



# Potential of For-Profit Schools for Educational Reform

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**Abstract.** The rise of a for-profit industry in elementary and secondary schools is a relatively recent phenomenon in American education. In the past, a small number of independent schools – probably 2 percent or less – were for-profit endeavors, usually owned by a family or a small group of educators. However, over the last decade a group of for-profit firms has emerged with the goal of managing public schools on a contract basis. These firms have established contracts with both charter schools and public school districts. In exchange for a per-student fee (often the average per-student expenditure in a district or the amount of charter school reimbursement from the state), they will manage both the logistical and instructional aspects of the school. These firms can be analyzed according to their ability: (1) to be adequately profitable to attract capital; and (2) to improve education and initiate reforms in their schools, and stimulate reform in other schools that face competition from them or wish to emulate them. This paper suggests that the ability of EMOs (Educational Management Organizations) to be profitable is, at best, problematic. Although spokespersons for almost all EMOs suggest that it is only a matter of gaining more schools to reach economies of scale, the evidence on scale economies in education is at odds with this claim. A combination of high cost structures at central headquarters and the need for major marketing activities are also major challenges. In addition, education is a much tougher business than many of the EMOs anticipated because of the many-layers of political scrutiny and the ability of charter school sponsors and school districts to cancel term contracts after relative short periods. On the basis of existing evidence we have not yet seen substantial innovation in instruction by for-profit EMOs, although we have seen some logistical advantages in school organization. Evidence on educational outcomes is also mixed. This paper concludes with the view that for-profit EMOs are less promising than potential other forms of for-profit endeavors in education.

**Keywords:** for-profit schools, education reform, educational privatization, school efficiency.

## 1. Introduction

Private schools preceded public schools in American history. Although schooling was often a cottage industry in colonial times in which an adult might provide tutoring for a fee to one or more students in a household, private schools as organized institutions were not designed to yield profits. School

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organizations were likely to be church-affiliated and dedicated to particular educational, philosophical, and religious values. Only at the beginning of the nineteenth century do we see the rise of what was ultimately to be called the common or public school as each of the states adopted education as a constitutional responsibility.

Towards the end of the nineteenth century, a system of Catholic schools was established to shield Catholic students from the Protestant bias found in public schools and to provide religious instruction (Tyack 1974: 84-86). In terms of sheer numbers of schools and enrollments, the Catholic schools soon outnumbered the other independent schools in enrollments, as they do today. At the same time, public schooling continued to expand, and by the turn of the twentieth century almost all states had compulsory attendance laws. A major controversy arose over whether independent or private schools could meet compulsory attendance requirements. This issue was resolved by the U.S. Supreme Court in 1925 in *Pierce vs Society of Sisters* which declared that compulsory schooling laws could be met in any independent school approved by the state.

What is notable in this brief historical flow is the absence of a significant presence of for-profit schools in the development of the U.S. educational system. This raises the question of whether there is something about education that does not lend itself well to for-profit operations (Levin 2001). There are undoubtedly a relatively small number of family-run schools or those operated by individuals or partnerships that provide a living to these families or individuals. However, even these are not common, and there is little evidence of substantial returns on investment. In general, long hours and constant attention to a specific clientele seem to be needed to make these schools succeed, an experience that is also common in privately-run pre-schools.

The last decade has seen the rise of for-profit companies in elementary and secondary education, but few of them own schools. Rather, they have established businesses for contracting with school districts or charter schools to operate their schools, functioning as educational management organizations or EMO's. These schools continue to function as public schools even though they are run by private contractors. Charter schools are a relatively recent phenomenon (Cookson & Berger 2002; Finn, Manno, & Vanourek 2000; Murphy & Shiffman 2002). Such schools are given both specified public funding and dispensation from most state and local rules and regulations in order to provide greater autonomy in operations. In order to qualify as a charter school they must tender an application to the charter school authorities in their state (typically school districts, universities, or state departments of education) with a clear purpose (charter) that they will address and the enrollment objectives, organization, staffing, and provisions for financial accountability. Many groups establishing charter schools have had little or no experience in operating schools, so they have sought assistance. Thus, it is

hardly a surprise that the growth of EMOs has followed closely the growth of charter schools in the U.S., of which there are about 2,400 in 2002 in 37 states and the District of Columbia enrolling some 600,000 students.<sup>2</sup> Most charter schools are “start-ups”, that is newly established schools; but some are conversions of existing public schools to charter status. Reinforcing this link, charter schools also turn to EMOs because charter funding structures tend to disadvantage schools that do not have access to capital funds. EMOs may provide access to start-up capital.

In addition, EMOs have been active in contracting with school districts to operate specific schools within those districts, usually schools with poor educational results and many challenges. The district provides a specified amount of funding, often a generous arrangement for the EMO relative to the funding provided to comparable schools operated by the district.<sup>3</sup> In some cases the EMOs have been able to get additional funding from philanthropic organizations because of their commitment to school reform. One advantage of contracting directly with school districts is the availability of a school facility, an advantage also conferred upon some charter school conversions. In contrast, the establishment of new charter schools requires a search for and financing of a proper facility – and many states do not provide funding or adequate funding to pay for charter school facilities.

It is appropriate to examine whether for-profit EMOs have the potential to reform public education. To answer that question one must ask two further questions. First, can EMOs succeed as a business, and under what conditions? Second, are EMOs likely to stimulate changes in elementary and secondary schools that will improve educational outcomes. Clearly, if EMOs are not adequately profitable, they are unlikely to have an educational impact in the long run. Even if they prosper, the next question is whether they will change education through innovation and competition.

## **2. Can For-Profit EMOs Be Profitable?**

It is useful to begin by setting out the early expectations of both the founders of EMOs and the investment community as to why this looked like a promising opportunity. In the early 1990s, the climate for privatizing public services had been well-established. The Reagan and Bush administrations had criticized government as the problem rather than the solution and had praised the private

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2. The Center for Educational Reform provides a continuous update of schools and enrollments. See <http://www.edreform.com>.

3. A common arrangement is to provide the average per-student expenditure of the district even though the district average includes services not provided by the contracted school. See Levin (1998: 383-384) and Miron & Nelson (2002: 62-68) on the cost accounting issues when comparing the costs of public versus private schools.

sector, deregulation, and tax reduction as the solution to inadequate public services. The Clinton and Gore administration followed up this appeal with a variety of approaches to Reinventing Government, including privatization of government services and continued support for privatization of health care through Health Maintenance Organizations (HMOs).

The specific appeal to the investment community for privatizing elementary and secondary education was a sector spending almost one billion dollars a day, the largest government sector that had been untouched by privatization. Wall Street firms went to their investment communities with glossy presentations showing declines in test scores, poor test results relative to those in other countries, rising educational expenditure, and particular educational challenges in the inner cities (e.g. Merrill Lynch, 1999). Many of these critiques were overstated, and the causes of the shortcomings were overly-simplified as being the fruits of leaving education to government bureaucracies. In short, it was asserted that funding was spent inefficiently with too little being allocated to classrooms and too much to central administrative headquarters of school districts. Educational specialists in the investment industry argued that if the education sector were privatized, its performance would rise, and the returns to investors would be substantial because of the enormous gains in efficiency. Indeed, such investments were referred to as opportunities to do well (high returns) by doing good (improving education), so they were both economically and morally justified.

This wave of justification for privatization had one major down-side. Few of those who decided to enter the business of education had studied carefully the economics or politics of education. They failed to look carefully at resource allocation in existing public schools and its underlying justification, primarily in the belief that whatever was being done was highly inefficient and could be easily improved by the private sector. They assumed that there were large economies of scale in running schools so that profitability would be an increasing function of size of firm and the numbers of schools managed. They did not understand the politics of education and the fact that when public dollars are financing the enterprise it cannot be separated from political decision-making. At a time when large fortunes were made on selling possibilities and dreams, due-diligence was in short supply in the new economy.

What they did not realize is: (1) education is a tough business because it is regulated, monitored, and subject to the demands of multiple audiences and layers of government on the basis of public funding; (2) EMOs are challenged by high marketing costs that public schools do not face; (3) relatively short-term contracts (3-5 years) have their own risks in amortizing investments at school sites – whether the EMO does well or poorly; (4) the economies of scale that were anticipated do not exist; and (5) one size does not fit all, creating a

challenge for a uniform educational model, quality control from afar, and the establishment of national and regional brands.

### **3. Education is a Tough Business**

Ideally, a business would like to provide a concrete product or service with as few restrictions as possible and delivered under stable conditions to a predictable clientele. Risk, change, and uncertainty are unwelcome and require a premium in returns. As Cyrus Driver has found in applying contract theory to school administration, education is characterized by multiple goals and authorities with constant shifts in the relative importance among each as political, demographic, and social trends intervene. Multiple goals include establishing schools as safe and disciplined environments accommodating a wide variety of student needs, ranging from those of gifted students to those of handicapped students. Goals include developing student skills in a multitude of subjects including reading, writing, speaking, mathematics, science, social studies, art, foreign languages, and physical capacities. They also include development of creativity, character (such as respect, honesty, judgment, and persistence), problem-solving, personal health and hygiene, patriotism, and citizenship. From the standpoint of a productive enterprise, this is a complicated production process because it is one in which many “products” must be produced simultaneously and with limited resources that require continuous tradeoffs among goals. Furthermore, student capabilities, motivations, and goals have a profound influence on educational outcomes, factors that are often beyond the control of schools.

Schools are subject to the interventions and pressures of three government bodies and the demands of their clientele. For example, contracted schools within school districts are governed by federal, state, and local laws, regulations, and policies. These strictures and guidelines are voluminous and often difficult to interpret or understand because of their multitudinous details and complexity. The recently passed federal law, No Child Left Behind, is more than one thousand pages, a single law among tens of thousands. It will be translated into concrete procedures and regulations by federal agencies for transmission to the states; each state will interpret these details and apply them to local districts, providing hundreds of new regulations and thousands of pages of interpretation for school authorities. Definitions of allowable achievement tests, testing frequency and procedures, and the consequences of tests for students and schools will be determined for all schools including charter schools. Three levels of government monitor contract schools in each district. State chartering agencies monitor charter schools according to federal regulations and to those state regulations that have not been relaxed.

In addition, the clientele and potential clientele for these schools provide pressure in a variety of ways. For charter schools, families have the prerogative of choice and will leave if they believe that the charter school has not delivered what they want. In addition, they have access to the charter school board, charter school director, and individual staff to press for the types of services they want for their children. Schools contracting with EMOs within school districts face similar pressures from parents and through the various governing mechanisms. Finally, teacher and other professional organizations often set restrictions on hiring and working conditions based upon either their collective bargaining agreements or their political power.

The result of all of the government regulation and scrutiny and that of the choice options and demands of clientele is that the EMO is subject to competing pressures and changes from many sides, with little stability over time. It must somehow find a way to balance a large number of competing claims, a phenomenon that does not lend itself well to a standard schooling process that will allow substantial uniformity across different sites. Yet, most of the EMOs seek to establish national and regional brands that promote a uniform model, one that is highly consistent from site-to-site and confers a brand image.

#### **4. Marketing and Contracting Costs**

EMO's face costs that do not have to be borne by local school districts. The most important are the marketing costs that are required to attract and sign charter schools and districts to contracts. Not only are the EMOs competing against other EMOs, but there is overall resistance by many citizens and educators to delegating schools to for-profit management. To many, the disagreement is fundamental, the view that profits will come from squeezing services rather than from greater efficiency. They believe that such schools have incentives to select students who will be least problematic and require few services outside of routinized instruction, leaving the more costly student needs to the regular public schools. The result is that EMOs must engage in substantial promotion and marketing activities, from advertising to participating in the regional and national conventions of education associations, and also to direct marketing of the EMO concept and services to school districts. The last of these may consist of direct appeals to administrators and school boards through expensive retreats at which the potential decision-makers are provided with luxury accommodations, meals, and entertainment, as well as presentations by the sponsoring EMO.

Marketing activity requires substantial personnel who solicit school districts and potential charter school organizers or even offer to do all of the preparation of applying for charter school status. For every contract that is

obtained, the EMO may have to solicit intensively among a much larger number of potential districts or charter school sponsors. Even when there is overall agreement on establishing a contractual relation, the details must be worked out by lawyers, accountants, and business executives on the EMO staff to assure that the EMO obtains a beneficial contract. Both the marketing and contracting costs must be funded ultimately from the operational revenues received from states or school districts, excess expenses that are not intrinsic to school districts that operate their own schools.

## **5. Short-Term Contracts**

Typical contracts between EMOs and charter schools or school districts are only three to five years. This means that overhead costs for establishing the contract and gearing up to operate the school must be amortized over a relatively short period of time, especially given the risks of contract non-renewal. Contracts may not be renewed for poor performance, and many argue that it takes at least five years to turn around a failing school or to get a new charter school on its feet. This means that the EMO risks losing contracts before it can amortize appropriately its start-up expenses. But, the situation is also precarious if the EMO succeeds. It is clear that districts seek for-profit EMOs to operate schools that are dysfunctional and performing poorly, not its better schools. Often these dysfunctional schools have poor leadership, unqualified teachers, disruptive students, high pupil mobility, and community factionalism. If the EMO is able to turn around the school in five years to make it functional, the school district may have an incentive to take the school back into its own operational fold.<sup>4</sup>

## **6. Elusive Economies of Scale**

Among the most seriously erroneous assumptions built into the business models was that there are substantial economies of scale in education (e.g. Chubb 2001). The thinking seemed to go something like this. The establishment of a for-profit company will entail a large fixed expenditure for addressing all of the above issues and more. But, the amount that will be received for each student will allow a fairly large surplus of revenues over costs for operations at the school site. The logic seemed to be that there is considerable waste at the school site in conventional public schools, although where substantial savings might be made was never specifically identified. As

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4. There is some evidence of this phenomenon in the recent announcement by the charter school's board that it would take over the Renaissance School from Edison Schools.

in the appeals to investors, the assumption of greater efficiency of the private sector was used to justify this claim. In order to offset the high fixed costs of a central headquarters, it was only necessary to contract with enough schools. In this way the high fixed costs would be spread over enough schools that a net profit would be generated from school operations.

This meant that the high costs of getting started and establishing EMOs were to be expected, with attendant losses over the early period, and it justified large amounts of investment capital prior to profitability. But, the business model suffered from one major flaw. Not only had no one demonstrated the economies of scale that were counted on, but the economics of education literature finds that economies of scale set in at fairly low enrollments at both school sites and in school districts. Many EMOs have already expanded far beyond the most efficient scale in terms of enrollments. The reason is that schools have very high variable costs. Each new school requires a facility; administrators, teaching and support staff; equipment and supplies; maintenance; utilities; and other resources. Since schools are labor intensive, virtually the only way to reduce costs substantially is to use lower-cost staffing and labor-saving technology. But, teachers and educational administrators are not highly paid relative to their responsibilities and to other professional groups, so savings are limited by a restrictive teacher supply at lower remuneration. Further, parents and state regulations oppose cutting back educational qualifications to substitute less-skilled labor for professionals. And, educational technology has historically represented added cost at school sites – without assurance of educational benefits – rather than a guaranteed strategy for capital-labor substitution (Cuban 2001).

To reduce costs at school sites, the EMOs have pursued three strategies. The first is to try to save costs by hiring less experienced teachers. The problem with this strategy is that younger teachers are more likely to leave to start families, return to college, seek better positions, or accommodate changes in the career of a spouse. This turnover creates additional costs for recruitment and training, and these may offset completely the salary advantage. The second is to use standard operating<sup>5</sup> procedures and low-cost educational strategies that minimize the need for ancillary personnel and provide a bare-bones pedagogy in which all teachers follow a standard script of instruction at each grade level. This approach also has costs in terms of mobility of teachers who seek more creative opportunities, as well as the further challenge that one approach may not fit all students at all sites. In addition, such approaches with

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5. In the latest review of the evidence on economies of scale, the authors conclude that: “Sizable potential cost savings may exist by moving from a very small district (500 or less pupils) to a district with ca 2000-4000 pupils, both in instructional and administrative costs. Per pupil costs may continue to decline slightly until an enrollment of roughly 6,000, when diseconomies of scale start to set in (Andrews, Duncombe, and Yinger 2002):255”.



their emphasis on basic skills may not be appropriate to the increasing sophistication of tests to measure higher order skills and creativity.

The third strategy for reducing costs is to recruit and retain students who are least demanding in terms of resources. It is no surprise that most EMOs do not accommodate moderate or severely handicapped students, but they can also discourage students with even modest behavioral problems or learning needs. Or they can maintain strict requirements on parental participation, discouraging single parent families and those who face difficulties in taking on additional responsibilities. Strict discipline policies can be used to suspend or expel disruptive students. In the long run scrutiny by local and state education agencies and by communities will create resistance to these policies as well as undermining public relations.

Overall, the strategy of large-scale expansion before becoming profitable is not a promising one, based upon three decades of research on economies of scale. The most recent summary of research on the topic (Andrews, Duncombe, and Younger 2002) finds that the lowest average cost per student is reached with a school district enrolling about 6,000 students. The largest of the EMOs, Edison Schools had about 130 schools and 75,000 students in the Spring of 2002. Yet it suffered \$ 17 million in losses in its most recent quarter (March 31, 2002) and cumulative losses since its founding in the early nineties of about \$ 200 million. It continued to premise its future on a large expansion that would provide profitability based upon economies of scale, as have other EMOs. Yet, its present size is more than ten times the estimated size for an efficient school district. Moreover, there is considerable evidence that the average cost per student of larger districts rise considerably as supervision, monitoring, and communication become less efficient and require more personnel relative to enrollments. Even this evidence refers to a single school district. When one considers the long supply and communication lines when schools are spread over many districts and large regions, the added costs of maintaining such a large network are even higher than when concentrated in a single school district.

## **7. A Uniform Product**

The business plans of the EMOs push for a uniform educational product across their school sites for several reasons. First, they seek to control costs by standardizing their use of curriculum, pedagogy, and school inputs. A standard approach provides several advantages. First, it means that the procedures for establishing and operating schools, selecting and training personnel, and purchasing equipment and supplies can be routinized and made uniform throughout the enterprise and the school network that it sponsors. Personnel can be shifted among sites almost without disruption because of their

commitment to and familiarity with a single operation. Moreover, to the degree that it obtains a common set of equipment and supplies for each school, it can benefit from competitive bidding and discounts for large purchases (even though such cost savings will be a modest part of the overall cost structure). Second, the uniformity of the educational product contributes to the notion of a recognized brand of education for a particular company. With national or regional aspirations, each EMO seeks to establish brand identity based upon product differentiation.

But, educational needs can differ immensely from one community to another. In some cases a majority of students are immigrants speaking a first language that is not English. Differences in home backgrounds, handicaps, giftedness, ethnicity, poverty, and cultures can create large variance in the types of educational programs and materials that will benefit particular groups of students. Differences in local customs with respect to educational organization can also be important. The states and school districts also set different criteria among subjects to be taught and tested, so adjustments must be made to meet these “standards”. Further, demographic characteristics of students and educational content standards and testing programs change over time, sometimes very rapidly. All of these factors contradict the assumption that a standard model, representing a branded approach that changes little from site-to-site or over-time, is a sound business goal.

## **8. A Viable Business Model**

It is highly dubious that the business model that has been pursued by many of the EMOs is viable economically. It appears that it is based more upon generic assumptions of greater business efficiency than a careful study of the specific features of school operations. Virtually all of these assumptions violate what is known about the economics and politics of schools. Schools must deal with multiple governments with conflicting priorities and constantly shifting objectives rather than a stable business context. EMOs face large costs of marketing and promotion and costs of contracting that do not seem to have been anticipated. The relatively short-term contracts that the EMOs are able to obtain do not allow sufficient time to amortize investments at school sites if contract renewals are not forthcoming. The substantial economies of scale that were anticipated in operations are illusory. And, the notion of a uniform model that can be implanted anywhere under a specific EMO brand does not comport with the reality of the different educational conditions encountered.

Although several of the EMOs have tried to make some adaptation over time, most have held to models largely based upon these fallacious assumptions. The result is that large operating losses have been continuing, and several have been unable to get continuous access to capital to finance

their operations and cover their losses (e.g. Advantage Schools, Learn Now, Tesseract/EAI) and have gone out of business or merged with others. At this point the viability of the predominant model for privatizing schools, that of the EMO, seems highly dubious.<sup>6</sup>

It is difficult to attribute these poor results to inadequate financial remuneration. In the case of charter schools the EMOs are working with contracts based upon the same remuneration as the non-EMO charter schools, where most of the latter are able to succeed. Moreover, some of the charter schools using EMOs have been very successful in obtaining philanthropic contributions, as have some of the EMOs directly. Further, a common practice of the EMOs with respect to contracts with districts is to obtain a contract based upon a full share of the average per-student expenditure.<sup>7</sup> But, most of the contract schools do not provide the full range of central office services that the district must carry. Moreover, the contract schools are typically at the less-expensive elementary level rather than the more resource intensive secondary level; and the contract schools and charter schools operated by EMO's enroll few of the costly special education students, the moderately and severely handicapped. Thus, the contractual payments typically exceed what a comparable district school receives in resources.

## **9. Do EMOs Contribute to Educational Reform?**

Even if the existing business models of the EMOs do not suggest economic viability, one can still examine their educational approaches to ask if they contribute to educational reform. There are two paths by which EMOs could stimulate educational reform. The first is to operate schools that make organizational or pedagogical breakthroughs that might lead to their success and to emulation by public schools. The second is to create competition between EMOs and public schools that will stimulate public schools to improve their operations. It is also possible that just the potential threat of EMOs, as opposed to direct competition, will spur the public schools to be more responsive to their clientele.

No careful survey has been made of the strategies of the EMOs, but descriptions of their approaches are found in promotional materials. In addition, there have been studies of particular schools (e.g. Miron & Nelson

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6. There is a great deal of focus on when EMOs might reach the break-even point as if that is the criterion of success. But, the real issue is whether they can earn a substantial return on capital that will be competitive with other investment opportunities.
  7. For a discussion of how to compare costs and the findings that suggest greater largesse received by EMOs than comparable school sites, see Miron and Nelson (2002: 62-68). For cost comparisons in Baltimore under an EMO that operated nine schools, see Richards, Shore, & Sawicky (1996: Chap. 2).

2002). I have also visited a small number. So, what follows is based upon a variety of sources, but not a systematic survey.

## **10. Pedagogical Approaches**

There is little evidence of major new pedagogical approaches practiced by EMOs. Many EMOs emphasize a back-to-basics approach that is heavy on traditional drill and practice or what is called direct instruction. There are at least three reasons for reliance on this traditional approach. The first is that there is at least some evidence that direct instruction provides achievement gains in basic skills. Second, many school districts that are contracting with EMOs or charter schools are seeking traditional approaches and test score gains in basic skills. And, third, this approach keeps down costs for the EMOs because it is truly a no-frills method without enrichment and often with minimal instruction in the arts or areas outside of basic skills. The Edison Schools, the largest of the EMOs, rely largely upon standard curricula that can be purchased by any school district, although it has developed some applications for its technology and has incorporated other subjects. Edison relies heavily on a combination of direct instruction and broader approaches. Many of the other EMOs rely upon a “cookie-cutter” approach to the 3 Rs (Miron & Nelson 2002).

Without question there is no evidence of “revolutionary” breakthroughs by EMOs with respect to curriculum, instructional strategies, or use of technologies. Virtually every aspect of their pedagogical approaches can be found somewhere in existing public schools, and, in many cases, in a large number of public schools. Perhaps it is too early to expect these kinds of innovations or the funding is not adequate to create the incentives and development that are needed.<sup>8</sup>

## **11. Personnel and Organization**

In the areas of personnel and organization, one finds definite departures from many existing public schools. In particular, many of the EMOs seem to do a more systematic job than the average public school in creating an overall system of personnel selection and training and curriculum consistency across the entire school. According to my observations and inquiries, the EMOs place more effort on selecting their school-site administrators and teaching personnel and evaluating both. In some cases they also provide more training

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8. Brown (1992) provides an economic analysis of why private schools deviate so little from public schools in their basic features.

and greater performance incentives. There is greater focus on accountability of site administrators and school staff through sanctions and rewards. The EMOs view schools as a system to a greater degree than I have seen in public schools where the pieces often lack coordination and “new” approaches are adopted helter-skelter.

This difference is especially notable in some of the inner-city environments where traditional public schools are chaotic with high teacher and administrator turnover, high student mobility, frequent shifts in curriculum approaches and pedagogies, uncoordinated staff development, and haphazard use of educational technologies. Even the appearance of the facility is unkempt and in need of repairs and renovations. In contrast the EMOs have a good record of attempting to select staff and immerse them in a more systematic pedagogical approach with articulation from grade to grade. Staff are evaluated on their success in implementing the curriculum and pedagogy and on student success, to the degree that it is possible to measure the latter.

Perhaps the greatest visible strength is the ability to of EMOs to accomplish the logistics of school maintenance. In many cases, the EMOs are able to physically transform school facilities that have been unsightly, damaged, and compromised for years. Facilities are painted and repaired, and custodial work is taken seriously. School appearance does not necessarily improve test scores, but it is an important symbol of how seriously the school authorities value educating the local population. The EMOs seem to have a major advantage in this area relative to the standard district administration.

## **12. Do EMOs Outperform Conventional Schools?**

At this time there is little rigorous evidence comparing EMOs with comparable conventional schools. Some EMOs have reported superior results, but without the documentation required to substantiate the claims. Typically, they have reported that test scores have risen in most of their schools, but the specifics of which tests, how tests were administered, and which students were included is not given. Moreover, public schools have also raised tests in this new era of “standards” and high stakes testing and reporting in the public schools - in many cases, concentrating on test preparation rather than learning. So, the real issue is whether the test scores have risen in EMO schools at a faster rate than in comparable public schools when test scores are viewed as the currency of the realm.

Gary Miron and colleagues have done two studies that attempt to provide preliminary answers to this question. In their study of early Edison schools, they found about the same pattern in test scores between Edison schools and matched public schools (Miron & Applegate 2000). In their study of Michigan EMOs they found that the non-EMO, charter schools outscored those operated

by EMOs (Miron & Nelson 2002: 143-145). Test scores are not the only indicators of success with respect to school reform, but there is even less evidence on other indicators.

### **13. Do EMOs Spur Competition?**

Even if EMOs do not directly create breakthroughs in educational practices and results, they do offer an additional alternative to parents. Moreover, they may also spur competition with public schools and non-EMO charter schools by creating a more competitive environment. It is possible that they spur competition and improved results for the educational system, although there is no direct evidence on this matter. Hess (2002) has found that with more intense concentrations of charter schools and other alternatives, there is at least some emulation by the public schools of practices that may attract students. But, the overall results are fairly nominal, what Hess calls “revolution at the margins”. In an analytic review of almost 40 econometric studies of competition, Belfield and Levin (2001) found modest effects (about a .1 standard deviation improvement in achievement for a one standard deviation increase in options). This improvement is comparable to about 10 points on the verbal Scholastic Aptitude Test (SAT), not a significant amount. Direct studies of the competitive effects of EMOs on student achievement or other outcomes are not available.

### **14. What Has Been Learned?**

What has been learned in this first decade of for-profit EMOs? What we have learned is that contrary to the facile claims of their investment promoters, privatizing of operations of public schools is not a business that is easily convertible to profitability. Whatever the flaws of existing public school management and its poor performance in many urban areas, it does not appear that privatization, alone, is an effective answer. For-profit EMOs have generally not been profitable, nor is there evidence of breakthroughs in educational results. And, there is virtually no evidence that the quest for larger and larger numbers of schools will solve the dilemma through economies of scale.

This does not mean that for-profit EMOs or for-profit firms in elementary and secondary education will always fail to succeed. What it does mean is that the present model is unlikely to be the answer. In the spirit of experimentation, there are a number of directions that might be more promising:

- Smaller firms with a few schools are more consistent with the literature on economies of scale in education. Schools can be more easily managed and adapted to local conditions and can focus on improving effectiveness in a world of high variable costs. The single, for-profit school may hold promise for those committed to educational entrepreneurship. Close monitoring of costs and the needs of clientele are essential to make a profit in this challenging industry. It may also be possible for this type of endeavor to expand modestly with careful oversight.
- In the case of multiple schools, cost controls for central administration are important. The claims of some EMOs were that they could do a better job educationally at lower cost by avoiding the “waste” of central administration in public schools. The paradox is that their costs are considerably higher because of generous staffing, salaries, and benefits in their central headquarters – with stringent cost controls at school sites. Multiple-school companies will need to reverse this priority. Even so, it is not clear that a company can provide a unified brand of education over a large number of schools and school sites. Greater flexibility in school-site operations is required to adapt to different needs and contexts - while focusing the brand identification on goals and concepts rather than the uniformity of operations.
- Containing marketing and promotional costs is crucial. One strategy is to create outstanding demonstration schools, and to recruit new schools on the basis of demonstrated performance at existing ones. This strategy would call for a slower expansion, but one in which marketing costs could be reduced and a learning curve could be used more beneficially to improve operations.
- In the case of EMOs it is important to seek longer contracts, if possible, perhaps with performance benchmarks for each year on which payments will be based. The contract should be long enough to amortize fixed costs of starting-up at a site while providing reasonable assurance of completing the contract. In some cases the EMO might set its costs on the promise of a “turnkey” operation in which a dysfunctional school is returned to the district as a functional one - with certain performance criteria and incentives.
- Following successes in higher education, it is possible that the highest returns will be in niche markets. This has been the case in higher education where such firms as Apollo and its University of

Phoenix division have targeted older and fully employed workers providing conveniences such as parking and child care, modular courses of a standardized nature, practitioner teachers from the community at low cost, placement, and an ambitious approach to evaluation and quality control. DeVry has developed a profitable, niche market in providing preparation for technological careers. In both cases the niche consists of filling the needs of a specific clientele that is presently underserved, in a way that is attentive to costs and results. It is not an attempt to compete with conventional higher education. This fact alone reduces the political opposition that can be very costly to overcome by those attempting for-profit incursions into mainstream, public services.

- Niche markets can include special education where for-profit institutions have been successful historically. They can also include other groups of very high cost and at-risk students such as dropouts who are induced to return to school. But, in addition, they can include areas that are already profitable to some providers such as professional development, after-school services, counseling, administrative support (e.g. payroll, insurance, maintenance), and professional support services such as provision of curriculum, case studies, and software as some e-learning companies are doing. While these may sound less ambitious and less promising economically because they do not replace public schools, they can be highly profitable.

Two facts should give pause to those who believe that it will be easy to create a large for-profit network of EMO schools. The first is the dearth of for-profit schools that have entered the market historically among independent schools. This is probably less a matter of ignorance on the option of for-profit operation than of careful analysis. Elite private schools in the major metropolitan areas charge tuitions that are greater than \$ 20,000 a year, two to three times what is spent for each pupil in the surrounding public schools. Yet, the for-profit sector has not been able to show a presence. Further, in addition to tuition, almost all independent schools engage in considerable fund-raising, with the highest tuition schools raising the most additional funding. (The same is found for private universities). Why haven't for-profit schools broken into this potential market in significant numbers to show what can be done with market incentives? This is worth contemplating by those who see large profits in operating or owning elementary and secondary schools.

Finally, this analysis is premised on existing methods of financing education. It is not clear how it might change if educational vouchers or tuition tax credits were to become widespread. My intuition tells me that a large



enterprise with multiple schools would remain problematic. Certainly, this is the lesson to be learned from countries that have large for-profit sectors in elementary and secondary education such as Chile and the Asian countries with large numbers of for-profit schools.<sup>9</sup> To my knowledge, no corporate entity has become a major factor in private education in those countries.

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9. For Chile see Carnoy & McEwan (2001).

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