
Education Week, Bethesda, MD

Limitations of the Market Model

August 7, 2002

Heidi Steffens and Peter W. Cookson

<<<>>>

This document is available on the Education Policy Studies Laboratory website at
<http://www.asu.edu/educ/eps1/EPRU/articles/EPRU-0208-30-OWI.doc>

A decade ago, during the corporate boom of the 1990s, Christopher Whittle had an idea: Why not start a system of publicly financed for-profit schools? It was the ideal environment for such a venture.

The market was hot, and so was education. The public sector was in disrepute. The time seemed ripe to replace cumbersome, overly politicized public school bureaucracies with smart, efficient corporate management and show how the market could improve the outcomes and the efficiency of public schools.

So Mr. Whittle founded the Edison Project (later renamed Edison Schools Inc.), raised tens of millions of dollars in capital, hired a qualified, well-connected team, and set it loose for three years to design an exemplary school. When the first four Edison schools opened in the fall of 1995, they implemented "the Edison design," the well-researched educational plan still used in Edison schools today. In many ways, Edison did the school management business right.

Moreover, Edison has tackled educational challenges that others either refused to accept or failed to remedy. In essence, the company has undertaken to convert some of the country's most troubled schools into educational successes. That low-performing schools became Edison's market should surprise no one. The crisis of our country's schools isn't a crisis of schools that educate middle-class or affluent children; it's a crisis of poor children's schools. And while a few school management companies have intentionally positioned their schools to attract specific segments of the middle-class market, Edison's concentration on managing existing public schools under contract to school districts, its reliance on the Success For All model, and its free computers for students' homes seem designed to appeal to struggling schools for disadvantaged children.

Edison's growth has been exceptional. Starting with four schools in 1995-96, the company grew 20-fold over its first five years, running 79 schools in 1999-2000. In spring 2000, Edison could boast that it had never lost a contract. And while the idea of for-profit school management, and Edison Schools as its vanguard, always has been controversial, the company's media coverage remained overwhelmingly favorable for many years.

From the beginning, Edison claimed that students in its schools were posting significant achievement gains. True, it didn't take long for researchers to begin collecting data and questioning the company's claims; and Edison's "Annual Report on School Performance"—with its lack of backup data and its facile school rating system—reads more like a marketing piece than a serious analysis of student achievement. Still, even the company's harshest critics allowed that the performance of Edison-run schools was "mixed," or on a par with other public schools. Given that the company was attempting to turn around some very troubled schools, this performance was nothing to be ashamed of, even if it didn't live up to Edison's claims.

Edison's business strategy of taking over regular public schools under contract to school districts (as well as running charter schools) practically ensured that staff members in many of its schools would be covered by collective bargaining agreements. From its first year of operations, many Edison teachers have been represented by the National Education Association and the American Federation of Teachers, and the company made an early decision to try to work with the two unions. Some NEA and AFT affiliates actively opposed Edison; others just as actively cooperated to bring the company to their districts and to make the Edison-run schools successful once they were there. Both of us visited a number of Edison schools during the company's first five years; we found those schools to be safe and educationally productive.

So far, so good. Market advocates should be cheering. But anyone who follows either education or the stock market knows that Edison Schools recently underwent a dramatic reversal of fortunes. The company's stock has plummeted from over \$36 a share in February 2001 to barely \$1 at the end of this May. The persuasive Chris Whittle, widely acknowledged as a master at raising capital, was hard-pressed to find the \$40 million the company needs to open the schools it's scheduled to operate this fall. The same media that for years spoke glowingly of Edison's accomplishments now tell a tale of corporate woe. (["Edison Reels Amid Flurry of Bad News,"](#) May 22, 2002.)

Certainly Edison is, at least in part, the author of its own misfortune. Its effort last year to take over five New York City schools was an unmitigated disaster, characterized by reliance on high-level political deals and a failure to organize in the schools' communities. Edison repeated its New York mistakes in Pennsylvania, managing to alienate almost the entire city of Philadelphia while relying on its ties with the governor's office. By overpromising, the company managed to turn the award of 20 Philadelphia schools—the largest ever to Edison or anyone else—into a defeat.

But Edison's downward spiral has been caused by more than political ineptitude and excessively optimistic business predictions. The company could probably recover from these problems. It's the troubles in Edison schools that are the real cause for concern.

Over the past two years, Edison has lost a total of 27 schools, including 16 at the end of the 2001-02 school year. (By contrast, a total of 26 schools have renewed their contracts with Edison.) In each case (with the exception of three schools from which Edison initiated the pullout for primarily financial reasons), the reasons school districts and charter school boards have given for canceling or not renewing Edison contracts have been a combination of low test scores, declining student enrollment, high teacher turnover, and Edison's cost. Moreover, at least 15 additional schools that will remain with Edison next year are on their states' low-performing lists, and six districts that plan to remain with Edison, at least in the short term, have expressed dissatisfaction with the company. Far from the educational home run Edison has been claiming, the company risks an educational strikeout.

Why, when it had so much going for it, does Edison today find its very survival in question? Did the leading school management company self-destruct—or was it done in by contradictions inherent in the concept of operating public education as a business?

The answer, of course, is both. Some of Edison's problems are self-inflicted. But the root of its troubles lies in trying to operate public schools as a successful business. The rules that govern the market—that require companies to establish brand identity, attract capital, and become profitable—contradict essential requirements for creating and maintaining excellent public schools.

Establishing 'Brand' and Growing Rapidly. Successful consumer companies establish "brand," allowing what they sell to be readily identified in the marketplace. But replicating a successful school at multiple sites is not like replicating a successful restaurant or bookstore. Schools' raw materials (students) are highly individual and unpredictable, the product of forces external to the school. The central control required to create schools that look and feel and educate like all a company's other schools stands in direct contradiction to the need for every school to respond to its students and community, its "customers."

School design and curricula are only the starting points of the complex and nuanced task of creating a successful school. There's the matter of finding the right leadership and faculty, and nurturing their understanding of teaching and learning and their relationships with each other, their students, their students' families, and communities. And once a thriving school climate is established, it requires cultivation and support.

The requirement for rapid growth further complicates the enormous challenge of establishing brand and controlling quality while responding to local needs. A criticism of Edison is that it has grown too fast. While this is certainly true, rapid growth wasn't simply an Edison whim. It was a demand of the market. In the absence of profitability (more on this later), Edison needed enormous growth to position itself as the market leader and produce steadily and rapidly rising revenues that would bolster its market value. (In all likelihood, this is behind the company's recent problems with the Securities and Exchange Commission. Earlier this year, the SEC found that Edison consistently reported as revenue funds, amounting to over 40 percent of reported revenues, that had never even passed through its banks, but were used by school districts to pay salaries, transportation costs, and other expenses for Edison schools.)

So Edison has been attempting to assert corporate control, maintain quality, establish brand, and respond to local conditions—all while adding over 20 new schools a year. It is a Herculean feat, and one at which Edison is failing. But if investors are going to continue putting capital into the company and keep its stock price high, they want to see significant revenue growth.

The Demand for Profitability and the Illusion of Scale. The bottom-line demand of the market is profitability. But Edison has never been profitable. It has accumulated \$261 million in losses since its founding and recently took on another \$40 million in debt so it can continue operations in the 2002-03 school year. Since the company's earliest days, Edison executives have said that when it gets big enough their company will become profitable. While the number of schools said to be needed for profitability has increased over the years, the basic notion has remained: When we have enough schools over which to spread our overhead costs and negotiate discounted prices from suppliers, we'll show a profit.

The problem with this scenario is that economies of scale don't apply to the business of schooling. Economies of scale work in industries with uniform products. But as noted above, schooling is not one-design-fits-all, and individual school faculties and communities want input into their schools. In addition, while one can assume that Edison with its 130 schools can bargain a better price with suppliers than a school district with 10 schools, materials and supplies are not what make schooling expensive. Schooling is highly labor-intensive, with salaries constituting 80 percent or more of school budgets. Short of hiring cheap labor (underqualified teachers) or replacing teachers with computers, neither of which is recommended as a way to create successful schools, there's simply no way to dramatically reduce labor costs.

In the end, the market metaphor does not apply to public education. What is rational for a society—investing in education—may well not constitute a viable business. The troubles of Edison, a company that began its life in a thriving economic environment with a generous supply of capital and a solid educational blueprint, attest to the difficulties inherent in creating a system of good schools that serve the diverse needs of our nation's children.

Public education is a social commitment that transcends individual interest and corporate gain. It is highly probable that schools designed to meet this responsibility are inherently unprofitable. This does not mean the commitment should be abandoned. It means that, as a human service, education is grounded in a belief in human dignity that transcends the values and behaviors associated with markets. It means public education cannot be squeezed to fit the market model and still meet the needs of a just society.

Heidi Steffens is a senior policy analyst at the National Education Association in Washington. She can be reached at hsteffens@nea.org. Peter W. Cookson Jr. is the president of TC Innovations and a professor at Teachers College, Columbia University, in New York City. He can be reached at pwc7@columbia.edu.