



Privatizing University Services

Colleges and universities engage in a variety of activities that are secondary to their central mission of education. Across the United States, many have turned recently to privatizing services as a way to reduce costs in these times of tight budgets.

Which of the many services institutions provide—housing, bookstores, security, healthcare—are best suited to privatization? Sharon Oster, Wolfe Professor of Economics and Entrepreneurship at the Yale School of Management, presents a framework for evaluating the costs and benefits of privatization, based upon higher education's nonprofit status and the characteristics of the service in question.



Higher Education— A Complex Good

An education is a good whose quality is not easily judged. Thus, consumers are dependent upon a university's reputation and their trust in it to make purchasing decisions. Nonprofits are better suited to serve in such trust markets than for-profit businesses because the incentives and rewards for managers of nonprofits are not centered on making money, but rather on less profit-based motives such as providing a quality education. Given their complicated goals and reliance on a variety of sources for revenue, colleges and universities have more varied constituencies than the typical for-profit firm, with its owners and shareholders. With several constituencies laying claim over their operations, however, decision making is inevitably both more involved and more political than in the for-profit organization.

The strengths of colleges and universities lie in the provision of complex, hard to evaluate goods and the ability of managers to stay focused on matters of reputation and long-term goals. A well developed ability to balance the interests of multiple constituencies also is crucial.

Two additional characteristics of nonprofits are important to consider in the privatization question. One is their difficulty in raising capital, since by definition they are precluded from issuing equity

or the right to a share in the residual profits of an operation. Thus, the advantages of economies of scale are not readily available to colleges and universities. The second characteristic is the decentralized, independent and informal culture of the higher education working environment. Success of the enterprise is very dependent upon the efforts of autonomous employees, so that as an institution grows, problems of control and motivation increase rapidly.

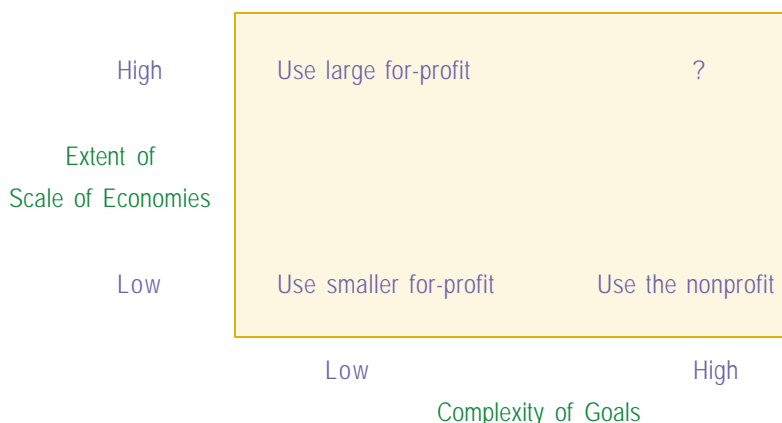
What to Privatize?

The comparative advantages of nonprofits and for-profits in accomplishing complex goals and capitalizing on economies of scale are incorporated in the organizational form matrix below. Where a university service falls in the matrix guides the decision whether to privatize that activity.

Bookstores present an interesting example to apply the matrix. In decades past, bookstores typically were quite small and minimum efficient scales were quite low. Campus bookstores were considered places to develop young minds, not just market to them. Thus, most bookstores were under the university umbrella and would have been in the lower right quadrant of the matrix. Technology, however, has changed the book distribution industry: improvements in the areas of inventory control and invoicing, for example,

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Organizational Form Matrix



have greatly increased the advantages of size, creating a few super stores that dominate the industry. At the same time—and largely as a result—the mission of the bookstore has become more narrow, focused on the business of merchandising high margin items, such as sweatshirts, in addition to books, rather than on the added business of intellectual development. As a result, today’s typical college bookstore is firmly lodged in the matrix’ upper left quadrant, pushed there by the force of large scale economies.

Facilities management presents another possibility for privatization. This function generally belongs in the lower left quadrant, given its low scale requirements and clear, uncomplicated goals. Colleges and universities have no particular advantage in accomplishing this task. However, the task often is complicated by matters of social policy, with discussions of wages and working conditions tied not to the market, but to fairness and social justice. In this environment, many institutions are inclined to escape such issues through privatization. Whether such avoidance is possible, though, is uncertain. In some instances it may be that increased complexity due to related goals of a function may point toward maintaining it within the university structure.

Connection with Educational Mission

Generally, support services are more likely candidates for privatization than activities directly related to the educational mission of an institution. A third dimension might be added to the matrix to reflect this notion: that is, how connected to the core enterprise is the activity? Is there a synergy between the activity and good learning? If so, the task may best be undertaken by the institution itself.

Privatization need not be limited to support services, however. It is possible that certain teaching activities may be successfully privatized. Some distance learning activities, for example, or remedial or in-

troductory foreign language courses may be effectively outsourced, freeing faculty and staff to focus on other endeavors.

Potential Pitfalls

Whether privatizing a support service or an instructional activity, managers must be prepared to face the challenge of working with a for-profit vendor, whose interests may diverge from their own. For-profits may readily engage in opportunistic behavior with negative consequences for the institution and its mission; avoiding such behavior is one of the central challenges of privatization.

The principle way to control such behavior is through credible threats on the part of the institution to take its business elsewhere for the next contract. This threat depends on the presence of other viable vendors. Thus, it may be profitable in the long run for the university to retain relationships with secondary vendors, or, in the case of isolated campuses, to maintain some level of internal capacity to ensure its own future bargaining power.

Conclusion

Clearly, compromising an institution’s mission would be a considerable price to pay for reducing costs. The fundamental question institutions must address is whether there is any basis for thinking that privatizing a function could reduce costs, and, if so, whether there would be any adverse effects on the ability of the university to achieve its overall mission.

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