Policy Update 10

Revenue and Results: How Student Achievement Gains Can Save the Private Education Industry

by Lisa Snell

October 2001

How the Economy Affects Education

In light of the current economic downturn, some education analysts have asked about the future of private education companies such as Edison Schools, Inc. Public school budgets are largely immune to the failing economy, even when they fail to produce results. Are private education providers also immune to these forces? Driven more by legislative mandates and less by the economy, the private industry will likely ride out this downturn and, in fact, may enjoy some areas of vigorous new growth.

Historically, educational spending has increased regardless of the state of the economy. In public education, according to Hoover Institution Senior Education Fellow Eric Hanushek, real spending per student–i.e. per pupil spending adjusted for inflation–has grown steadily and dramatically. From $164 per student in 1890, the average has quintupled roughly every 50 years, reaching $4,622 per student by 1990. Such an increase over such an extended period of time represents truly amazing growth   growth that is hard to match in any other sector. And by all accounts, this growth will continue. On October 4, for example, the House Appropriations Subcommittee on Education Appropriations approved a 20 percent increase in Title I spending: an addition of $1.7 billion. Overall, the subcommittee has raised education funding by $7 billion over last year's level, and $4.7 billion more than what President George W. Bush requested.

Based on federal, state, and local allocations of education funds, per-pupil spending will continue to grow in the next decade. While this growth could be slightly mitigated by an economic slowdown (and by less tax revenue), government spending on education is more protected than other government sectors because inflexible statutes often set funding levels. When budget cuts are required, other sectors with more flexibility and less potential for political backlash will be cut first.

In much the same way, the private education industry will be driven less by ebbs and flows in the economy and more by federal legislation mandates concerning student testing and increases in student achievement.

Shakeout in the Education Market Leads to Focus on Student Achievement

The private education industry has suffered a shakeout, just as other technology sectors have. Boston research firm Eduventures, Inc. has reported a 70 percent decline in venture capital investment in education in the second quarter of this year. The business model of selling abstract education concepts through Web sites without well-defined products will no longer work.

However, while venture investment fell for all segments of the education market, overall private-sector education industry spending grew 8 percent to a record $105 billion in 2000, and was projected to reach $133.2 billion by 2003. Many education companies are still posting profits and record growth despite the slowing economy. The one element these growing companies share is a focus on student achievement. The bottom line for the education industry is that companies who tie their business model to increasing student achievement or to support services that indirectly lead to increases in student achievement will prosper–even in a recession.

Both the House and Senate versions of President Bush's education reform bill contain his proposal to track student progress with annual tests in reading and math in grades three through eight. At present, only 15 states test both subjects during all six years. As Michael Fletcher and Neil Irwin argued in an August 16 Washington Post column, "President Bush says his education reform plan will empower parents and hold educators responsible for how students perform in school. But the bill also is certain to have another, less vaunted effect: to create a lode of new business for private educational firms."

Among news reports of several high-profile education companies, one trend stands out: the tendency to report revenue increases and profits alongside data about student achievement. Clearly, in the minds of education industry analysts, revenues and results for student achievement are linked. Take this recent analysis of Nobel Learning Communities:

> *For the year ended June 30, 2001, the company reported record revenues of $148 million, an increase of 16 percent over the prior year level of $127 million. Nobel reported record revenues of $39 million for the fourth quarter 2001, an increase of 10.3 percent over the $35 million for the comparable period in the prior year. Nobel students, once again, scored high on the Stanford Achievement Tests, one to four years above the national norms. For example, one of Nobel's children in Pennsylvania won first place in fifth grade math statewide.*

It has become the norm for education companies to report revenue alongside performance outcomes for students or teachers. In these uncertain times, tying revenue to achievement may be their strongest selling point.

The Cast of Edison

One significant opportunity is for private school managers to help reconstitute failing schools. Edison Schools, Inc., for example, should benefit from the identification of more troubled schools. While Edison's stocks may have been marginally affected because of the economy, they have been more severely affected by Edison's failure to show a profit.

According to Edison chief executive officer Chris Whittle, Edison's profit is linked to attaining a certain number of public school management contracts. Like other education companies, Edison's relationships with school districts are not directly dependent on the economy, because school boards and school districts usually make financial decisions independent of the economy. Edison's future is much more dependent on convincing more districts and school boards to let them run their schools.

Federal legislation that will force more school districts to use innovative approaches to raise student achievement is the key to Edison's future. If Edison does not win more school contracts, it will fail. And winning more school contracts rests largely on proving that Edison can improve student achievement. Many of the districts that have been considering relationships with Edison are in urban areas with high concentrations of poverty. Edison's specialty is working with low-income disadvantaged students. In most of the places where Edison pursues new schools, the districts and individual schools are desperate to find a new way to meet student-achievement mandates. These pressures are likely to intensify under tighter federal requirements for student improvement on standardized tests. Moreover, a downturn in the economy may entice some of these districts to look more closely at private partnerships, with an eye to potential savings.

Edison, of all private education companies, may most acutely suffer the impact of the recent terrorist attacks, due to the appointment of former Pennsylvania governor Tom Ridge as the U.S.'s new Homeland Defense Secretary. When Ridge was overseeing the reform effort in Philadelphia's schools as well as the state contract with Edison to make a recommendation for reform, Edison was almost guaranteed the job of running some of Philadelphia's schools and subsequently moving toward turning a profit. In Ridge's absence, new players will now control the reform effort, and it is unknown whether Edison will earn any contracts to run Philadelphia's schools. What is clear, at least, is that federal reform is likely to encourage more districts to seek Edison's services.

Where Will Future Education Growth Occur?

Several specific sectors of the private education industry are likely to see continued vigorous growth, despite the economic downturn.

Testing. Established testing companies like Kaplan, The Princeton Review, and the Educational Testing Service will realize record growth as well as many opportunities for testing start-ups as states grapple with how to implement testing for all students in grades three through eight.

Education Management Organizations. As school failure is made more transparent and public, failing schools will likely call on private management firms to help them better manage their education systems.

Remedial Education Services. Companies like Sylvan Learning and others that contract with public schools for Title I remedial education programs will see more contracts as schools try to raise student achievement and receive business from parents that are awarded tutoring vouchers to supplement failing curricula.

Special Education Services. Companies that help schools manage special-education students and raise student achievement for these special populations will have record growth.

Teacher Quality. Companies like the University of Phoenix that supply schools with an immediate, high-quality supply of teachers who have the skills to raise student achievement will also show record growth. Many established education companies like Edison and Sylvan are also adding alternative-teacher programs or teacher-training programs to their stable of school services to develop a reliable supply of competent teachers.

Home-schooling Providers. As failing public schools become more visible, parents will be unwilling to wait three years to transfer their children to a better-performing school and will turn to companies with a home-schooling focus like William Bennett's K12 online learning service to find alternatives.

Ancillary Services. The student-achievement requirement will trickle down to education companies providing services that are traditionally unrelated to student achievement. Large cities like Detroit, Chicago, Los Angeles, and Houston are turning to outsourcing of ancillary school services to provide higher quality services at a lower cost and also, more importantly, to redirect revenue into school activities that have a more direct correlation with student achievement. A 1999 survey of nearly 500 Illinois school districts found contracting to be a popular form of service delivery, and that it is expected to rise for transportation, food services, and maintenance. School districts have steadily increased the use of contracting services as a way to save tax dollars and to improve performance and accountability. Through outsourcing support services, school officials can also get access to other cutting-edge private sector management techniques such as performance contracting, adapting best practices used by their peers to ensure the success of a contracting initiative, and focusing on their core mission: educating schoolchildren.

Conclusion

A significant policy issue facing U.S. public education is why dramatic increases in resources for schools do not appear to translate into enhanced student performance. As the federal government mandates improvement in student achievement, and the failure of public schools become even more transparent to the general public, the private education industry will be called on to help solve this problem. Companies that can add value to the bottom line of student achievement will not only survive this economic downturn but also see substantial revenue growth.

About the Author

Lisa Snell is director of the Education and Child Welfare Program at Reason Public Policy Institute, where she oversees RPPI's research on social services and education issues. Her most recent RPPI policy studies include *Remedial Education Reform: Private Alternatives to Traditional Title I; Child Welfare Reform and the Role of Privatization*; *Private Options to Help Students Read*; and *Innovative School Facility Partnerships: Downtown, Airport, and Retail Space.*

Ms. Snell frequently comments on education issues on radio and television media including recent appearances on the Fox News Channel, ABC's "Wall Street Journal Report," and numerous regional news programs. Ms. Snell has published numerous articles and op-eds on school choice in newspapers including the *Milwaukee Journal Sentinel, Las Vegas Review Journal, Orange County Register*, and the *Los Angeles Daily News* and frequently speaks about these issues. She is a monthly columnist for RPPI's *Privatization Watch* and makes regular contributions to RPPI's *Annual Privatization Report.*