

## **Research on Business Model Innovation and Control of China's Education & Training Industry: New Oriental Education & Technology Group as an Example**

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### **Abstract**

The for-profit education and training industry in China began in the late 1980s. As a result of the growing demand for education and training services and of lower barriers to entry into the training market, the number of education and training companies has increased in the past twenty years. This paper provides a case study about New Oriental Education & Technology Group, a company that has been in the industry since the beginning of its development. The aim of the paper is to explore how New Oriental adapted in the face of rapid market changes. The authors argue that New Oriental's success story stresses the importance of value innovation fueled by constant adjustments to its business model. The case study also reveals that management and control play integral roles in the success of business model innovation.

**Keywords:** Education and Training Services, China, Business Model Innovation, Managerial control

### **Introduction**

China's education and training industry started late, but has developed rapidly. With the

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establishment of the market economic system and China's accession to the WTO organization, the training market has expanded from providing only English language training to now providing information technology, accounting, management, and other specializations. As the market grew, there emerged a number of successful education companies including New Oriental, TAL Education Group, Xueda, Ambow, Global IELTS, among others. Because of fierce competition among these enterprises, business model innovation has become a key source of competitiveness for these enterprises.

New Oriental was once synonymous with training. In its early years, the company did not have core resources. However, over the course of time it formed its own unique core competitiveness through business model innovation. The dynamics of the market pressured New Oriental to adapt and adjust, thus becoming a model of success today. In this regard, there is a special significance in studying the evolution of New Oriental as a way to identifying how business model innovation can help China's education and training industry grow.

Of course, innovation will not lead to success if there is a lack of effective management and control. First of all, there is not just one business model that has been attributed to success. Business models are successful because of good management and control. It is by management and control that enterprises can find the boundaries of innovation, identify the risk points, locate the targets of innovation, and ultimately achieve the intended purpose of innovation.,

This paper starts by elaborating on theories of business model, and then uses a case study of the company, New Oriental Education & Technology Group, to showcase how business model innovation can bring sustainable competitiveness. The paper also argues that management and control play integral roles in the success of business model innovation.

## **Theories on Business Model Innovation and Control**

### **Business Model**

The concept of business model was first proposed in the 1950s, but it was not until the 1990s that the concept was popularized with the arrival of the information age. Academics have

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approached the concept from such points of view as system theory, value-added mode theory, profit model theory, among others. For example, Paul Timmers (1998) proposes a business model concept based on system theory. For Timmers, a business model refers to an integrated system consisting of products, services and information flows, including all participants, their roles, their potential benefits and the corresponding profit sources and ways. Allan Afuah and Christopher Tucci (2000) conceive of a business model as a series of internal or external operation activities that have been planned and are constantly updated to help companies remain profitable. Thus, a good business model should be able to answer a series of questions such as where to find customers, how to provide customers with unique value and service, how to price, how to pay, how to ensure profitability, and how to maintain a comparative advantage..

Christoph Zott and Raphael Amit (2007) contend that the business model is the focus of innovation, and is the decisive source for enterprises to create value for themselves, suppliers, partners and customers. Peter Weill and Michael Vitale (2001) introduce market elements into the concept of the business model, holding that the business model is a description of the responsibilities of and relationships among business consumers, users, allies and suppliers. The representative theory that the business community accepts is Michael Rappa's approach, which argues that a business model in its most basic sense refers to the way a business survives and generates revenue. That is to say, the business model provides a company with its position in the value chain and provides guidelines about how to make money. Alexander Osterwalder, Yves Pigneur and Christopher Tucci (2005) posit that the business model is a conceptual tool that contains a large number of commercial elements and inter-relationships, so as to clarify the business logic of a particular entity.

In summary, the business model can be generally defined as an integrated solution that enables a business to form a high-efficient operation system with unique core competitiveness and to achieve sustained profitability goals by providing products and services that maximize the customers' value.

### **Business Model Innovation**

The concept of innovation can be traced back to Schumpeter who proposed that innovation

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involves the introduction of new production factors and conditions to the production system. Business model innovation thus refers to how enterprises provide value creation, that is, introduce to the social production system value for customers. Business model innovation is the most original form of innovation. Without a business model, other innovations including management innovation, technology innovation, marketing innovation, and so on, will have minimal impact on the goals of sustainable development and profitability. Successful business model may involve innovation in technologies, or the transformation in business processes, or the restructuring of the original business model, or even redefining the rules of game in an industry. Therefore, business model innovation runs throughout the entire business processes, and all aspects including the enterprise resource development, research and development mode, manufacture mode, marketing system, and circulation system are involved. Innovations in any of the above components are likely to shape a new, successful business model. It can be said that the business model innovation determines the success or failure of the enterprise.

To sum up, the business model innovation has several distinctive features. First, the origin of its logical thinking is customers' demand—more specifically, how to effectively satisfy customers according to their needs, which is significantly different from many technical innovations. Second, its effects are more systemic and fundamental and often involve significant organizational strategy adjustments. Therefore, it is consistent with integrated innovation rather than just the change of a single factor. Third, it is in effect more likely to create a brand new profitable field, and more likely to bring lasting profitability and competitive advantage to the enterprise.

PEST analysis, Porter's five forces model and SWOT analysis can be used to analyze whether the enterprise's business model innovation can adapt to the macro environment (Porter 2008). On the basis of a clear understanding of the external operating environment, PEST analysis enables the enterprise to take advantage of the favorable factors wherein to provide good platform and security for the enterprise's development. Five forces analysis and SWOT analysis can help to make clear the strengths and weaknesses of the enterprise in the industry, and judge whether the business model is ideal for cultivating core competitiveness.

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## **Control of the Business Model**

Business model innovation must be coupled with effective managerial control. Control in this case refers to risk control, that is, the company's risk managers must undertake the necessary measures and methods to eliminate, reduce or avoid the possibilities of risk events, or to minimize losses caused by risk events. We know that for all companies there is no lack of creativity in business model innovation; however, the task of managing risk tends to be neglected after business model innovation plans are proposed. The effect of business model innovation must be able to withstand the test of the market, while the uncertainty of market risk makes it imperative that the enterprises must conduct risk assessment for themselves. Therefore, successful business models are also the results of good management and control. Through effective management and control, enterprises can find the boundaries of innovation, identify the risk points, locate the targets of innovation, and ultimately achieve the intended purpose of innovation, that is, to really add value to the customers, while ensuring profitability.

### **Status Quo of China's For-profit Education & Training Industry and Business Model Practice of New Oriental**

#### **Status Quo of China's Education & Training Industry**

The for-profit education and training industry in China began in the late 1980s. After more than twenty years of development of the market economy, the demand for education and training has significantly increased. At the same time, with lower barriers to entry into the training market, training institutions have mushroomed. Due to increasingly fierce competition, the market has gradually entered into the era of meager profit. How to adapt to changes in the market, formulate development strategies, adjust business structures, and search for new profit growth points, are issues that figure in the minds of education and training institutions today. In Beijing, Shanghai, Guangdong and other large metropolitan areas in China, where the education and training industry is most concentrated, there are large numbers of education and training institutions. At the same time, in order to obtain market competitiveness, many of these institutions have undertaken business model innovation, however, their efforts have not yielded

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equal results.

### **Growth Background of New Oriental**

The company, New Oriental Education & Technology Group, was established in the context of the rapid development of China's education and training industry. The experiences of New Oriental can offer potentially helpful guidelines and lessons for other participants in China's education and training industry. In 1993, Yu Minhong established New Oriental School in Beijing, which experienced rapid development thereafter. Nowadays, New Oriental offers foreign language training and basic education as its core area of competence, and owns multiple development platforms including short-term training system, advanced education system, basic education system, vocational education system, research & development system, oversea education consulting system, cultural industry system, science & technology industry system, among other. Thus, the firm is a large-scale comprehensive education science and technology group which integrates training, research and development, audio and visual books publishing, overseas education services, vocational education, online education, and education software development. The Group has established more than 40 schools, 200 learning centers, 25 bookstores, as well as various companies and subsidiaries in more than 40 cities across the country. Over the past decade, millions of students have used New Oriental's services and products. The staff number in New Oriental has developed from the first few people to the current nearly one thousand, of which more than 300 received education overseas.

Ten years ago, the industry was defined by New Oriental. Today, the Group faces stiff competition from new arrivals. According to *National Statistic Gazette of the Educational Development* that is published by the Chinese Ministry of Education, the potential scale of the education and training market in the next 5-10 years will reach 500 billion RMB. The tremendous market demand spurs the continuous expansion of the education and training industry, and also attracts many investors. As a result of the implementation of the Non-governmental Education Promotion Law and other pieces of legislation that have liberalized the industry, for-profit education training institutions similar to New Oriental have sprung up.

New Oriental was formed as a result of an initial investment of \$22.5 million by Tiger

Fund. Subsequently, it received investments from other sources, laying the foundation for New Oriental listed. On September 7, 2006, New Oriental was listed in NYSE marking not only the Group's successful capitalization but also that of the Chinese education and training industry. Over the past five years, the industry has undergone a tremendous change, witnessing the emergence of large and small education and training providers thanks to a consistent influx of investments. However, the exponential growth of the industry has been accompanied by the emergence of various problems. Among the problems are the difficulty in controlling product and service quality, conflicts between standardization and customization, lack of talent, and low level of research and development investment.

### **New Oriental's Business Model Innovation and Control**

During the 20 years of New Oriental's existence, its business model has constantly been adapted to meet new challenges and opportunities. From 1993 to 1995, the company had a single-mode operation. At that stage, the market was huge but very fragile. Due to low barriers to entry and obvious geographical restriction, the industry featured market fragmentations. New Oriental at that time aimed for the right market entry points. It seized the key link in the value chain of production and operation by hiring competent teachers and letting their teachers be idols of their students and students to be fans of their teachers. The main profit-acquiring means of this period for company was to attract a large number of students by way of offering low-priced services performed by excellent teachers. There was almost no control involved in the implementation of this business model. Figure 1 is the business model in the stage of single-mode operation.

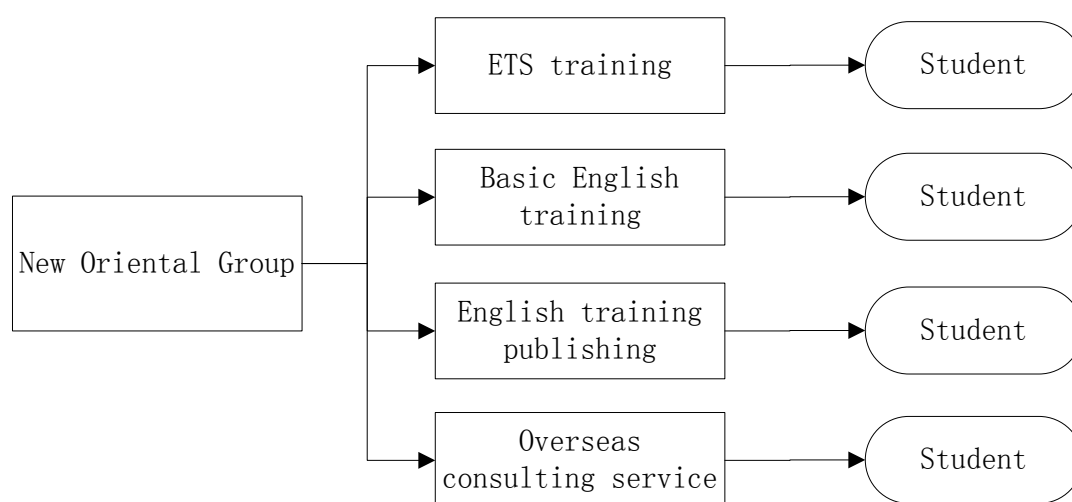
**Figure 1: business model in the stage of single-mode operation**



In the second stage, from 1996 to 2000, New Oriental witnessed rapid development. The expansion in college enrollments and the increase in English certificates' value brought more

students to New Oriental. At the same time, the rapid expansion of the company's market share also brought many problems, forcing New Oriental to start conscious business model innovation. For example, the company began to address problems arising from its loose governance structure, business segmentation, and insufficient product and service quality monitoring. During this period, with the increasingly important application of English, New Oriental began to expand to other fields and industries, culminating in the New Oriental Group which included ETS training, basic English training, English training publishing, and overseas consulting service, among other businesses. In addition to the training fee, the profit acquiring means of the company during this stage was the added value of the associated business. Figure 2 is the business model in the stage of rapid development

**Figure 2: business model in the stage of rapid development**



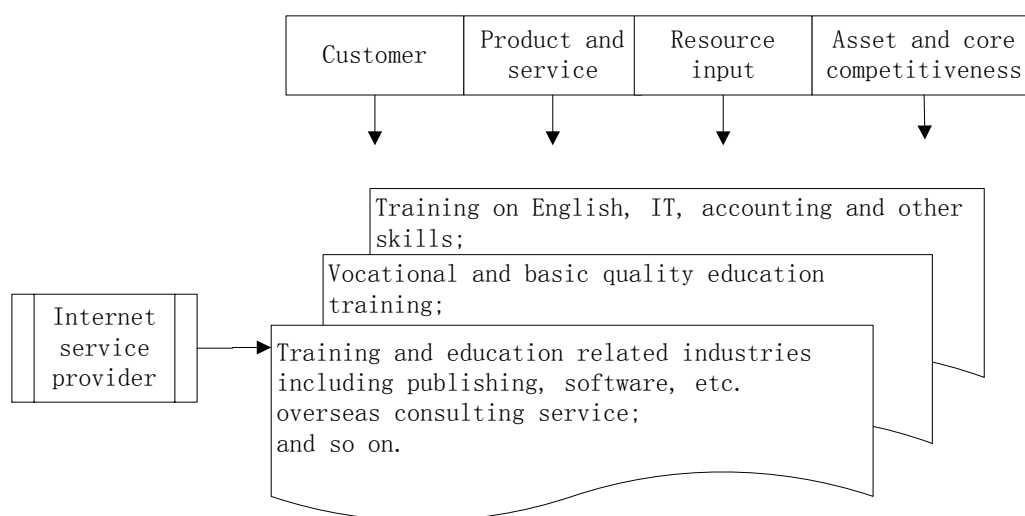
New Oriental's business model was redesigned starting in 2001 in order to address the industry's emerging realities. The industry witnessed important changes since the early 2000s. First, the comprehensive and in-depth reform of the education market led to much more English training market competitors. Second, foreign training institutions flooded the Chinese market after China's accession to the WTO. Third, the needs of customers (primarily students) have become more diversified. Fourth, IT, accounting and other professional certification exam training market have been rapidly expanding. Fifth, the popularity of the Internet has made it possible to break the geographical restrictions through online education, distance education



and other means.

In light of these industry developments, New Oriental adopted a business strategy of differentiated services. Because its brand was deeply rooted in the hearts of its customers, the Group was able to circumvent the entry barriers of the market, allowing for a smoother expansion into such fields as IT, accounting, and MBA, as well as the formal education fields such as vocational education and basic quality education. By developing complementary positions in the fields of training and formal education, New Oriental was able to secure long-term, stable and predictable sources of income, moving into a mature stage of its core competitiveness. Strategic management and control in this period had "learner-centered" emphasis, which included strengthening the core faculty resources, preventing competitors from entering this market niche, and continuing to launch new products. Figure 3 is the business model in the stage of group operation

**Figure 4: business model in the stage of group operation**



The succession of business model innovations during these stages illustrates how New Oriental adapted to new market realities, ensuring its survival and profitability. All the while, the company's evolving business model sought to form and reform its core competitiveness thus establishing the company as China's first education and training brand.

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## **Business Model Competitiveness Comparison of New Oriental with Other Training Schools**

### **(A) Business Model of TAL**

TAL, founded in 2003, is one of the well-known educational institutions engaging in primary and secondary school tutoring in China today. It is also New Oriental's fiercest competitor. In its tutoring business, TAL currently has 109 schoolrooms and 87 service centers, scattered in Beijing, Shanghai, Shenzhen, Guangzhou, Tianjin and Wuhan. TAL provides three types of training services for trainees: TAL small class, Zhikang VIP, and TAL online. Among them, TAL small class has been the flagship project across the curriculum for primary and secondary education. Zhikang as a kind of VIP service, requiring teachers to customize a personalized training program for each trainee, including courses, learning materials and learning progress, and provides the trainee with a full-time guidance teacher for counseling. TAL online lets trainees to learn primary and secondary school curriculum through an online format.

TAL adheres to three things in the development process. Firstly, the company firmly believes that the quality of teachers is the key to the success of the education & training sector. Therefore, in order to maintain the quality of teaching, the number of students recruited at any time is determined by the number of available teachers. Secondly, while expanding their teaching network coverage, they also emphasize domain name management very much and have formed a number of full-spelling domain names to serve as primary assets. Thirdly, they conduct quality control in a wholly-owned direct-operation mode and build all their schools into one unity of interests by management integration and process docking. In addition, TAL also implants the perspective of elite education into customers' minds, and has established a concept in the minds of students and parents that good students should go for tutoring more. For the above reason, TAL has caught the most important but easily ignored market in the primary and secondary schools tutoring market.

### **(B) Business Model of Xueda**

Xueda Education Technology (Beijing) Co., Ltd., which was established in September 2001, is a high-tech company combining high-quality education resources with state-of-the-art

information technology focusing on the field of Chinese education services. The company is headquartered in Beijing, and has offices in more than 30 cities including Shanghai, Guangzhou, and Tianjin, and over 130 peer-to-peer personalized learning centers. After years of research and practice, Xueda has established a set of effective peer-to-peer personalized training services (PPTS), including peer-to-peer consulting, customization, training and management. It devotes special attention to stimulating primary and secondary school students' interests in learning, fostering their confidence in learning, regulating their study habits, and cultivating the ability to learn, thereby improving the overall quality of learning. Throughout the process, the students' performances on learning exercises and exams are included in their files. The company's original 6-to-1 program—that is, for each student, the school will assign a class teacher, a subject teacher, an education specialist, a psychology counselor, an accompanying teacher and an education consultant—is a trademark of the company and has been well received by the students. It can be said that Xueda is very competitive in the peer-to-peer education and training market.

Table 1 is a comparison of Xueda Education and New Oriental's Youneng Education

**Table 1: Comparison of Xueda Education and New Oriental's Youneng Education**

	<b>Xueda Education</b>	<b>New Oriental's Youneng Education</b>
<b>Branches</b>	Branches in more than 30 cities, with over 130 learning centers.	Branches in more than 40 cities, with over 300 learning centers.
<b>Features</b>	Peer-to-peer personalized training services	Personalized curriculum; high-quality courses
<b>Students' level</b>	Primary and secondary school students	Students from grade five to senior
<b>Contents</b>	General education	Mainly English teaching

(C) Comparison of New Oriental and the Above Training Institutions

The Youneng Secondary School Education operated by New Oriental Group is also a well-

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known secondary school education brand. It relies on the New Oriental's excellent teaching resources, focuses on providing first-class general training for primary and secondary school students, and endeavors to create a high standard of teaching products. The Group has established nearly 300 learning centers in more than 40 cities across the country. It provides many choices of activities including inspirational education and a variety of winter/summer camps entitled "cool study, cool play" in addition to providing personalized curricula in order to fully ignite students' learning enthusiasm, stimulate students' positivity and initiative, and thereby improve the overall academic performances.

New Oriental has its own distinct characteristics, compared with the above training institutions. First, by taking advantage of the accumulated resources and the brand recognition, New Oriental firmly occupies the English training market and effectively seeps into the related fields of training. Second, it has relied on its excellent team of teachers, guaranteeing teaching quality assurance which is a trademark that New Oriental has developed over the course of time. These few but qualified star teachers, not only impart knowledge and learning skills, but also embody the New Oriental's spirit and propagate it to their students. Here it should be mentioned that the charisma of the founder, Mr. Yu, is particularly commendable.

Third, word-of-mouth marketing plays a very important role in the formation of the New Oriental brand. In the earlier periods, it was small ads and leaflet that spread the company's reputation. But due to the word-of-mouth phenomenon, most of the students come in droves to the New Oriental with feelings of curiosity and "pilgrimage". Stories and jokes about New Oriental School circulate rapidly in campuses, Internet, and BBS. Recently, New Oriental started to focus on marketing activities to expand its corporate reputation.

Fourth, because of regular news coverage and public attention, New Oriental is associated with the perception of risk-free, high quality-based service provision.. With the help of its strong brand, New Oriental has also spread and consolidated its other training areas in IT, accounting, and primary and secondary school teaching and tutoring market where that TAL and Xueda are involved.

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## Conclusion

We can extract from New Oriental's success story the importance of value innovation fueled by constant changes in the orientation of its business model. There is no way for other companies to copy New Oriental's successful business model because none has cultivated the same endowments or faced the same circumstances. The success of any business model is based on how well it addresses external conditions and leverages a company's assets and potential. As market environments change, a business model that was once successful can become obsolete today. Therefore, an enterprise should always reassess its circumstances and external environment in order to make the necessary adjustments to its business model in order to survive and remain profitable, as New Oriental has done with success since its founding.

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