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## APPLYING A BUSINESS MODEL TO THE UNIVERSITY

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I often find myself feeling aggravated whenever I hear a candidate for public office say, "I'm going to see to it that our government is run like a business." My reaction to statements like this is invariably: a government is not a business and so why would you want to run it as if it were?

Well, when I hear a university president or provost propose running a university as if it were a business I feel the same way. A university is not a business. At least up until now universities have not been organized and operated on that premise. But if influential people are starting to talk like this, those with an interest in education need to think about whether a university can and more importantly, should, be operated as a business.

It is certainly not clear to me what it would mean to operate a university or college as if it were a business. For example, economists begin organizing their thinking about businesses or firms by endowing these enterprises with a psychology, however rudimentary it may be. Specifically, we make an assumption about what motivates a firm to do what it does. And since the 18th century, that assumption has been, more or less, that the firm seeks to maximize its profit, the difference between the monies it receives from the sale of its products and services and the monies it spends on those products and services it buys in order to produce whatever it is that it produces.

Whether or not the firms selling us cars, building us houses, arranging vacations for us, -and so on are as single-minded as this is debatable. Nonetheless, it is a reasonable starting point since there is good reason to believe that profit-seeking is deeply engrained in the psychology of private enterprise. But it is hard to imagine a university, particularly a public university, adopting this objective, explicitly or implicitly. If profits are made, to whom will they be distributed? Will universities and colleges sell shares and then declare dividends? That certainly could be done and in fact, if I'm not mistaken, it is exactly what Phoenix University IS doing. Be that as it may, I think it is HIGHLY unlikely that Western Michigan University, the University of Michigan, Kalamazoo College and all the other universities and colleges in the United States are going to direct their activities toward bringing the institution the largest possible profit. Of course, even if a college or university could not become a profit maximizing enterprise, it could adopt similar objections. For example, it could attempt to maximize its revenues as it minimizes the cost of any initiative it takes.

In any case, could the academy let "the market" guide it in making decisions about enrollment, standards, staffing, investment in plant, and so on? Could the academy become more entrepreneurial in its outlook? I think the answer to these questions is: certainly. And I think that this is what people mean when they talk about managing the university as if it were a business, something that to some extent, administrations have been doing for some time. Universities and colleges have grown in size and scope and class sizes have changed over time. Why? Presumably because the "demand" for college education increased and faculty salaries rose in real terms, among other reasons.

Obviously the academy is much different today than it was fifty years ago, and the changes that have occurred are undoubtedly due to structural changes in the economy. An institution could possibly ignore these changes. I wonder if Kalamazoo College, Oberlin, and even places like the University of Chicago are today markedly different programmatically than they were 30 years ago. But will they be the same 30 years into the future as they are now? I think that's impossible to predict. Be that as it may, there is no reason to suspect that a university is making a mistake

when it develops a program in a field that is brought into existence by scientific discoveries or by any other development outside the academy.

Now these observations are largely preliminary. The question that those with the power to move the academy in one direction or another must ask is: what should universities and colleges be doing? Well, let's think about an educational system that is entrepreneurial and highly responsive to market forces. Such universities would in all likelihood be quick to react to changes in the number of applicants, and the prices of those goods and services used by a university to reach its objectives. As these variables change, they would be ready, perhaps even quick to change their objectives as well as the way in which they go about reaching their objectives. The university would possibly be a more vibrant, dynamic institution that it is today.

But the important question, the question that the people in Lansing, Springfield, Harrisburg, Columbus, and Washington D.C. must ask is: in taking a more entrepreneurial approach to their operations, will universities be maximizing their contribution to "social welfare?" Now, social welfare is a very arcane concept that economists have a very peculiar view of, peculiar in the sense that our perspective here is not the perspective that others take. I haven't the time, and don't believe that this is the place to expound on this view. Suffice it to say that economists argue that public policy should induce firms, households, and all other participants in the economy to act in a way that will maximize social welfare.

And so when we are considering a reorientation of the academy, we need to think about whether or not that reorientation will increase social welfare. If people are thinking about running universities like businesses, we should be asking: is this going to increase the contribution of the university system to social welfare? Well, let's confine our attention to the application of market principles to university management. Would this increase social welfare or not?

If you've listened much to what economists say, you may have the impression that economists have a great deal of faith in the power of markets. You may have that impression because they do. But what "power?" And the answer to this question is: power to allocate resources and set the prices of goods and services so that social welfare is maximized. However, in that mystical rapture that they often fall into when contemplating this power, economists often forget that not all markets are capable of doing this! Only what is known as a "competitive" market will do this, and then only if certain conditions are met.

But I think that the undeniable truth is this: competition is nothing more than a theoretical construct. So, if the market for education is not competitive - and it is unlikely that it is and ever will be - adopting market principles to chart the course of the academy is not necessarily going to result in an increase in social welfare. It may, but it could very well cause social welfare to decrease.

This then, in operational terms, is the question that policy makers need to ask: will restructuring higher education - giving university presidents the freedom to turn their universities into "businesses" whatever that may mean and entail - will this initiative produce benefits outweighing the costs that will have to be incurred to bring about that restructuring? There is no reason to believe that a system of state colleges and universities, each pursuing self-interest however defined; each competing with the others for students and scarce resources; and each mechanically reacting to the markets which relate to its operations, will produce a greater net benefit to society than a system comprised of colleges and universities whose programs and

initiatives are coordinated for the explicit purpose of maximizing the net social benefit from higher education.

The challenge that those concerned about the new perspectives being considered by university administrators is to convince those able to influence the direction in which higher education will move to adopt this criterion. And though the sort of analysis that I'm promoting here is easier described and defended than done, I would maintain that rough estimates of social benefits and costs can be made and will at least help to inform and frame our thinking about this important subject.

Now, having addressed the normative question that any restructuring of the academy raises, I want to turn to a positive question. Namely, what impact would a market orientation of the academy have on the economic status of the professoriate? I'm afraid that any prediction of the effect of such a change in outlook would be little more than speculation. But I think that no harm can come from thinking about possibilities.

The possibilities that I intend to concentrate on are those which we would have to confront if administrators began looking at faculty in the same way that profit seeking businesses look at their employees. The story that economists like to tell is this. A prospective employer would be willing to bid a prospective employee's salary and benefit package up to the point where the employer is indifferent to hiring the individual or not. As an illustration consider a law firm that could bill an additional 2000 hours in the upcoming fiscal year at the rate of \$100 an hour if it added a lawyer. Let's suppose that the expenditure on support - secretarial and clerical help and so forth - for a lawyer billing that many hours would be \$40,000. What is the maximum amount that this firm would pay a lawyer in salary and benefits to do this work? The answer is obvious: no more than \$160,000. Hence, if the firm has to bid on prospective employees, it would not enter a bid over \$160,000. This is the way that economists believe that profit-seeking businesses look at employment decisions. Well, what if a college or university looks at it the same way? The first question that would have to be addressed is: what would the dollar value of the output from a prospective faculty member be? This is certainly not a number that is easy to calculate. A professor teaches, helps in the administration of her department and the university, and engages in research. In my opinion, it is impossible to place a dollar value on some of the tasks that faculty perform. However, I emphasize the word "some," since it is quite easy to place a dollar value on part of the work that faculty do.

After all, while a law firm bills clients for hours that its staff devotes to their cases, the university bills students for the hours that professors spend teaching them. Therefore, in my opinion, placing a lower bound on the value of a particular faculty's output is a straightforward and simple job: add up the tuition and fees that his students pay. You can admit students, register them, organize entertainment for them, and do all the other things that the administration does for students. But you can only collect tuition from them if they are taught.

I think it is only somewhat more challenging to determine the value of the administrative work done by faculty. In this case, we merely need to figure out how much would have to be spent to have administrators to perform the administrative duties being performed by faculty. And so by adding this amount to tuition and fees, we have accounted for much of what faculty do.

Of course, faculty also engage in research. However, this research is not bought and sold. Faculty do not carry out research projects which the university administration then shops around. Even funded research is not bought and sold. The funding agency merely agrees to pay the cost

of carrying out the funded project. There simply is no market for this output and consequently, it is very hard to place a dollar value on any research conducted by university and college faculty. This is not to say that it is impossible to do this. It is just extremely difficult. And certainly substantially more difficult to do than it is to place a dollar value on the number of hours a faculty member spends teaching classes.

Now, with these observations before us, let's think about how faculty salaries might be affected if administrations based personnel decisions on the impact of those decisions on revenues and costs. I think that in all likelihood, there would be winners and losers from such an orientation. That is, this would lead to higher salaries and more perquisites for some faculty and lower salaries and fewer perquisites for others. More specifically, it would seem that those willing to teach more and bigger classes would be likely to earn more if university administrations begin thinking about personnel like profit-oriented organizations think about personnel. Likewise, those who are willing and able to do supported research would see their salaries rise. Everyone else would be likely to suffer some financial loss.

Whatever the impact of a more entrepreneurial approach to university administration on faculty salaries and benefits, the important question is still the normative question raised by such a change in outlook. By themselves, these changes in compensation are neither necessarily good nor necessarily bad. If because of changes in the way in which their university is managed, one professor's income falls while that of another rises, it is impossible to say if the change in management is for better or worse. Personally, I think that it would be a good thing to reward people more generously for teaching. After all, teaching is the foundation of academia and sometimes it seems that universities are more inclined to reward mediocre research than good teaching.

In any event, there is the likelihood that good and important research would come to mean externally funded research. And this bothers me. Undoubtedly faculty would change their research agendas if they are rewarded for doing funded research. But this could very well make the academy a much less creative place than it historically has been. Certainly, this would be a great loss, since as a center of creative thinking, the academy has few rivals. Thus, the de-emphasis of creative thinking that could possibly follow a change in thinking about how a university should be managed is perhaps the greatest cost that this change would impose on society. Of course it is difficult to quantify that loss. Nonetheless, an inability to determine what that loss amounts to does not mean that it should be ignored in any thoughtful, objective evaluation of alternative paradigms.

There is no fault in keeping an eye on how university revenues and costs are changing over time; or in thinking about how new revenues could be generated and costs curtailed. But there is a danger in making expanded revenues and lower costs ends in themselves. There may be benefits from a more fiscally sound academy, but there would also be costs. Both need to be weighed to determine if an entrepreneurial approach to university management and administration should be encouraged, however difficult that may be to do. Thank you.