Doo & Cool was famous for its “big backstage and small front stage (*da houtai he xiao qiantai*, 大后台和小前台).” Furthermore, Doo & Cool strengthened its central coordination and control after a group of teachers left in 2006. Similar to what happened to ETOs in the 1980s and 1990s, a mass exodus of teachers damaged Doo & Cool in 2006. It therefore enhanced its central coordination and control, seeking to further reduce its teachers’ power.

Although the centralized model prevented the problem of independent kingdoms, it limited the capacity of branch school presidents. Since Headquarters provided multi-faceted supports, branch school presidents did not have to explore new areas. They also lacked competence in organizational operations. They were born with crutches. As a veteran manager commented:

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<sup>4</sup> Doo & Cool had initially registered a company under the name of “Olympic Culture Corporation.” Later, they had to change the name only because the Administration of Industry and Commerce did not allow the use of “Olympic” as part of the brand.

*Well, our branch school presidents are not as capable as Supernova's. Theirs can handle really tough situations. That is why many of their presidents have now become entrepreneurs. Our presidents were not so strong, but we had a strong system. We pretty much knew how much growth we could get from a city. It did not matter which person we sent. Of course, we were not ruthless. If someone made a mistake, we would give him/her more chances. If he/she did not fit the job, we would relocate him/her to another position. We would not easily fire employees. One of our branch schools in Central China had a succession of three presidents in a short time period. You know, the local brands were so strong. We could not beat them. The previous presidents who had to relocate came back to our Headquarters, but remember our Headquarters was aggressive. So when they came back, they would not be working with symbolic positions. (Informant No. 53)*

### **The Franchise Model as a Dead End**

To the extent that the rise of the managerial class was tied to cross-region expansion, it is worth investigating why no strong managerial team emerged from the franchise model. In this section, I show that the franchise model, especially given the institutional environment of the 1990s and early 2000s, was detrimental to both internal control and the rise of the managerial class.

On the franchisee side, they often would use a brand name without paying the franchise fee. Local law enforcement let them get away with this practice. Headquarters also did not honor their agreement. It was common for headquarters not to provide the promised services and support. A former senior manager at Roaring English commented on this messy situation:

*All the branch schools of Roaring English were franchise organizations. Whether these franchisees paid a franchise fee to Roaring English basically depended on those franchisees' good hearts (liangxin, 良心). In most cases, those franchisees just fooled the Roaring English people. The branch school in Beijing, for example, was operating relatively well. It was also a franchise school and those franchisees just refused to pay the franchise fee. Later, the Roaring English founder could not do anything to the franchisees. He had to ask his sister to establish a directly managed school in Beijing.... You know, Roaring English did not have a lawyer or any management. So there was a time when numerous people in different places just used the Roaring English flag and recruited students. After they had recruited enough people, they would ask Duan to fly over and give a lecture. They told Duan that they would "split the bread" if he came over. (Informant No. 49)*

Even in the late 2000s, disputes frequently broke out among franchisees and Headquarters. A report by China's *Economic Weekly* (Wang et al., 2010) showed how an ETO's headquarters annulled their contract after the franchisee invested his own money in marketing for the brand and recruiting students. In short, it was difficult to control the franchisees and their procedures, not to mention building a managerial team out of the franchise system.

Even among directly managed schools, it was not easy to maintain control over distant schools. A founding member at Blue Ocean recalled how they established branch schools:

*(It was extremely difficult to expand to other places) due to policy reasons. For example, if Blue Ocean wanted to open up a branch school in Heilongjiang Province, we would have to register at the local Education Bureau. Then, we would have to establish a local branch. There was a similar requirement for those in charge of the branch school: he/she had to be an associate professor or above, and had to have a local residency permit. So once we invested money into these local schools, our management could not follow. We could not send everyone at Headquarters to those branch schools. What we could do was to train an employee for one or two weeks, and then send him/her to be the president of that local school. But you can imagine how loyal this person could be with only one week of training. Also, the legal representative was a local guy, so we would make an investment and let them run the branch themselves. If the branch school were running well, it would belong to the legal representative. Legally speaking, the school would be his/hers! He/she could ask our headquarters to pay him/her a large fee, or else he/she would take the school over. Another thing (what would happen) was when you would send someone who was not loyal. Nowadays people pay tuition by card. Back then, people all used cash. If he/she recruited five thousand students and put them into ten classes, you (Headquarters) would never know what the real number was. If there had been 480 people in a class, he/she might say there were 420 and then keep the difference. (Informant No. 8)*

As this quote shows, although the state's regulations against cross-region expansion did not prevent ETOs from expanding, regulations did complicate Headquarters' control over branch schools.

This chapter investigates the rise of the managerial class in the ETI during the 2000s. I have shown that the rise of the managerial class was largely attributed to a selection mechanism, as most older ETOs could not adapt to the managerial model. Supernova, as an exception, adapted not only because it had moved away from family control, but also because it had expanded with a decentralized system of directly managed branch schools.

## **Chapter Seven**

### **Conclusion**

My dissertation investigates the privatization, marketization, financialization and formalization of China's ETI from 1980 to 2010. Specifically, I ask how and why the ETI evolved into a for-profit industry led by large, private, formal and globally financed enterprises, despite systematic restrictions placed on private ownership and for-profit activities in this industry by the Chinese state. Using primary and secondary data on 28 existing and defunct ETOs, I develop a systematic theory of double ambiguity.

The ETI and other doubly ambiguous industries transformed because double ambiguity provided divergent resources and organizational repertoires. More importantly, double ambiguity attracts marginal entrepreneurs who push changes with nonconforming practices. It also imbues organizations with internal conflicts. Accordingly, the transformation under double ambiguity is contingent and non-incremental. In the ETI case, marginal entrepreneurs, nonconforming practices and the internal conflicts are the driving forces for ETOs' adaptation. On the other hand, I found that most ETOs are trapped by structural inertia and could not adapt to environmental changes. The rise of a particular model, such as the managerial capitalism, is largely driven by selection. In short, whereas the change of forms is a selection process, firms can be adaptive. The adaptation of market leaders, such as Supernova in the ETI, can even facilitate and accelerate the industry-wide selection process.

The early phase of development in doubly ambiguous industries is governed by nonconformity, rather than norm compliance as new institutionalists suggest. Nevertheless, the general trend for these industries is toward greater predictability, certainty and norm compliance. China's ETI and other doubly ambiguous industries are converging to the taken-for-granted capitalistic model around the globe. But this convergence also creates a counter-movement: institutionalization of doubly ambiguous industries can create new areas of nonconformity, unpredictability and uncertainty.

My theory of double ambiguity moves beyond new institutionalism and existing theories of ambiguity. My findings show that innovation is more likely to take place in ambiguous and boundary-blurred social spaces as something non-classifiable. This conclusion challenges new institutionalists' emphasis on the role of the classification logic in organizational innovation and valuation. My dissertation also develops existing theories of ambiguity by adding agency to their structural logic. My theory of double ambiguity locates the engines of change in the interaction between structural conditions and the particular kind of agents attracted to the structural condition.

My study also has important implications for understanding China's private economy. Indeed, a large portion of China's private economy did not grow out of clear private property rights or state-led developments. Numerous predominantly private industries flourished from below. Nevertheless, strong private economy did not necessarily thrive below the state's radar from far away rural areas. Neither does the bottom-up trajectory mean that surviving enterprises are more norm-compliant than those that failed. In fact, my findings show that enterprises that were more nonconforming were the initial winners and rule makers in the early phase of the

industry's development. They pushed the privatization and marketization of the industry from below.

The way the ETI privatized can be used to explain the transformation of other industries, such as the specialty healthcare and the fashion publishing industries. For example, the specialty healthcare industry emerged as an extension of general state hospitals, and it was not privatized or marketized. This industry is represented by specialty hospitals in cosmetic surgery and sexually transmitted diseases. Similar to the ETI, specialty hospitals relied on state hospitals and the second economy for doctors, facilities and organizational repertoires. Although state-affiliated specialty hospitals initially dominated the field, market leaders shifted to prototypical private hospitals founded by the so-called “barefoot doctors”—marginal entrepreneurs who had no professional medical training and started their businesses as migrating medicine peddlers. Transposing second economy repertoires into highly nonconforming medical practices, these prototypical private hospitals outcompeted state-affiliated hospitals and finally pushed the state to formalize their private ownership and for-profit nature. The fashion publishing industry, represented by cartoon book publishing, witnessed a similar pattern. Here the state publishing houses were even more dominant: they were the only legitimate entities to publish books. Ironically, the rise of the marginal “book businessmen” turned this highly regulated industry into the world's largest outlet of pirated books. In short, these industries also grew out of the shadow of the state medical and publishing systems.

My findings urge us to rethink the second economy or the black market as a source of capitalistic development. Some scholars doubt the possibility of modern formal capitalistic enterprises emerging out of the second economy (e.g., Rona-Tas, 1994; Nee and Opper, pp.23–25). My findings not only challenge this view, but they also move beyond Stark (1989)'s general

conclusion by specifying the role of the second economy as a source of organizational repertoires and private entrepreneurs as the agents for transposing repertoires. My dissertation can also serve as an invitation to re-evaluate the possibility of China's revolution legacy in economic transition. Shirk (1993) has documented the Cultural Revolution's unintended consequences in the decentralization of China's industries. This decentralization paved the way for the boom of rural industries in the 1980s and 1990s. It is plausible that the constant revolutions from the 1950s to the 1970s also created a ubiquitous second economy and a vast number of entrepreneurs marginalized from the state system.

My study also contributes to the discussion of the state's role by introducing a group of neglected industries. One of the reasons why scholars hold divergent views about the state's role is their choice of vastly different industries. While scholars who study the energy, finance, export and other strategic industries in general see a significant role of the state (e.g., Wang, 2015), scholars who work on rural enterprises and petty individual businesses often find a much more limited state (e.g., Huang, 2008). My dissertation uses Chinese ETI and other doubly ambiguous industries to shift attention to a group of special industries. These industries used to be part of the socialist welfare system. They were proximate to the giant state. The state imposed heavy restrictions on the marketization and privatization of these industries. Ironically, the state's resources and restrictions unintentionally led to strong private enterprises in these industries.

## **THEORETICAL IMPLICATIONS**

In this final section, I discuss the implications of my dissertation on relevant theoretical topics. I use the idea of double ambiguity to rethink boundary and temporality, the micro-macro link, embeddedness and institutions.

## **Boundary and Temporality**

My dissertation develops the paradigm of studying “things of boundaries” (Abbott, 2001, pp. 261–279). This paradigm is different from the existing paradigm in organizational studies that examines “organizational boundaries” (e.g., Hannan and Freeman, 1989, pp. 45–65; Aldrich, 1999, pp. 113–140). The basic premise of “things of boundaries” is that organizations as “things” do not come before the making of their boundaries. Rather, new types of organizations flourish in the boundaries of existing structures. They become thing-like entities when their boundaries become clearer. My study of the ETI, therefore, does not start with a given entity. Instead, I pay close attention to what happens in the boundaries and how boundaries shift. China’s ETI, as I have shown, indeed thrived in the boundary between the state, market and professions. After thirty years’ development, it has turned into a social entity with relatively clear external boundaries: private, for-profit and non-degree-oriented educational services fall into this field.

The paradigm of “things of boundaries” presupposes a processual and dynamic view of the social world (Sewell, 1996a, 1996b; Abbott, 2001, pp. 261–279; Zhao, 2015, pp. 377–380). According to this view, temporalities are local and contextual, and the rate of change for different eras and social spaces might be hugely different. I provide specific examples of how the ambiguous social space is more likely to lead to rapid and contingent change. In addition, studying “things of boundaries” means organizing the social process in contextualized “narrative analyses”. Unlike control experiments’ isolating causes with statistical methods, explanations for boundary shifts need to embrace the temporality. This not only means that explanations need to be situated in historical contexts, but also means that narrative itself is a form of explanation. Causal explanations cannot work without narratives.

Specifically, my narratives cover how particular organizations rise and fall and how different niche markets are “yoked” together (Abbott, 2001). Before 1990s, the idea of an integrated education industry was unheard of in China, although the practice of making money through the educational or training service was present. The market was segmented along multiple dimensions: customers (college students, adults, kids, secondary school students and professionals), teaching objectives and content (test preparation for going abroad, language training for communication and technical training for job-hunting), arrangements of time and space (full-time boarding, short-term after-school programs, tutoring at schools and online). By 2010, however, a nationally integrated education and training ecology had taken shape: stock market analysts, auditing companies and consulting firms had started to issue annual reports on the “education and training industry.” Moreover, the Chinese Association of Non-Governmental Education was founded in 2008, although it was still inchoate in terms of influence. Chinese ETOs are also increasingly involved in global summits on education and technological industries.

Market leaders, such as Supernova, have played an integral role in yoking previously unconnected fields and making the industry’s internal and external boundaries clearer. For example, Supernova was a purely test-preparation school from its founding in 1993 to 1996/97, and it internalized consulting and publication in 1996/97, online and adults’ language training in the early 2000s, kids’ languages around 2003 and finally one-on-one K-12 tutoring programs around 2007. Each time Supernova internalized a new business, it started to compete with new rivals and also galvanized them to initiate their yoking. Some yoking strategies were successful while others were not, and even Supernova failed to internalize the bulk of technical training. When old boundaries were broken, new boundaries began to emerge while others remained blurred.

My findings also remind us of the importance of order and timing. For example, all the dominant players in this industry started with study-abroad-oriented test preparation courses, and then expanded to other niche markets. Two mechanisms came into play here. First, the order of expansion from GRE/TOEFL to Spoken English helped these corporations develop a more authoritative image because English learners in China believe that GRE/TOEFL is a higher form of knowledge than Spoken English. In other words, English learners and teachers interactively constructed a hierarchical knowledge system. This process could have delayed or hindered the professionalization of English teachers in China. When teachers at Supernova and United IELTS proved their authoritativeness with their impressive test scores, there was no need for them to obtain other certificates. Of course, the answer to the slow professionalization of ETI teachers could be much more complex. But we should not ignore the importance of the yoking order.

The yoking order described above also made the accumulation of capital easier. Starting with test-preparation courses produced visible training effects in an early stage, and it means that ETOs could start with students with clear objectives. In the Supernova case, the earliest customers all came from elite state universities. It benefited from starting with a group of self-motivated learners.

### **Micro, Macro and the Link**

My dissertation rethinks and revives the claim about the micro-macro link (e.g., Alexander et al., 1987). Currently dominant organizational theories, such as new institutionalism, are most interested in examining organizational and economic processes on macro levels. My dissertation pays close attention to individual human actors. Human actors, their social embeddedness and networks played integral roles in the early stages of the imprinting process. Accordingly, I place

emphasis on human actors in the early phase of the ETI's development. As the external and internal boundaries of a field become clearer in the later stages, human agency is more likely to be bounded and trapped in inertia.

I also place emphasis on individual organizations and their adaptation. Adaptation is difficult, especially in the transition from predatory stages to more institutionalized stages. With that said, adaptation is still possible. I outlined three conditions under which adaptation is more likely to be successful: a) controllable internal conflicts; b) leadership succession and c) organizational learning.

Furthermore, the adaptation of an individual organization can have long-lasting impact on the evolution of an industry. By showing the role of Supernova in the ETI's financialization, I revive the tradition of the micro-macro link. As I mentioned before, the micro-macro link I am proposing is relative and multilayered. If we study human actors as micro-level dynamics, organizations can be considered as macro-level units. Compared to the change in organizational forms in a field, however, internal dynamics of individual firms are micro-level processes. This also points to the direction of the firm-form interaction: we should be *specific* about whether we are talking about firms or forms, but that does not mean we should *separate* them in our analyses. Once we pay attention to micro-level dynamics and the link, we will be able to see both the Darwinian selection and the Lamarckian adaptation.

It is important to note that I am not discussing whether human organizations are Darwinian or Lamarckian (Nelson and Winter, 1982; Hannan and Freeman, 1989; Zhao, 2015). My point is that, compared to non-human animal organizations, human organizations are *more* Lamarckian. Human organizations should be at least more capable of learning, transforming and adapting to environment change than animal organizations, as many organizational theorists have

pointed out (e.g., Cyert and March, 1963). In empirical examination, we should at least assume that the adaptation and transformation of individual organizations are possible. We should also pay close attention to human actors and firms in the studies of financialization and institutionalization. This not only means the attention to the interaction between firms as micro-level actors and institutions as macro-level forces. In some cases, we also need to consider the interaction between human individuals as micro-level actors and firms as macro-level forces. Only in this way can we hope to revive the micro-macro link and “bring men back in” (Homans, 1964).

### **Rethink Embeddedness and Institutions**

New economic sociology starts with the idea of embeddedness and institutions (Granovetter, 1985; Polanyi, 1957, pp. 3–20). The argument that economic activities are embeddedness in social relations and culture moves beyond economists’ individualist view. Economic activities as instituted processes also mean that researchers need to put economic processes back to their social contexts.

However, the embeddedness argument cannot take us far if it only reminds us of common sense. Past studies in the tradition of embeddedness often only focus on one level of social context at a time. For example, White (1981) and Granovetter (1985) only investigate meso-level network patterns and ignore macro-level contexts, such as state. Of course, bringing back the idea that the market is socially embedded is important. But is it necessary to claim that capturing social context is sociology’s greatest advantage over economics? I am afraid not. Bringing back common sense only prevents us from falling down, but it cannot help us achieve high. Therefore, a few debates with economists along this line are sufficient. Unfortunately, sociologists are

making every effort to prove how every market—insurance, banking and law—is socially embedded and how everything in the market has a social meaning.

This attempt may very likely be fruitless because economists are fully aware that *in reality* markets are socially embedded. The reason why they do not treat social context seriously is methodological convenience. Economists' reliance on formal modeling requires simplifying reality in order to capture clearer and more mechanical co-varying relationship. Claiming that markets are socially embedded, then, is like holding a meaningless debate with economists: empirically they might agree with us and even find our point redundant. Methodologically, however, economists cannot give up their own toolkit. In this meaningless battle with economists, sociologists have forgotten how to make the best out of our own advantages and march on from common sense.

My findings and theory also point to a neglected aspect of embeddedness. Studies of embeddedness since Granovetter (1985, p. 487) most often consider embeddedness a crucial source of trust. Few scholars pay attention to embeddedness as a constraint to change. If organizations were only embedded in one type of social institutions, as State ETOs were, they would be trapped in current organizational arrangements; on the other hand, organizations that are embedded in the interstices of multiple social institutions have the potential to become agents for change. Discovering different kinds of embeddedness and their relationship to change should be a direction for future research.

With regard to institutions, current theories have also narrowed the understanding of institutions to be norm compliance and trust production. Indeed, institutions are associated with predictability. But the way it produces predictability is different under different social spaces (e.g., clear or ambiguous) and cultures (e.g., Western or Chinese). As my study of China's ETI

shows, there was substantial level of predictability in the early phase of development, but social actors did not comply with explicitly coded norms. While we should keep exploring along the Polanyian direction of contextualization, we should also consider alternative ways in researching embeddedness in order to move beyond the Granovetterian tradition.

## Appendix: List of ETOs with Primary Data

Name	Year and Place of Founding	Initial Niche Market	Primary Data Source and Distribution Among ETOs (The number in the parenthesis indicates number of informants or pieces of archives)
Capital University ETO	Early 1980s, Beijing	TOEFL/GRE and More	Interviews (3)
Central College ETO	Early 1980s, Beijing	TOEFL/GRE and More	Interviews (2)
Shining	1983, Shanghai	TOEFL/GRE	Interview (1)
Nova Academy	1984, Beijing	TOEFL/GRE and More	Interviews (6), Archives (>20)
Questing	Mid-1980s, Beijing	TOEFL/GRE	Interviews (2)
Seven Swords	1987, Beijing	TOEFL/GRE	Interviews (4)
Cornerstone	1990, Beijing	TOEFL/GRE	Interviews (3)
Pioneers	1993, Beijing	TOEFL/GRE	Interviews (4)
Supernova	1993, Beijing	TOEFL/GRE	Interviews (46), Archives (>50), Observation
Blue Ocean	1993, Beijing	Graduate Exam	Interviews (2)
Roaring English	1995, Guangzhou	Spoken English	Interview (2), Archives (2)
Scholastic Time	1995, Guangzhou	Spoken English	Interview (1)
United IELTS	1999, Beijing	IELTS	Observation
Nasdaq English	2000 (Entering China), Overseas	Spoken English	Interview (1)
Duvell	2001, Beijing	K-12	Archives (>10)
Doo & Cool	2003, Beijing	K-12	Interview (4), Archives (>10), Observation

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