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**NEW ZEALAND ASSOCIATION OF PRIVATE EDUCATION
PROVIDERS**

**A BUSINESS PERSPECTIVE ON THE PRIVATE
TERTIARY EDUCATION SECTOR**

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Introduction

It's a genuine pleasure to speak at this conference today. The New Zealand Business Roundtable has been arguing the case for improving the policy framework for all tertiary providers since the late 1980s. Some progress has been made and it's impressive to see that the private tertiary sector is developing into a thriving industry. I would like to think that we have helped to make this possible, but you must be congratulated on doing the hard work.

It appears that the Business Roundtable and the New Zealand Association of Private Education Providers share many core beliefs. We both believe that quality education is crucial for New Zealand's future. We both believe that education should be delivered by the provider that best meets the needs of the students concerned. Both our organisations have supported greater competition in the tertiary education sector and argued that funding should follow the student. Speaking to a group which shares so many beliefs is a pleasant experience, and I look forward to discussing some ideas with you this morning.

The main issues for this session are the expectations that businesses have for tertiary education and the role that Private Training Establishments (PTEs) have to play in that sector. The role of the government in developing a regulatory framework for education services is relevant to both of those issues.

The expectations of business

The Business Roundtable is an organisation of 50 – 60 chief executives of some of New Zealand's largest businesses. Our aim is to support policies that advance the interests of the wider community rather than sectional interests. That may be another belief that our organisations share.

The business community takes a keen interest in education not just because of the long-term effect it has upon business competitiveness but because of its wider benefits for society. Human capital – the knowledge and skills embodied in people, their health and the quality of their work habits – accounts for a large and probably growing proportion of GDP.

An individual's potential human capital is due to innate ability, but the way in which that potential is developed is strongly affected by the performance of our formal and informal education systems. The expectations of business are that those systems will encourage optimal investment in human capital in New Zealand and thereby promote a more prosperous economy and advance other social and cultural goals.

The informal education system, operating through on-job training and personal development, may account for a larger portion of educational expenditure, in time and money, than the formal education system. Studies have found that informal education and training contribute more than formal education to people's incomes. This suggests that investment in informal education may be larger than in formal education. The formal education system, including PTEs and tertiary education institutions (TEIs), is, however, where most of the policy debate is focused. I will concentrate on that area today, but businesses and individuals will weigh up formal and informal educational options when they make their own investments.

One of the key themes of vested interests in the tertiary education sector is that education is special and should be treated in a different way from other sectors. In his 1995 Sir Ronald Trotter Lecture, Richard Epstein of the University of Chicago Law School commented on that contention as follows:

Whenever somebody tells you that something is special, remember that the history of government failure is littered with arguments that this, that or the other thing is special. We had labour unions in the industrial sector because it was special; we had Medicare in health because it was special; we had subsidised public housing because housing was special; we had price controls in agriculture because it was said to be special. It turns out that there is nothing special about anything. A few central principles consistently applied will tell you the appropriate scope for individual choice on the one hand and for

government action on the other. Education is not a case of overgrazing of a common. It is not a case of negative externalities from pollution. ... Education is the stuff of ordinary transactions, which should be as routine as we could possibly make them if only we had the wit to allow our imaginations to run wild with our schooling instead of with engineering our social arrangements.

While tertiary education is not special compared with most other industries, investment in it entails an important decision for individuals and businesses. That should lead to considered decisions as to the nature, length and level of tertiary education students undertake. Businesses should also make careful decisions about the skills they require from employees and send the appropriate signals through their recruitment, development and remuneration policies. These decisions are likely to have the lowest risk and greatest return for individuals, businesses and society when they are made in a stable environment with a minimum of government intervention.

The Business Roundtable's submission to the Tertiary Education Review argued that the policies required to encourage appropriate investment in tertiary education include:

- a stable macroeconomic environment which fosters certainty and facilitates investment, including long-term investment;
- an efficient labour market which provides strong incentives for people to develop desirable work habits and to acquire education and training;
- an open immigration policy which facilitates the introduction of new skills and promotes innovation;
- a low level of government expenditure and taxes, the avoidance of excessive regulation and a carefully designed welfare system. These are necessary to limit perverse incentives which impair work habits and discourage investment in human capital;

- a reduction in the level of subsidies for tertiary education and a review of the type of activities which are assisted so that any subsidies that are provided are justified on valid public policy grounds. This would eliminate the bias toward off-job education and training, improve the effectiveness of spending on formal education and training and reduce the tax burden;
- a reduction in barriers to entry into, and exit from, the education industry which would improve the efficiency of the provision of education;
- the adoption of private ownership arrangements; and
- the removal of preferential treatment for any state entities that are retained and the introduction of governance arrangements which would facilitate more effective decision making and improve their performance substantially.

Unfortunately, New Zealand governments have treated tertiary education in a 'special' way. They have 'planned' the number of graduates needed in particular areas, for instance in many health professions. You will be well aware of the list of priority courses that the Ministry of Education has hitherto used to ration funding to the PTE sector. It may be cold comfort for those whose courses were not prioritised that the Ministry's own advice to its minister was that:

The priorities were not based on any analysis of supply and demand or occupational forecasting.

It is unclear which is worse – that officials did not carry out such a wasteful analysis or that they carried on with the policy without any empirical backing at all! It seems that the Ministry of Education stopped using all the tools of central planning but could not quite break the habit.

The government has also limited the choices available to students by imposing high entry barriers. Any tertiary institution can now offer a degree as long as it meets the NZQA's complex and arbitrary standards, and ensures that its teachers are engaged in research. There is no good reason for all degree courses to be taught by researchers just as there are no good reasons for clothes to be sold by designers.

You may order a made-to-measure garment from the designer but you can still purchase a perfectly serviceable coat from the retailer. The choice should be up to the consumer.

The consequence of excessive government intervention in the economy is low consumer satisfaction. Today, education and health – rather than the telephone system – stand out as major areas of community dissatisfaction in surveys of public opinion.

The tertiary education industry's performance

So how does the government affect the education industry? The government has three main roles in the education market at present. It provides the largest share of funding of students' education and favours those studying at its own institutions. It owns institutions that have a very large market share, while requiring no return on the equity invested in them. It also regulates the sector by creating high entry and exit barriers, thereby limiting competition and reducing diversity in the market. This creates poor incentives for managers and academics to perform and low levels of responsiveness, innovation, productivity and consumer information.

Students and businesses expect high levels of responsiveness to their needs from education providers just as they do of doctors, dairies and entertainers. Many TEIs have been unresponsive to changing needs, often placing students in queues for course places or taking two or more years to develop a new course. They are frequently distant from business needs.

Private providers who are always looking for new profit opportunities or new ways to serve a particular community are more likely to meet any interest, and minority interests in particular. This can be seen in the development of PTEs and semi-private TEIs such as wananga that meet the needs of Maori, Pacific Island people as well as emerging business needs – such as in the design or early childhood education areas. Indeed, PTEs appear to enrol a higher proportion of people from lower socioeconomic backgrounds than do TEIs, turning the myth of elitist private institutions on its head. Private providers are looking for a market while a problem

with public providers is that they are directed by political parties aiming for the swinging voter.

A second problem in the tertiary education market is low productivity. Any institution that is protected will argue that it is operating at maximum productivity. Its achievement is usually credited to its level of protection – as manufacturing industries argued in the past. In opposing the reforms of the late 1980s, the university sector strenuously maintained that it was operating at the frontiers of international excellence. Given that starting point, it is remarkable that the universities have greatly improved their human resources, marketing, property and financial management performance over the last 10 years. They have also increased the attention they pay to student satisfaction with academic and non-academic services. But as anyone with any acquaintance with universities knows, there is enormous scope to do better. The PTE sector has achieved still higher usage of facilities through longer teaching days and years, it has improved its marketing techniques, built better linkages with employers and reduced administrative overheads.

A lack of innovation is a third problem with our current system. Innovation is not a characteristic of centrally administered organisations. Prior to 1990, polytechnic courses had to be approved by the Department of Education. Now polytechnics and other TEIs are free to offer whatever courses they wish, providing they can secure approval, funding and students. However, they are still slow to exploit new delivery methods. This is not the fault of the people employed in these institutions. Since they have limited freedom in staffing, governance structures, management and finances, they simply don't have all the tools necessary for innovation. PTEs, on the other hand, can develop a more entrepreneurial culture and respond to incentives to innovate. They can change their mix of resources, implement new ideas, and think the unthinkable. Accordingly, they have consistently led the field in offering shorter courses or more student contact time in order to meet consumer needs.

Information is a fourth problem area – an area that is crucial to effective human capital investments. Like all investments, those in human capital are risky and

people seek information to reduce the risk involved. However, when students pay a relatively low proportion of the costs of tertiary education, they will spend less time and money making informed decisions. TEIs receive most of their funding from the government and they face limited competition for students. This means they have poor incentives to supply better information. In contrast, PTEs face tougher competition, source more of their revenues from students and thus have to do more work convincing students to enrol. Accordingly they generally produce better quality information about their offerings and returns on them, including graduate employment rates.

The main problem with the public provision of services is that the incentives facing public providers are relatively weak, whether services are judged on price, quality, availability or other factors. Public managers' rewards may come from the size of their budget or staff numbers rather than the satisfaction of their customers. Political considerations, rather than demand, may drive decisions about supply, resulting in rationing, unsatisfactory products or no products at all. Managers may also have limited freedom of action in deploying human, financial or physical resources.

Such insights may seem obvious to anyone who has been exposed to the IRD's telephone system, but they have seldom been applied in New Zealand tertiary education. As the Department of Education put it in 1987, in an analysis of the role of the private tertiary education sector:

The existence of the private market serves as a reminder to the government funded formal sector of the need for effective delivery and consumer satisfaction.

We should commend education officials for recognising that the private sector delivers effective services that satisfy consumer needs. It is difficult to understand, though, why the government didn't shift the funding from the sector that needed to be reminded about such fundamentals to the one that was already highly conscious of them. It says something about the diffusion of ideas in the public sector that it took the government until 1998 to follow the argument through.

Private provision of tertiary education

A slow pace of reform is a familiar story around the world in the provision of social services, which are often the last industries to be reformed. The World Bank has found that there are usually three waves of privatisation in an economy. The first concerns organisations that already operate in a commercial environment, such as airlines. The second deals with infrastructure such as gas and electricity operations while the third wave relates to social services, such as health and education. We are just starting on that third wave in New Zealand and it may be the most important for our long-term prosperity.

The public policy basis for private provision of tertiary education services is quite clear-cut, given the inevitably weak incentives facing public providers. Even the major TEI associations now support the public funding of PTEs, as long as they meet "certain conditions". The issue is now clearly in the political arena and the aim must be to demonstrate the benefits of private tertiary education to politicians and the public.

We are not starting from a blank slate with private tertiary education. There are 800 registered PTEs in New Zealand, and many thousands of unregistered computer applications trainers, driving schools, speech therapists, time management and planning consultants, dance teachers and the like. Besides those stand-alone operations there are thousands of people employed in human resource units in firms and many more managers who coach and develop their staff. Everyone in this country has some experience of private education.

There are thriving private sectors in other countries. In Australia, the private tertiary education sector is at a similar stage to that in New Zealand, although there are private universities. In the United States, there are private institutions at all levels, from small proprietary institutions to major universities such as Yale and Harvard. In Japan, most of the tertiary education sector is privately owned while there is a flourishing for-profit tertiary education sector in the Philippines and in Chile.

There are some interesting for-profit institutions in the United States as well. The De Vry group of companies offers short vocational courses as well as degrees in computing, electronics and business management. Another company, the Apollo Group, offers masters and bachelors programmes at over 100 campuses around the United States and in London. Both companies are listed on the NASDAQ stock exchange and have current revenues of around US\$300 million each. They are part of a growing wave of listed education companies. The University of Phoenix, a subsidiary of the Apollo group, now has nearly 70,000 students; it operates in 12 locations and on the Internet and is one of America's largest universities.

Even larger companies are emerging in the US education market. Knowledge Universe, a new entrant with over US\$1 billion in annual revenues, is seeking to redefine education provision. It is currently investigating buying either Apollo Group or De Vry to complement its preschool, school, tertiary and supplementary education services. The progress of such initiatives will influence our education system in the future as it develops new delivery techniques, synergies and cost structures.

Similar developments are occurring in other countries, including in the schools sector. In Britain, chains of for-profit schools are being set up. The largest of these, Nord Anglia, has 24 schools in Britain and Eastern Europe and is listed on the sharemarket. In India the for-profit National Institute for Information Technology has 400 campuses and is now expanding into 18 other countries including China, Malaysia, Indonesia, Botswana and even the United States.

These overseas trends illustrate the likely outcomes of greater private sector involvement in tertiary education. New organisational forms, including listed companies and community trusts, are likely to develop. The opportunities provided by a freer market will support a greater variety of organisations, some with different approaches. These are the types of benefits to which the public needs to be exposed.

Of course, PTEs have already innovated through course type, length, qualification type, price, quality and resource mixes. New entrants will not have an easy ride, but it would be foolhardy to believe that current providers are operating at the

highest possible levels of productivity. PTE managers should seek new ways to develop their services, just as they have managed to improve the provision of TOP and Skill Enhancement programmes.

Unfortunately, there are still obstacles in the way of innovative organisations. One of your members, the Sir George Seymour National College of Tourism and Travel, recently won two prestigious awards – one for education in the tourism industry and the other for its achievement in marketing its services. Such success should lead to significant increases in enrolments, but under the current rules the College would be unable to secure a higher level of government funding. That major constraint will change next year, but we should be trying to remove all impediments to the sector's performance.

The Tertiary Education Review

The current Tertiary Education Review has been too restrictive in exploring what the nature and scope of government intervention in tertiary education should be. This work needs to be done so that the whole regulatory framework is re-examined afresh.

The aims of the Tertiary Education Review Green Paper were unclear. They included higher participation in tertiary education but no case for that goal was set out. Quite clearly more of anything is not necessarily better beyond a certain point, even something as important as tertiary education. Another aim was to increase the proportion of Maori and Pacific Island people in tertiary education but there were no policies for targeting assistance to such groups. The Green Paper suggested that the government retain ownership of TEIs without offering any arguments for doing so. More basic questions need to be asked about the government's role in this industry.

Regardless of this confusion over the aims of its policies, the government has come up with some useful initiatives, some of which were announced in the latest budget. The most important of them is opening up the tertiary education sector to competition through more equal subsidies for PTE and TEI students. That should

lead to a mix of lower costs, higher quality and greater choice for consumers, but more work needs to be done on funding, ownership and regulatory policies to enhance those benefits.

Funding should be reduced over time to levels that can be justified on public policy grounds. Subsidies should be related to the public good element of courses. As Milton and Rose Friedman have put it:

The present use of tax monies to subsidise higher education seems to us one of the great suppressed scandals of our day. The young men and women who go to college on the average come from higher-income families than those who are not in college – yet both sets of parents pay taxes. And, whatever the income of their parents, those young men and women will occupy the higher rungs of the economic ladder. Indeed, *we doubt that there is any other government program that so clearly and so massively transfers income from relatively low- to relatively high-income classes.* We in the middle income classes in effect have conned the poor into supporting us in a style that we take to be no more than our just deserts.

It is extraordinary that those who profess to be concerned about inequality in New Zealand are not the most vocal opponents of such an inequitable transfer. Equity objectives in higher education are better served by scholarships or loans.

The priority accorded to government ownership should be reversed in favour of private ownership. The current TEIs should be either sold or restructured as private not-for-profit trusts, as Sweden has done with two of its universities. If state ownership of those institutions is retained, their governance arrangements should be changed. Governing bodies need to have the expertise to oversee the strategies of TEIs and monitor their managers' performance in achieving them. The current representative model does not adequately meet that requirement.

The government must also curtail the scope of its regulation. Entry barriers should be reduced, not increased through the excessive financial accountability requirements and examination of detailed business plans proposed by the Ministry of Education.

The coverage of the National Qualifications Framework should also be limited and be made voluntary. Such a Framework may be suitable for some students and for

some providers but certainly not for all. The danger is that the government will choose to maintain and increase the Framework's coverage in its White Paper. This would disregard individuals' choices over course quality and impose high compliance costs.

The government still needs to make high-level decisions about its role in regulating the tertiary education industry. Providing the necessary advice may be beyond the capacity of the Ministry of Education and require outside experts to review current proposals. This might delay final decisions for a short time, but it could result in higher quality decisions.

The future

The Universal Tertiary Tuition Allowance (UTTA) opens up many opportunities for PTEs and TEIs to better meet the needs of businesses and students. There will be fewer inequities in resourcing arrangements between PTEs and TEIs, and student demand – rather than bureaucratic forecasting – will drive resourcing. These initiatives are necessary, but not sufficient, to meet the expectations of businesses.

Businesses do not want to pay high taxes to subsidise an off-job education system when on-job training is more effective. Businesses are also wary of the inefficiencies that unnecessary regulations are likely to create in private and public organisations. PTEs will be subject to some of the same incentives as TEIs to raise the barriers once they are allowed on to the playing field. Such new barriers to competition should not be allowed to distort what could become a dynamic part of our economy. The PTE sector must continue to press for a level playing field in order to meet its customers' needs – both those of students and businesses.

If we can secure the gains of better funding arrangements without imposing new and costly regulatory barriers, we can look forward to significant improvements in the effectiveness of the tertiary education sector overall. In such an environment the private sector could lead the way in terms of innovation and effectiveness and be assured of a bright future.

