On Being Market Smart and Mission Centered

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Author's note: This keynote address draws from and extends perspectives first developed in Robert Zemsky's "On Classifying Universities: Policy, Function and Market", in Luc E. Weber and James J. Duderstadt, editors, Reinventing the Research University (2004) and in Robert Zemsky, Gregory R. Wegner, and William Massy's, Remaking the American University: Market Smart and Mission Centered (2005), particularly Chapter 4 "On Being Market Smart and Mission Centered." I am particularly grateful to my colleague Bill Massy who developed the non-profit mode that informs the last half of this address.

For nearly a decade now the American correspondent Tom Friedman has dominated the market for depictions of how globalism transforms nations by altering their pursuit of power and advantage. First in *The Lexus and the Olive Tree* (1999) and more recently in *The World is Flat* (2005), Friedman has supplied concept and prescription, telling stories that are easy to remember and drawing lessons that are all but impossible to ignore. And yet, though encyclopedic in its coverage, what was missing from his first volume were the research universities of this world. Universities, in fact, were never actors in his drama, but rather warehouses of interesting people Friedman could lunch with as he went about the task cataloging the causes and consequences of a world suddenly linked so closely that what was happening "here" almost instantly impacted what was happening "there."

The World is Flat reversed that oversight, in part because Friedman has changed his mind about the role universities can play in globalism, but mostly because what has changed, in his view, is the now dominant importance of individual—as opposed to national or even corporate—advantage in determining the world's winners and losers. It's all about the skills and the attitudes and the kinds of entrepreneurship American universities have come to champion. "It is a truism," he observes, "the more educated you are, the more options you will have in a flat world" and then goes on to quote Bill Gates:

> We fund our universities to do a lot of research and that is an amazing thing. High-IQ people come here, and we allow them to innovate and turn [their innovation] into products. We reward risk taking. Our university system is competitive and

> experimental. They can try out different approaches. There are one hundred universities making contributions to robotics. And each one is saying that the other is doing it all wrong, or my piece actually fits together with theirs. It is a chaotic system, but it is a great engine of innovation in the world. . .

Both Friedman and Gates have come increasingly to focus on the successes that derived from the American research university's having mastered the discipline of the market—or, to use the title of this symposium, having mastered the process of marketization. The lessons American research universities in particular have learned over the last thirty years—again as this symposium demonstrates—are becoming increasingly important to universities across the globe as each seeks to win a place at the top of *The Times [of London] Higher Education's* "World University Rankings." So complete is this transformation that few seriously question that markets now matter or that universities have either become or are in the process of becoming market enterprises caught up in a world wide competition for funds, for top faculty and students, and for the kind of recognition and status that a "winning" institution can garner.

At the same time, this transformation has and will continue to raise a pair of related questions: "Just how much have market forces actually changed higher education?" and "Is market competition or marketization turning universities into businesses largely consumed by the pursuit of market advantage?" My goal this morning is to launch a discussion of each of these questions.

How Much Structural Change?

Most scholars when asked to calibrate where and how the pursuit of market advantage has changed higher education cite a host of troubling trends: the fact that students are now footing the bill for an ever increasing share of the cost of their education even at publicly funded institutions; that with public funds providing an ever diminishing proportion of the typical university's revenue, public agencies have substantially less influence in determining what the university can and cannot do; the commercialization of research has eroded that traditional independence universities once enjoyed as they pursued basic research in engineering and the sciences; and finally, that universities are coming to be indistinguishable from the businesses in which the "guy at the top" is a CEO in name, function, and perks and that what matters is not "doing good" but "doing well" in terms of increased margins and market shares.

I want to propose a more direct way of gauging how much market forces have altered the structure of higher education. Thirty years ago, international descriptions of higher education systems embraced the classifiers' passion for pigeonholing universities in terms of government endorsed definitions of form and function, on one hand, and, on the other, governance and financing. In the Soviet Union as well as those countries whose systems of higher education followed the Soviet model, the classification of institutions reflected a remarkably narrow set of industrial and employment classifications that were the essence of Soviet policy. In the United Kingdom there was a hard and defining line separating universities and polytechnics. Here in Japan, the classification of universities and other institutions of higher education reflected the historic role of the imperial university played in the modernization of the nation. The result was a remarkably straightforward sorting process that shaped both student and faculty aspirations and helped define national ambitions. Each of these classification schema—along with those in the U.S.—were important because national governments made them the basis for the allocation of resources and the conferring of status and legitimacy.

Today, however, both the classifiers and the governments who sponsored their work have lost ground. The line separating universities and polytechnics in the UK has been erased—they are all universities, at least in name. In Russia and across Eastern Europe and China, the Soviet higher education model of vocational- and industrial-based universities supplemented by research academies has been recast. Here in Japan, the government is in the process of divesting itself of its national universities, removing faculty and staff's civil service status and generally preparing the way for further privatizing Japanese higher education.

In the U.S., any and all attempts at government-endorsed classification have been abandoned, as "university" becomes the label of choice for most institutions—including the for-profit University of Phoenix. Not so coincidentally, it is in the U.S. where the impact of market forces have had the greatest impact and where the outlines of a "declassified" system of higher education are most strongly etched.

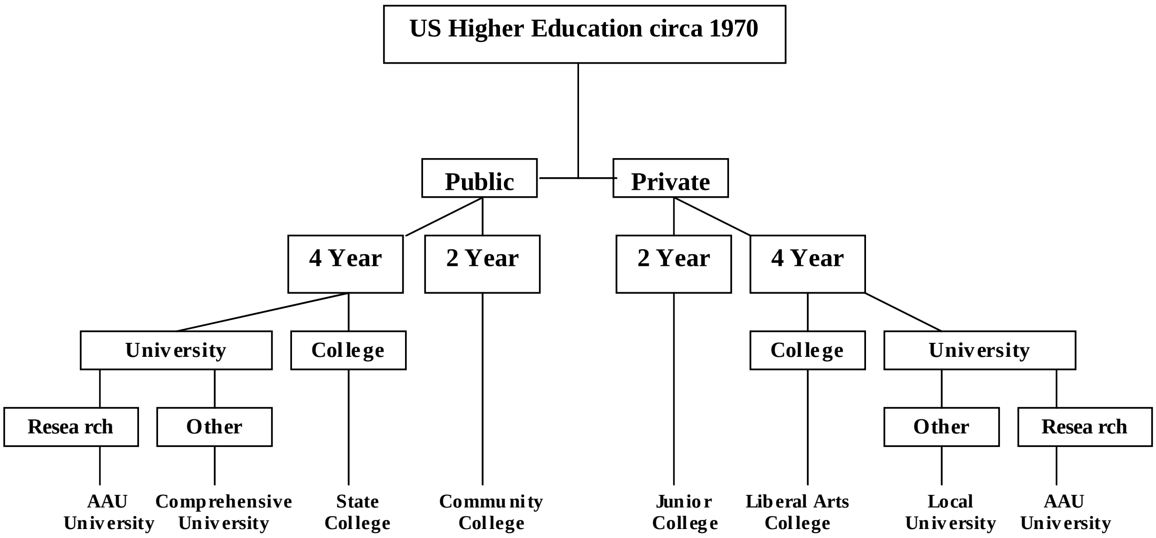

Figure 1: The U.S. Higher Education Landscape in 1970

To understand how the market has reshaped the U.S. system of higher education, one needs to begin with the American higher education landscape in the early 1970s before market forces had any noticeable impact. Then, most taxonomies of U.S. higher education employed the classification system developed by the Carnegie Foundation. (Figure 1.) There was a basic symmetry to the system: first, a split along the lines of governance and finance (public or private); then, a split along the length of the standard undergraduate curriculum (four years or two years); then, a parsing of institutions according to the traditional college/university division; and, finally, definitions that separated the research universities (principally those belonging to the Association of American Universities, or AAU) from what Carnegie came to consider "lesser" doctoral and comprehensive universities. Among the two-year institutions, all community colleges were public and most junior colleges were private. Among the nation's colleges there were essentially two flavors: private liberal arts colleges and public state colleges, many of which had started out as normal or teachers' colleges.

Thirty years later, it is a landscape that market forces have substantially altered. (Figure 2.) To the traditional public/private split has necessarily been added a third category: for-profit institutions. While this category remains small in terms of its total number of students, its principal occupant, the University of Phoenix, looms large: more than 200,000 students enroll in what is essentially a store-front operation that has now aggressively branched out into online distance education.

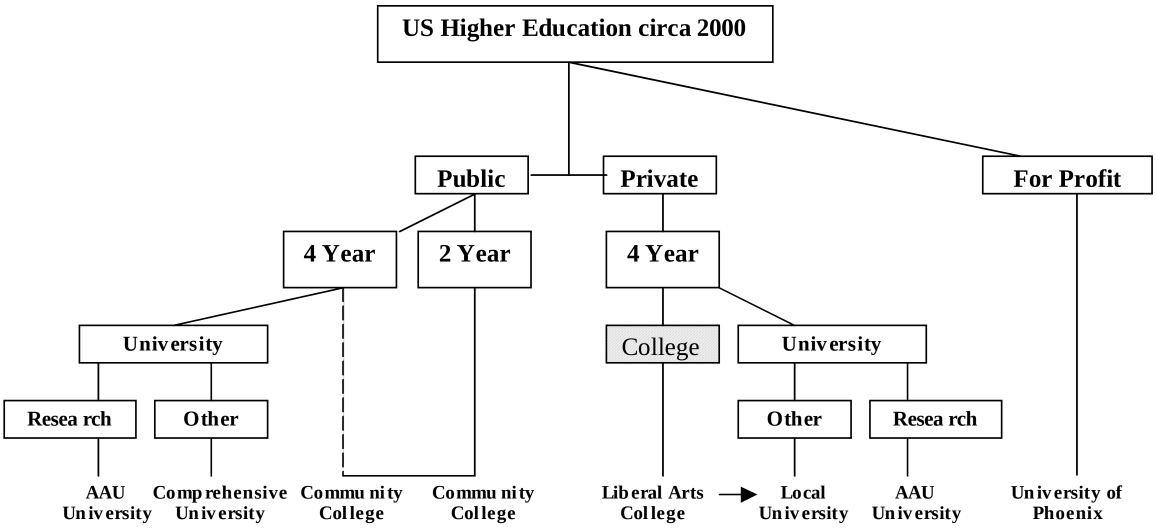

Figure 2: The U.S. Higher Education Landscape in 2000

Other changes are evident. In Figure 2, the private sector has been compressed and shifted toward the right. Gone are the private, two-year junior colleges. The entire college category is being diminished (hence the shading of the box in Figure 2). Where once-premier liberal arts colleges the likes of Amherst, Williams, and Swarthmore competed head-to-head with Harvard, Yale, and Princeton for both students and faculty, that competition is now decidedly more one-sided. Almost always the comparable university wins, simply because it offers both more options and more support. Liberal arts colleges with lesser reputations are finding that the best way to compete and survive is to mimic the university—often coming to call themselves universities, while adding a variety of post-baccalaureate vocational master's programs (a shift indicated by the arrow in Figure 2).

The public sector has undergone a parallel transformation. Most state colleges are now called universities, with many seeking the research and graduate education portfolios that once exclusively belonged to their state's flagship campuses. The nation's public community colleges are being similarly recast. Estimates of the number of students currently enrolled in a community college that who already possess a baccalaureate degree range upwards from 20 percent—suggesting the shifting role of the community college as a general supplier of work-related skills, including those skills essential for white-collar careers. At the same time, a number of community colleges are actively exploring, and a few have actually instituted, four-year programs leading to the baccalaureate degree or its equivalent.

Each of these changes reflect the push-pull of market forces, as institutions of nearly every stripe have sought to ensure sufficient revenue either to stay in business or to fulfill their ambitions. The "dreaded rankings" have replaced the Carnegie Classifications as the national arbitrator of institutional status. What the rankings in general and those published by *U.S. News & World Report* in particular measure is nothing more nor less than market position. To group universities into the tiers reflected in the *U.S. News* rankings, all one needs to know is the percentage of each university's entering class that earns a baccalaureate degree within six years of matriculating. It is a remarkably consistent relationship: the higher the graduation rate, the higher the price the university charges, and the higher the rankings tier to which the university belongs.

A Mission-Market Model

One should not be surprised that not everyone in the U.S. are happy with this linking of academic and commercial pursuits. Those most discomforted are principally faculty, particularly those whose scholarly pursuits are centered in the humanities. They are the ones most likely to see in their institutions' pursuit of market opportunities a future that can only undermine the traditional values of the academy.

On the other hand, Academic entrepreneurs at nearly every campus have readily embraced the market, often with little regard to how market initiatives square with the dictates of either mission or tradition. They are often the first targets of the traditionalists' scorn that, from the perspective of the entrepreneur, too easily translates into opposition against every proposal to launch a new venture.

What both sides can usually agree upon—except when the humanists have really dug in their heels—is that markets are becoming ever-more important—so important, in fact, that today they compete with mission for institutional attention. The question likely to be posed by all but the most energetic entrepreneurs is not whether the escalating importance of markets is detrimental to the academy, but whether anything can be done about it.

Actually, markets have been part of the academic scene since the beginning. Clark Kerr, President of the University of California during its growth years and later head of the Carnegie Commission on Higher Education, once described the tension between the acropolis, with its focus on values and mission, and the agora, the Greek word for marketplace. Arguing that universities always have served the market, Kerr went on to observe:

> The cherished academic view that higher education started out on the acropolis and was desecrated by descent into the agora led by ungodly commercial interests and scheming public officials and venal academic leaders is just not true. If anything, higher education started in the agora, the market, at the bottom of the hill and ascended to the acropolis at the top of the hill.... Mostly it has lived in tension, at one and the same time at the bottom of the hill, at the top of the hill, and on the many pathways in between.

Kerr was writing more than two decades ago. In the intervening years, the agora has consistently trumped the acropolis if, for no other reason, that is where the money is. Though it is largely the consequence rather than the conscious intention of policy, this process of privatization is not without justification.

One rationale holds that users should pay a greater proportion of the cost of their education. The idea that higher education confers private as well as public benefits fuels this view, leading, among other things, to policies that focus on student loans and need-based student financial aid as the principal means of guaranteeing access to higher education. A second, complementary rationale holds that ultimately the market can monitor the cost and performance of colleges and universities better than government bureaucrats. The market represents the summation of individual decisions about what to demand by way of education, research, and other university outputs, and from whom. Because in principle such decisions reflect the self-interest of consumers rather than of institutions, the public benefit is not just lowered taxes or a smaller government, but a range of higher education options and providers that meet real needs through the provision of cost-effective outcomes.

The question too often unexamined is, "But what happens when markets dominate mission?" The struggling institution that stays in business by changing its mission to better fit the market offers one answer—while in general, institutions that have gone to market, for whatever reason, have found it all but impossible to reverse course. Very few institutions have ever put the genie back in the lamp. They become trapped, as it were, in Kerr's agora. But then again, whether a college or university should be "at bottom of the hill, at the top of the hill, [or on one of] the many pathways in between" is not necessarily an answerable question. To stay safely within the acropolis means sacrificing funds and opportunities the market brings. On the other hand, dwelling too much in the market exposes the institution to forces outside its control—forces that may or may not align well with either the institution's mission or its values. Then again, institutions sometimes have no choice: their own lack of resources may force them into the market. But does embracing the marketplace mean subordinating mission to market?

Market power means control over price and the quality and quantity of the goods or services provided. American medallion or elite universities meet this test. They charge high tuitions, determine the benchmarks for education quality, and enjoy excess demand for student places. Their market power confers a high degree of discretion, not only in pricing but also in setting the admissions criteria that shape the student body. For-profit entities with this degree of market power are said to be earning monopoly profits. They might also dictate product specifications as in Henry Ford's famous dictum, "They can have any color they want, as long as it's black." Medallion institutions go even further. They define what it means to provide a good education and then use their market power to make their pronouncements a self-fulfilling prophecy.

Institutions with less market power must respond quickly to competitive price cuts and shifts in consumer preferences. For example, struggling non-selective universities have little pricing discretion. They operate under the pricing umbrella of the elite institutions but must compete strenuously with other non-elite institutions for every dollar, yen, and pound. They must offer programs with direct and demonstrable appeal to the market segments they target—for example, programs with a demonstrated history of advantageous job placements. Accreditation sets a floor on what is required for a college education, but beyond that consumer demand trumps academic values—including institutional desires to emulate the elite schools' academic standards.

Research universities operate in a highly competitive market for sponsored projects. Here the medallion institutions still exercise a degree of market power based on the qualifications of their faculty, though some of that advantage may be slipping as an academic labor market in which the number of qualified greatly out number the number needed has dispersed scholars trained at top graduate schools across a wide spectrum of institutions. Price competition has intensified as the U.S. government has come to insist that universities provide substantial cost sharing on direct project expenditures and top-class facilities while placing strict caps on the rate at which an institution can recover the space and administrative overheads attributed to a sponsored or otherwise externally funded activity. On the other hand, major research universities have no choice but to compete in the sponsored project marketplace, even if it costs them substantial sums to do so.

As nonprofit entities, universities are not allowed to distribute profits to owners as for-profit enterprises do. Thus they are in a position to improve mission attainment by reinvesting the margins or profits earned in one activity to enhance other worthy activities. Bowen's Law, first specified by the economist and former University of Iowa President Howard Bowen, holds that "Universities will raise all the money they can and spend all the money they raise." The question is whether or not all the money should get plowed back into the programs that generated it. Most universities receive subsidies overall, either from current donors or the government, and some receive additional subsidies from endowment. The result, however, is not an economy in which each and every activity is subsidized, as some apologists for higher educations would have you believe. It is more than possible, for instance, that full-pay undergraduates pay more than the real cost of their education—especially at institutions that find themselves supporting the research efforts of their faculty as a means of retaining them.

Universities have just two sources from which to subsidize unprofitable programs: contribution margins from profitable programs, and revenue from endowments, current donors, and governmental appropriations. Such revenue is income not earned by any particular program, but rather by the institution as a whole. Such revenue can be used to defray the university's fixed costs and subsidize unprofitable programs. When these revenues are less than the institution's fixed costs, the university must rely on margins from profitable programs to cover the difference and to provide cross subsidies for unprofitable programs.

But what happens when a university is barely making it financially? Bill Massy has pointed out that institutions with just enough funds to cover current expenditures must inevitably behave just like a business. No money is available for subsidies. Without the ability to subsidize programs, the institution has no way to assert its mission. The "marginal mission attainment per dollar spent" term vanishes from the nonprofit decision rule, which becomes, again as Massy points out, "marginal revenue = marginal cost." The institution must remain market smart in order to survive, but it can no longer be mission centered.

Mission Centered, Market Smart

Hence the challenge that is central to higher education policy in an age of markets: how best to insure that governmental policy yields universities that spend the fruits of being market smart on projects that demonstrate they have remained mission centered.

The workings of the higher education market always achieve some elements of the public good—providing more options to students with clear educational goals and more efficiency in serving particular fields characterized by rapid growth and change. Likely to be lost in that mix, however, will be those mission-centered programs and initiatives that, in an earlier era, were the embodiment of the public's commitment to access and opportunity. Moreover, the values of inquiry and discovery that motivate traditional institutions and their faculty—the pursuit and conveyance of knowledge beyond what the market itself demands—could easily become lost in all but the best-endowed institutions.

For this reason alone, good governmental policy will necessarily mean something different from what it has meant in the past. Where governmental policy once created institutions that were largely separate from market forces, advancing the public good in the future will require policies that work with—or through—market. What will remain constant is the importance of money and the centrality of the questions first posed by Clark Kerr and the Carnegie Commission three decades ago —"Who benefits? Who pays? Who should pay?" In more modern dress, these questions become: How can the investment of public funds best ensure that the markets for postsecondary education deliver public as well as personal advantage? Can the leverage that such public appropriations provide purchase educational attainment as well as institutional access? What public objectives require the explicit action of policy to achieve—and what objectives are best achieved through the workings of the market? What are the incentives and processes available to public agencies for encouraging—perhaps even requiring—colleges and universities to be mission centered as well as market smart?

How, in fact, can universities grow to be more than just businesses even as they pursue the competitive advantages success in the markets bring?

When the world's universities have an answer to this question they will know that an important corner has been turned and that they no longer need fear the consequences of either globalization or marketization.

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