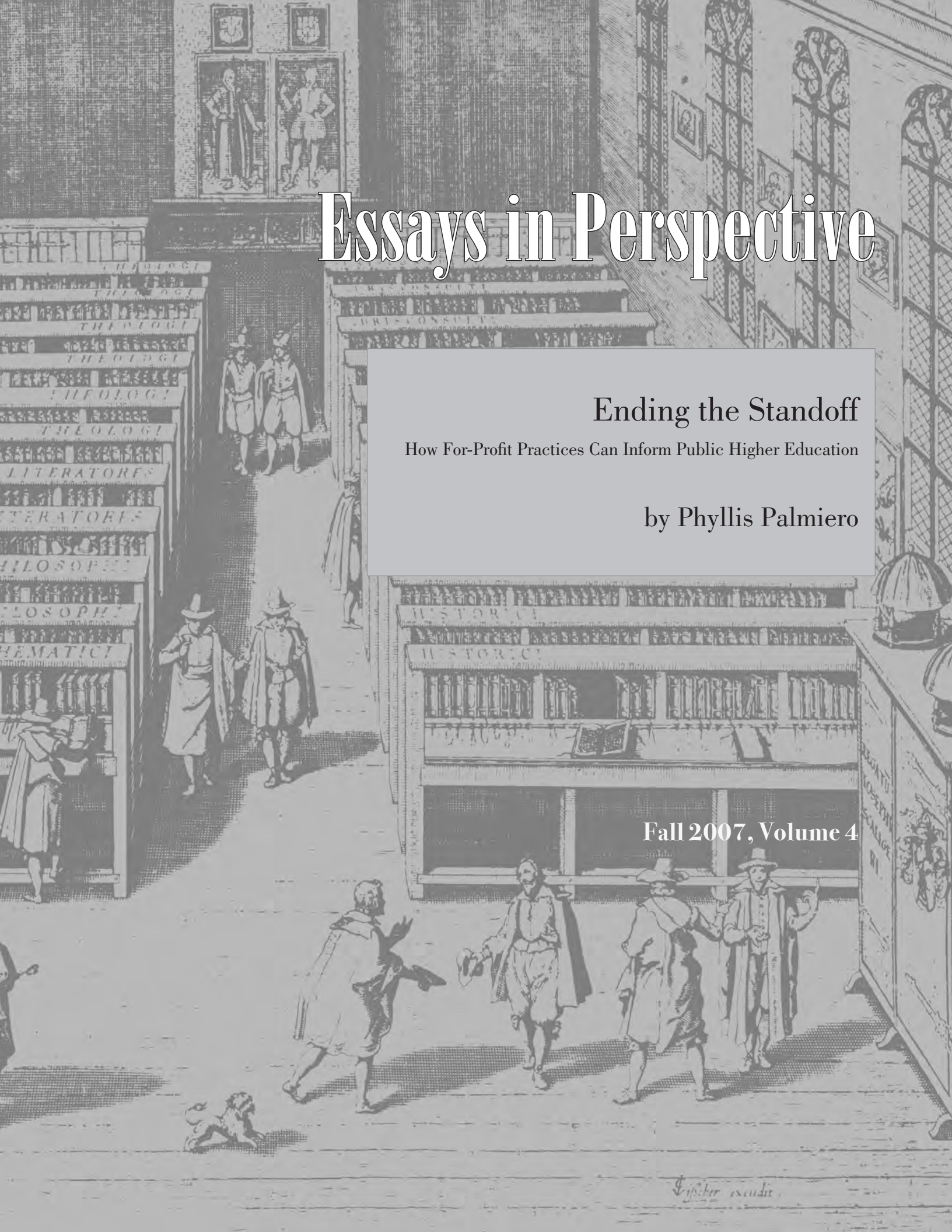

Essays in Perspective

Ending the Standoff

How For-Profit Practices Can Inform Public Higher Education

by Phyllis Palmiero

Fall 2007, Volume 4

The Institute for Effective Governance is a nonpartisan membership and service organization founded by college and university trustees—for trustees. It is devoted to enhancing boards' effectiveness and helping trustees fulfill their fiduciary responsibilities fully and effectively. IEG offers services tailored to the specific needs of individual boards, and focuses on academic quality, academic freedom, and accountability.

Introduction

Milton Freedman once said that the government solution to a problem is usually as bad as the problem. This quote is quite apropos when considering the calls for reforming higher education, especially public higher education in the United States. Rising costs, lack of accountability and unprepared students have heighted the need for higher education reform. Nationally and at the state level legislators and policymakers are grappling with the issues of reforming higher education with little and slow progress. If the answers do not lie in government, where shall ideas for reform come? The academy itself? Maybe, but given their denial that there is a problem at all, academe is an unlikely source. Alternatively, why not look at other providers of higher education? Could public higher education gain insight from its for-profit counterparts? We think so.

This essay identifies distinguishing factors between public and for-profit higher education with the hope that these distinguishing factors may help inform public policy relative to higher education reform. With waning state funds and the public's outrage over ever increasing tuition, higher education cannot continue with business as usually. It must consider alternatives to supplanting state funds with tuition increases. It must consider how it can become more efficient by reducing costs and increasingly more responsive to the needs of its students and employers—otherwise, higher education risks greater decay. Clues potentially exist where markets have thrived, the for-profit sector. It's work a look.

Phyllis Palmiero is the policy director at the American Council of Trustees and Alumni (ACTA) and directs its Institute for Effective Governance. She previously served as the Executive Director of the State Council of Higher Education for Virginia, the state's higher education coordinating board. Ms. Palmiero has an MBA in Finance and a BA in Economics from Fordham University in New York.

Through its periodic ***Essay in Perspective***, the American Council of Trustees and Alumni seeks to stimulate the discussion of key issues in higher education.

Ending the Standoff

How For-Profit Practices Can Inform Public Higher Education

By Phyllis Palmiero

America's system of higher education is a complex and decentralized one. And this is surely one of its strengths. Public and not-for-profit institutions, for-profits and technical colleges make up a diversified landscape—offering differing approaches to the provision of higher education. Are there lessons to be learned and shared?

There are, indeed, but you would scarcely know it. Far from mining each other's experiences, the varying sectors typically avoid each other. Public and not-for-profit higher education institutions often look down upon their for-profit counterparts—believing them academically inferior. For-profits, meanwhile, tend to begrudge the state support and limited regulation and oversight of their non-profit counterparts. The assumption is that neither sector has anything to learn from the other. But as William Tierney and Guilbert Hentschke suggest in their new book, *New Players, Different Game*, "rather than continuing their standoff, the two sectors could mutually benefit from examining each other's culture, practices and outcomes."[1]

That, it seems, would also be the sentiment of the Spellings Commission which in its recent report, *A Test of Leadership: Charting the Future of U.S. Higher Education*,[2] called on policymakers and trustees to think of more innovative ways to address challenges in higher education—particularly as they relate to cost, transparency, and accountability.

This essay is written in that spirit, examining how for-profits have coped with issues of cost and accountability, as possibly instructive paradigms for those seeking to enhance quality and efficiency in public higher education.

Background

The rise of for-profits began in the late 1990's as state support to public colleges waned. Tuition at public colleges rose and the spread between the cost of attending a for-profit versus a public college narrowed.[3] According to the National Center for Education Statistics, during that time enrollment in degree-granting for-profit institutions rose

threefold—from 304,000 in 1996 to 880,000 in 2004. And the growth was not solely in certificate programs. In fact, in 2006, 39 percent of the degrees awarded by for-profits were at the associate level or higher.[4] Given the current economic climate, this trend is likely to continue.

This growth phenomenon may very well be the result of the way in which for-profit colleges function. Kent Farnsworth, a professor at the University of Missouri-St. Louis, puts it simply, "private markets thrive where public markets fail."[5] As Farnsworth describes it: "For-profits function in a manner that is radically different from public and non-profit institutions—for-profits have a different decision making model, different ways to develop and deliver their model, and different ways to measure success....they eschew the established norms of the academy and pursue success in quite different ways."[6] As a consequence, agility and flexibility have become trademarks of the for-profit education sector.

Operating as a Business

In their simplest form, for-profit providers are businesses whose primary product is education. For-profits have shareholders, to whom they have to be accountable. They set annual targets and typically measure how well those targets are met: Are we increasing enrollment? Are we commercially successful in the market? Are we operating a tight ship financially? What is the profit? Could it have been more? Both the director and the shareholder care about the quality of the product since the long-term viability of the corporation, and thus, the stock price, depend upon it.

By contrast, in public and non-profit higher education, focus on results is relatively non-existent; there are no real shareholders regularly asking probing questions. And while there are trustees, acting somewhat like corporate directors, they are often unconcerned with the bottom-line, cost per product, or outcomes. They tend to focus more on inputs, process, and outputs.

For-profit colleges are quite clear on whom they serve and to whom they are accountable. In the end, as Gregory O'Brien, president of Argosy University, contends, "for-profits are bottom-line oriented and are tied to their stock prices; they can't tolerate 'bad outcomes.'"[7]

Encouraging public colleges to become more outcomes-oriented would move public higher education closer to a business model. So would requiring trustees, as "directors," to be more aware of their institutions' outcomes. According to Robert Tucker, president of InterEd, "an actual profit is not necessary, just a defined revenue and margin target—something most universities don't even know how to calculate."[8] By asking questions similar to those asked by corporate directors, trustees could help remind college administrators to whom they are accountable. With a greater focus on results and accountability, public higher education could increase the confidence that —namely, students, parents, and taxpayers—have in their product.

Agility and Responsiveness

According to Farnsworth, "For-profit colleges view employers, not students, as their primary clients. These colleges design programs, develop curricula, and shape student thinking primarily with the employers in mind. Students are viewed as the beneficiaries of the opportunity to get jobs."[9] For-

profit colleges employ a demand-driven approach and act quickly to make changes in order to respond to companies' needs for skilled employees. They also compress courses for quicker completion, albeit, sometimes at the expense of general education. Their agility is evidenced by their demonstrated ability to add new programs quickly to meet shortages in specific fields (e.g. nursing, information technology, etc.).

Public and non-profit higher education, on the other hand, tends to be supply-driven with the student as primary client. The focus is not on the student's ability to get jobs as much as it is on the "undergraduate experience."

In public and non-profit higher education, programs are mostly additive; public colleges tend to build upon what already exists or add new programs to their existing repertoire—whether these existing programs are any longer relevant or not. The presumption is that all programs are needed. Redesigning and adding new programs in public and non-profit higher education also takes longer—due, at least in part, to cultural and structural processes (e.g., program approval processes, faculty committees, etc.). As a result, traditional higher education is relatively slow to respond.

One barrier to responsiveness and cost effectiveness for both sectors of higher education is accreditation. For-profits have lamented how accreditation can actually impede a college's ability to respond. In the case of ECPI College for Technology, for example, faculty could not take on additional classes if they were already teaching the maximum course load dictated by accreditation standards. The result: Faculty who wanted to teach more ended up working part-time for other institutions, while the college—unable to capitalize on economies of scale—was forced to hire additional faculty to fulfill the demand. The American Council of Trustees and Alumni and the Spellings Commission have surely been justified in calling for a reformation of the accreditation process.

Consideration should regularly be given to removing barriers—both internally and externally—that impede colleges' ability to be more agile and responsive to the ever changing needs of students. There also should be a greater attention to program productivity analyses and review to ensure that existing programs are necessary and productive, cost-effective and efficient.

Measuring Outcomes

Typically for-profits measure success by outcomes—enrollment growth, job placement, and financial profitability while public and non-profit colleges tend to measure success based on the quality of their incoming classes (input measures) and the intangible "student experience." This is why the Spellings Commission call to measure outcomes has been particularly challenging for public and non-profit higher education.

Evidence regrettably is clear that students are able to graduate from programs without mastering all the desired skills. We know this from reports of the business community that stress a significant "skills gap" in our college graduates and call for "improved performance on student learning…[as] central to the national imperative to maintain economic growth, improve worker skills, enhance the diversity of the workforce, and increase educational productivity within higher education. Greater transparency about learning is also needed to maintain

public credibility about quality and performance in America's higher education institutions."[10]

While public higher education has been slow to establish competency-based assessments of their graduates, for-profit colleges have been using such assessments for years. What skills and competencies have college students mastered over the four years of their "undergraduate experience?" How do we know and how are they measured? These are legitimate questions that should be answered—whether it is a for-profit, public or nonprofit institution.

Return on Investment

For-profit colleges talk about the return on investment. They not only talk about it in terms of the return for their stockholders, but they talk about it in terms of the return that government gets on its investment and the return a student gets on his/her investment.[11]

True, public higher education does engage in economic assessments—many times to justify to the taxpaying public and policymakers their significant contributions to the state and local economy. But the intention is usually to garner additional public support. Rarely does a public college or non-profit talk about performance in terms of return on investment. Looking ahead, it appears that the public will increasingly seek institutions—from all sectors—that are willing and able to demonstrate clear learning objectives and measurable outcomes.

Transparency and Openness

For-profit institutions of higher education are subject to Sarbanes-Oxley, but public and non-profit institutions are not. While the Senate Finance Committee has been considering such rules for non-profit governance, public and non-profit institutions have resisted vociferously. So far, they have been successful, resulting in a continued wide difference between the role of for-profit and non-profit/public board members.

For-profit university directors are subject to liability for breach of fiduciary duty to shareholders of the corporation—and that means directors have an immediate and personal incentive to track the quality of the educational product, the financial bottom-line, and ensure proper oversight. They are attuned to looking at issues of long-term quality because, without that quality, the shareholders' investment would lose value.

But public and non-profit college and university trustees are not subject to comparable liability. Because there are no shareholders, public and non-profit trustees are virtually immune from any recourse for fiduciary neglect.

The principal remedy for mismanagement is removal from the board by the appointing authority or suits by the state attorney general. There is no direct shareholder to complain. Of course, the Governor or legislature could act quickly to cure governance defects by passing legislation to tighten rules, oversight, and possibly even modify the appointing authority's power. Such proposals have already been put on the table.

Judge José Cabranes, former general counsel to Yale University and current and former trustee at several universities, suggests that "there should be a legal shift, to increase board member liability thus creating an incentive for trustees to avoid litigation by becoming more transparent and accountable."[12] "Perhaps it is time," he says, "for law making bodies

to reconsider the historic restrictions on the standing of a university's co-owners to bring legal actions enforcing the duties of university fiduciaries."[13] Such a shift would be consistent with the transparency and accountability requirements required of for-profits, and subjecting trustees and officers of the institutions to liability would potentially wake up some sleeping trustees who have forgotten their fiduciary duties or who have become beholden to the administration rather than their implied "shareholders" - the stakeholders - namely, the students, donors, alumni and taxpayers who invest in them.

Cost Effectiveness

For-profits are more able readily to implement cost effective strategies than public and non-profit colleges. In part, this is due to the absence of the protocols of shared governance and tenure, which can serve as impediments to cost effectiveness, but also because for-profits are structurally advantaged to do so:

a. Less top-heavy organizations. For-profits generally tend to have less top-heavy organizations. Administrative layers are often quite deep at public institutions, particularly when compared with for-profits. This hierarchical structure can be an impediment to the public university's ability to respond quickly. Accordingly, the less top-heavy organization helps for-profits get things done more quickly and efficiently, reducing opportunity costs and overall cost.

b. Less bureaucracy. State institutions, in particular, have many hurdles to jump through in order to implement changes. Budgets and budget adjustments are often approved and reviewed by state budget offices and/or state coordinating organizations; capital construction often "manages" the construction of capital projects on campus; human resources are typically subject to the state's human resource agency's rules and approvals. In addition, most public institutions have a myriad of reports to submit regularly to the various state entities in the name of accountability-- even though there is scant scientific evidence that bureaucratic rules and oversight actually result in better- managed and cost effective institutions. This situation prompted the Spellings Commission to call on legislators to reduce regulations and bureaucracy. It in turn offers policymakers an incentive to explore tying accountability to meaningful outcomes while eliminating unnecessarily burdensome and often costly regulations.

c. Packaging and delivery of the curriculum. For -profits are experienced in standardizing their curriculum across campuses. According Tierney and Hentschke, "Two particular features of the for-profits are particularly advantageous: being able to spread program investment costs across more and more campuses, reducing per program development costs, and plugging into new campuses only those programs which appear to be most prone to growth."[14] This model could be instructive for public and non-profit colleges especially in the area of general education—particularly if a state agrees upon general education competencies required by all graduating students. There may be other areas or disciplines where such an approach has merit and enables colleges to be more efficient and effective in the delivery of instruction.

d. Different role of faculty. For-profits have held

down costs by defining the role of faculty differently than at traditional colleges. As Samuel Wood, former assistant professor of business at Stanford University explains, "At most for- profit institutions, individual faculty members don't design courses; they teach a curriculum that is provided to them and, as a result, tend to be paid lower salaries than faculty members at traditional colleges, who play a greater role in creating courses."[15] Standardized formats ensure a consistent level of quality throughout the programs and are extremely cost effective because as enrollment in courses grows, so do economies of scale. While this model might not be realistic and applicable for all faculty at public and non-profit colleges, utilizing this strategy in some way (i.e. general education) may prove cost effective.

Like it or not, public higher education increasingly has had to compete for public dollars with other sectors that tend to drive state budgets (e.g., Medicaid, elementary and secondary education, and public safety). When the economy is good, higher education does better financially than when the economy sours. These peaks and troughs in public funding have become the norm for public higher education. And while higher education has looked to tuition increases to supplant lost general fund dollars during the period of troughs, there is increasing displeasure from federal and state leaders, parents, and students about higher education's growing cost. Thus, policymakers and colleges and universities will need to look at new and innovative ways of operating—as the Spellings Commission made clear. Examining experiences in the for-profit sector may be a place to start.

END NOTES

1. William G. Tierney and Guilbert C. Hentschke. *New Players, Different Game: Understanding the Rise of For-Profit Colleges and Universities.* Baltimore, MD: Johns Hopkins University Press, 2007.
2.
3. Goldie Blumenstyk. "Special Report: Sarah E. Turner and Brian Pusser Watch the wind in for-profit colleges' sail." *The Chronicle of Higher Education*. July 15, 2005.
4. Goldie Blumenstyk. "Career Colleges Release First Economic-Impact Study." *The Chronicle of Higher Education*. July 6, 2007.
5. Kent Farnsworth. "The 4 Lessons That Community Colleges Can Learn From For-Profit Institutions." ***The** Chronicle of Higher Education*. October 27, 2006.
6. Scott Jaschik. "New Players, Different Game." *InsideHigherEd.com*, August 30, 2007.
7. Elila Powers. "How to Judge For-Profits." *InsideHigherEd.com*. July 10, 2006.
8. Robert Tucker, President, InterEd. In comments relating to "California's Regulatory Meltdown." *The Chronicle of Higher Education*. July 20, 2007.
9. Kent Farnsworth. "The 4 Lessons That Community Colleges Can Learn From For-Profit Institutions." *The Chronicle of Higher Education*. October 27, 2006.
10. The Business-Higher Education Forum. Public Accountability for Student Learning in Higher Education: Issues and Options. 2004.
11 *New Study Estimates Annual Economic Impact of Career Colleges*, Career College Association. June 2007.
12. José Cabranes. "University Trusteeship in the Enron Era," in a speech to the National association of College and University Attorneys, Annual Meeting, June 26. 2002 and reprinted in *For Trustees Only*, Institute for Effective Governance, January 2004.
13. Ibid.
14. Scott Jaschik. "New Players, Different Game." *InsideHigherEd.com*. ***August*** 30, 2007.
15. Goldie Blumenstyk. "Why For-Profit Colleges Are Like Health Clubs." *The Chronicle of Higher Education*. May 5, 2006.

Institute For Effective Governance
in higher education

1726 M Street, NW, Suite 802-A

Washington, DC 20036-4525

(202) 467-0376

Fax: (202) 467-6784

www.iegov.org

info@iegov.org