Public Money and the Privatization of K-12 Education

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I. Introduction

Fueled by anti-big-government state legislatures and governors at the beginning of the decade and a growing sentiment to privatize government functions, perhaps the invention of the "education industry" is arguably the most important development for public education during the 1990s. A booming economy at the end of the decade, and an even hotter stock market generating enormous private wealth, ensures that privatization will remain an important topic in the first decade of the new millennium. So far, however, privatization is more sound and fury than a force actually reshaping public education. Traditional providers of products and services such as textbook companies still dominate the education industry. Vouches are intended primarily to rescue the non-profit, primarily religious schools facing the same stiff economic pressures and teacher shortage as public schools. Small private management companies flourishing in the charter school movement offer a better opportunity to see into the future of privatization in K-12 education.

This chapter concludes by developing four ideas about the direction of public schools and privatization over the next ten years: (1) Abandonment of public financial support for continued privatization, (2) Continuation of privatization trends established in the 1990s, (3) Replacement of government schools with contract schools, and (4) Domination of K-12 education by a few large education companies under contract with large cities and state governments. In order to develop these scenarios, however, the first part of this chapter describes the current education industry. The subsequent section sets the stage for looking at the future of private involvement in public education by examining the development of private management companies in charter schools over the past few years.

II. The Education Industry

The education industry is enormous, accounting for nearly 10 percent of the U.S. Gross Domestic Product. Tax supported public K-12 and higher education comprises the bulk of the sector although private providers dominate the childcare, training and development, and educational products sectors. A vigorous nonprofit private sector contributes about 7 percent to K-12 spending and a somewhat larger percent of postsecondary education.

Publicly traded companies represent only 3 percent of the entire education "market", and in the K-12 sector the fraction is one-third of one percent.[1] Together, the publicly traded companies have an aggregate market capitalization ($38 billion) about half the size of the Walt Disney Company (Evereen Securities, p.7). But it's the opportunity that counts. Colossal growth in the K-12 sector is possible even if these companies never gain a double-digit market share. Similarly, the impact of private providers on the public debate over public education overshadows their current financial impact on public education.

Insert Table 1 About Here

Since 1980, childcare, K-12 and postsecondary education's share of GDP grew from 6.5 to 7.2 percent of GDP (NCES, 1999, p. 34). Over a different time period, however, K-12 education's share of GDP changed little, at about 4.4 percent of GDP in both 1970 and 1997. The education industry approaches $700 billion in spending inclusive of childcare, corporate training and development and the educational products/services (electronic media, publishing and diversified products) sectors. This inclusive definition of education spending raises education's share of GDP to

9 percent. EduVentures estimates that the for-profit education market now approximates $80 billion in spending and grew 23 percent in 1996, 25 percent in 1997, and 18 percent in 1998. (Evereen Securities, 1999, p. 5).

As we enter the new millennium, the private sector core of the education industry is concentrated in three sectors. As shown in Table 1, childcare represents a $35 billion market with 10 million students and 90,000 providers. Individuals and small business provide almost all childcare through the private sector. Training and developments is a $60 million market with a clientele of up to 55 million individuals served by about 5,000 private sector providers. Similar to childcare, 95percent of the industry is comprised of individuals and privately owned business. In contrast, publicly traded companies provide a majority of the $30 billion education products/services sector.

K-12 education represents a $340 billion market with 52 million students and about 110,000 schools. Nonprofit mostly religious schools dominate private K-12 education. While private school enrollment grew by nearly one million students over the 1990s, public schools grew equally fast. The proportion of students in private schools remained at about 11 percent of the K-12 sector over the past decade.

Highlighting seemingly low tuition, some analysts often compare existing private schools to public schools, and look to these comparisons for cost-effective solutions to contain ever-increasing public school costs. However, private education has struggled with cost containment as much as public education. In fact, the cost of private education has escalated at a higher rate than the cost of public education during the past three decades. After adjusting for inflation, public school spending increased 155 percent since 1964, and private K-12 education costs rose by 242 percent (Nelson, 1998a). From 1987 to 1994, private school tuition escalated at rates double the rate of public

school expenditures (NCES, 1996, p. 72; NCES, 1991, p. 70).

Despite legal limitations on public spending for private education, some public money has flowed to private schools for decades. Private school students are eligible for federal Title I services for low-income children and special education services provided on site by public school systems. Some states provide financial assistance directly to private schools—as much as $600 per student in Ohio.[2] Additionally, many states require school districts to provide transportation for private school children.

Voucher programs are usually at the center of the debate over public money and private schooling. Flowing public money through families, rather than directly to schools, often circumvents legal restrictions on public money supporting religious institutions. Furthermore, not all students are eligible for vouchers in the three extant publicly funded voucher programs for students attending private schools. The programs in Cleveland and Milwaukee are designed for low-income students. Florida's statewide program applies to students from failing schools.

In Cleveland, the 3,000-student program costs about $7.5 million for the vouchers, and about $12 million after accounting for all costs including $2 million for transportation.[3] Most assistance went to students attending religious schools or kindergarten students who had never been in school. Only about 200 students from public schools received vouchers. The only two for-profit schools in the Cleveland voucher program enrolled a disproportionate share of the formerly public school students (Metcalf et al, 1998). The for-profit Hope Academic converted to charter schools under Ohio's new charter school law for financial reasons.

While the federal courts may dismantle the Cleveland voucher program, Milwaukee's voucher program survived a challenge before the Wisconsin Supreme Court. The program costs up

to $5,100 per voucher student in 1999-2000, or $38 million across 4,200 students in religious schools and 2,300 students in secular schools (Bezruki et al, 2000, p. 17). The prominent management companies described in the next section do not operate any of the secular schools, in part because Milwaukee's charter schools get better funding.

Florida's voucher program began in 1999-2000, but a lower court quickly determined that the program violated the Florida constitution. About 60 students from two low-performing public schools (only students in these two schools were eligible in 1999-2000) had exercised an option to attend private schools at public expense. If the voucher program survives the legal challenge, students from hundreds of public schools may become eligible in future years.[4]

While the three voucher programs receive the bulk of public attention, several states have legislation to provide a tax benefit for families paying private school tuition. Forms of tax credit already exist in Iowa, Illinois, Arizona and Minnesota. The programs involve no school accountability. The laws hold the church state relationship at arms length, making them a preferred option for the support of parochial schools in many states.

Public funding has been instrumental in stimulating the growth of for-profit companies in K-12 education. Education management companies made their first foray into public schools by contracting directly with school districts to manage existing public schools. The experiment with these "contract" schools was dealt a near fatal blow with the terminations of several contracts. For example, from 1991 to 1995, Education Alternative Incorporated (EAI) managed one public school in Dade County, Florida; nine public schools in Baltimore, Maryland; and all of the public schools in Hartford, Connecticut. After numerous controversies, the Baltimore contract was canceled, Hartford terminated its contract and Dade County chose not to renew their contract (Ascher et al,

1996). Other controversial experiments with private education management companies include a contract with Alternative Public Schools to run a school in Wilkinsburg, Pennsylvania, and a Minneapolis contract with Public Strategies, Inc. Neither contract was renewed. As the new millennium began, the only company that contracts directly with school districts to operate public schools is Edison Schools, Inc.[5]

III. Privatization in Charter Schools

Distinct from contract schools the charter school movement gave new life to the concept of privately managed public schools. These new or converted schools are "chartered" by agents of the state, offering families options in addition to their neighborhood public school or other choices that may be available through their school district. Charter school legislation generally grants greater fiscal and educational autonomy from school district and state regulations. Typically, a charter school is organized as a nonprofit institution. Its governing board, however, may contract with a private education management company, an increasingly common practice.

Except for some schools managed under contract with school districts by Edison Schools, Inc., management companies operate almost exclusively in the charter school arena. The initial charter school concept envisioned small groups of teachers and parents starting innovative, experimental schools. However, charter school laws have also created an attractive environment for management companies where their schools—along with other charter schools--face fewer regulations and are often free from the supervision of elected bodies such as school and state boards of education.

By the 1999–2000 school year, 36 states and the District of Columbia had enacted charter school legislation. For-profit companies managed about 13 percent of the 1,500 charter schools.[6]

Since most companies operate larger charter schools than nonprofit operators, the percentage of charter school enrollment in management company schools is much higher than 13 percent.[7] Horn and Miron (1999) estimate that at least 70 percent of charter schools in Michigan during the 1998–99 school year were those involved with private education management companies.

The major education management companies involved with charter schools include Edison Schools, Inc., SABIS, Advantage Schools, Tesseract Group (formerly EAI), the Leona Group, Nobel Learning Communities, Beacon School Management (formerly APS), Mosaica, National Heritage Academies, White Hat Management Company[8] and others. They have successfully raised start-up money from wealthy individuals and venture capital firms. All are small companies. Few are publicly traded. These education management companies embody the popular privatization themes of the 1990s: private capital, innovation, technology, efficiency, cost containment, economies of scale, Wall Street glamour and the dominance of market forces over elected governments.

The remainder of this section profiles management company charter schools. This profile provides support for the scenarios presented in the concluding section of this chapter. Table 2 presents demographic and staffing data for several management company schools operating in 1997-98.[9] The table also contains comparable information for school districts in which the charter schools are physically located.

Insert Table 2 About Here

School size and pupil-to-teacher ratio. The average public elementary school has about 475 students. The average charter school enrolled fewer than 140 students in 1997-98 (RPP, 2000). Perhaps seeking economies of scale, the school size of management company schools looks more like

conventional public schools. In 1997-98, the average size for management company schools was nearly 400 students, as shown in Table 2. The typical Edison Schools, Inc. elementary school serves approximately 600 students if the facility is large enough. Some Edison Schools enroll more than 1,000 elementary students.

RPP (2000) reports that the median pupil-to-teacher ratio in charter schools of 16.0 was a little less than the national average for all public schools of 17.2. Management companies resemble other public schools. The pupil to teacher ratio was 16.8 compared to 16.9 in the surrounding school district (See Table 2).

Administrative costs and economies of scale. The perception of administrative bloat in public schools proves an easy target, but companies may not provide a solution. In the aggregate, management companies overlap rather than replace existing school district administration and support services. In addition to the obvious costs of travel and administrative overlap, multi-state school management companies also spend resources to acquire specific knowledge of each state and school district's regulations, reporting requirements and student assessments programs. For example, EAI cut instructional staff and redirected the resources to non-instructional costs, including lawyers, accountants, project administration, corporate travel, improvement of the physical plant, and profit.[10] Scale is also a problem for administrative efficiency. Highlighting the relationship between size and administrative efficiency, Edison Schools, Inc. 1999 Securities and Exchange Commission (SEC) filing, indicates that the company believes it will achieve profitability if it can open 200 schools. At this scale, Edison's virtual school district would rank as one of the 20 largest in the U.S.

The prospect of management companies improving administrative efficiency may be brighter in the charter school arena where diseconomies of small scale always present financial problems.

Management companies provide assistance with time-consuming state reporting requirements and "running the business". Companies can apply experience in reporting and administration to multiple schools. Providing education services, however, is not essential to management efficiency. Some companies provide only administrative and financial services. Arizona Benefits Solutions, for example, provides reporting and business services to more than 100 charter schools in Arizona, but leaves the educational and day-to-day operations to the charter schools.

Despite all of the reasons that management companies should be able to improve administrative efficiency in charter schools, some evidence indicates that full service management companies may be less effective than other charter schools in keeping administrative costs down. The PSC/MAXIMUS (1999) study of Michigan charter schools revealed that administrative costs were considerably higher in "chain" schools, defined as one of many schools operated by a single management company such as National Heritage Academies or the Leona Group.[11] The analysis of staffing patterns shown in Table 2 finds more administrators in management company schools (0.8 per 100 students) than in surrounding school districts (0.4 per 100 students). However, administrative support staff levels are practically the same as school districts.

Special education and disadvantaged children. Perhaps also a problem of scale, management companies have been ineffective in providing special education, especially to high-cost children. The major national management companies profiled in Table 2 serve an average of 3.8 percent of students in special education (defined as students with Individualized Education Plans required by federal law) compared to 10.2 percent in the average surrounding district. Generally, management companies seek to provide services only for special needs students who can be taught in regular classroom settings (KPMG-Peat Marwick, 1998; Wood, 1999, Zollers and Ramanathan, 1998).[12] In Baltimore, EAI

violated federal laws relating to special education and federal compensatory education programs for low-income children, and operated under extensive corrective action plans (AFT, 1994).

Management companies enroll children from economically disadvantaged families at a rate equivalent to the national average. Low-income students comprised 32.8 percent of enrollment in the management company schools profiled in Table 2. In districts surrounding the management company schools, however, low-income students make up 47.9 percent of enrollment. Management companies tend to concentrate in urban areas where dense populations make it easier to operate large schools, transport students and find facilities.

Innovation. Charter schools were envisioned as a way for teachers and parents to try innovative practices unlikely or impossible in traditional public schools. Most education management companies, however, are organized into "chains" of look-alike or "cookie cutter" schools with uniform school design and pre-packaged curricula. Like their school district counterparts, companies standardize to improve efficiency. Edison Schools Inc. utilizes Success For All in its elementary schools[13] Advantage Schools Inc. offers Direct Instruction.[14] National Heritage Academies uses a "back-to-basics" approach with a strong emphasis on moral values. Management contracts also restrict the innovative mission of charter schools because many contracts restrict the dissemination of company innovations and the intellectual property developed at company charter schools (Hassel and Lin, 1999; Ceresoli, 1999).

Performance contracting. Performance-based contracting logically should be at the core of private sector involvement in education. So far, this has not been the case. According to one study (Hassel and Lin, 1999), management companies generally make money simply by spending less than the revenue they collect rather than by improving student achievement.[15] Hassel and Lin, as well as the Massachusetts Inspector General (Ceresoli, 1999), also identify problems with monitoring contract

performance when companies play a strong role in selecting members of the nonprofit board governing the school or in financing school operations and facilities.

Cost containment. Ironically, cost containment has rarely been a serious objective of privatization in the K-12 education sector.[16] Though it is possible that management companies compete against each other based on price in order to get contracts with the nonprofit governing boards, the schools themselves do not compete based on price for the charter itself. Furthermore, since all charter schools receive basically the same funding, successful charter schools are unable to charge a higher price for their successful product. Unsuccessful charter schools are not punished by lower funding. With no way to raise the price for successful schools, and the diseconomies of small scale that plague charter school efforts to improve efficiency, cost cutting is the only way to make money for investors.

The cost-cutting formula for most management companies focuses primarily on reducing payroll costs, which is accomplished by increasing class size, hiring less experienced and less qualified teachers, or reducing compensation costs in other ways.[17] The average management company school has a pupil-to-teacher ratio matching the surrounding school district (see Table 2). Michigan, where management companies run a majority of charter schools, demonstrates labor cost cutting by companies in charter schools. According to Horn and Miron (1999), 48 percent of charter school teachers outside the Detroit area were under age 30 in the 1997-1998 school year. Teachers averaged 6.4 years of experience compared to about 16 years nationally (NEA, 1997). In the Horn and Miron study, only about one teacher in five had earned at least a Masters degree or higher, compared to 50 percent nationally. In Ohio, where White Hat Management Company ran five of the first fifteen charter schools, and teachers averaged 4.2 years of experience compared to 14.8 years in surrounding school districts (Marsh-Huggins, 2000).

Attracting private sector capital. Management companies have been able to attract private resources. EAI (now the Tesseract Group) raised $36.7 million in a stock sale (Richards et al, 1996). Edison Schools, Inc. raised almost $230 million from private investors, and raised another $120 million in its stock offering.[18] Advantage Schools Inc. has venture capital backing from Chase and Fidelity.[19] These companies use capital largely to finance their own start-up operations, but some of it is used for up-front investments in the schools they manage for facilities and technology. Company investments are repaid with interest over the life of the contract. Although the capital is appealing to cash-strapped districts, capital acquired through management contracts proves costly. School districts can borrow money from private investors by issuing tax-exempt securities at far more favorable rates than those charged by management companies. Private capital raised by management companies is more appealing to charter schools, which usually have difficulty maintaining cash flow, securing start-up funding, and procuring tax-exempt financing for facilities.[20]

Management company capital raises other troublesome issues. Most contracts with management companies clearly state that property purchased through the contract with public funds belongs to the management company (Hassel and Lin, 1999). If charter schools change management companies, schools may be left with no physical assets. The Massachusetts Inspector General (Cerasoli, 1999) found that loan agreements between charter schools and their management contractors could render the schools excessively dependent on their management contractors while reducing schools' contracting leverage.

Improving Student Achievement. According to an analysis of the education industry by Montgomery Securities (1997, p. 15), improving academic achievement and the need for a more knowledgeable and better-trained workforce will drive the growth of management companies. The

record of private managers with school district contracts, principally EAI and Edison Schools Inc., is unimpressive.[21] Early evidence on the effectiveness of management companies in charter schools—including company-dominated Michigan—demonstrates mixed results at best.[22]

Given the poor or mixed track record of the few management companies in business long enough to have one, it is surprising that several states enacted legislation that makes private management one of the tools for the reconstitution of low-performing public schools. Maryland is using its existing laws and regulations, and legislation allowing for forced privatization recently passed in Pennsylvania and Colorado.

IV. A Look Backward from the Year 2010
On the First Decade of the New Millennium

This section presents four ideas about the direction of public funding for privatization: (1) An abandonment of public financial support for privatization, (2) A continuation of privatization trends established in the 1990s, (3) The replacement of government schools with contract schools, and (4) The domination of K-12 education by a few large education companies under contract with state governments.

Scenario 1—The One Best System Triumphs

The tech bubble that greeted the new millennium busted under pressure from high interest rates. States soon exhausted their rainy day funds. Fickle states quit awarding new charters and suspended charter school facilities funding. Other financial loopholes gradually closed over time as states focused on "vertical equity"—funding students with different needs differently. Since it had not been able to operate at a profit in a good economy, the industries largest management company, Lightbulb Schools, Inc. folded. Smaller, more efficient management companies persisted for years in niche markets. Charter schools continued to show lackluster achievement gains, so state legislatures enacted "low-performing charter school" legislation. About 1,000 of the best charter schools still survive—mostly in the big cities and the fast growing states least threatened by charter school competition. The Catholic Church pulled out of voucher programs in Milwaukee, Florida, Chicago and New York City under court-mandated open records requirements regarding both student testing, personal records and finances. David Tyack

(1974) added a new chapter to *The One Best System* entitled, "Decentralization and the New Corporate Model: Contests for Control of Urban Schools, 1990-2010."

Scenario 2—Present Trends Continue

During the first decade of the millennium, states continued to enact politically popular voucher programs for low-income or low-achieving children, but generally without political or economic consequence. State and federal courts either rejected or sharply constrained most voucher efforts. Catholic support for Milwaukee's voucher program waned after a judge ruled that public support for church facilities must be limited to reasonable and annualized per-pupil facilities charges.

Charter school legislation was enacted in every state except North Dakota. Facilities funding for charter schools existed in all states. By 2004, 3,000 charter schools had opened, greatly pleasing President Clinton as she began her first term. Under financial pressure from diseconomies of small scale and a continuing shortage of teachers, charter school size, pupil-teacher ratios and teacher salaries increased. Growth proved fastest in large cities and fast growing states where charter schools had the least impact on school districts. Under continuing pressure to escape controversy, improve student achievement and follow state laws, one university authorizer in Michigan became the model for strict charter school monitoring and accountability. Fierce advocates complained that charter school growth slowed because they had become too much like other public schools.

Management companies dominated political action for charter school expansion. The companies had been singularly unsuccessful in contracting with school districts to run existing public schools because they needed a "low-wage" model to operate, and they also experienced continuing controversies over special education and services for at-risk students. Lightbulb Schools Inc proved the exception. It prospered in a niche market for contract schools when school districts needed to fight encroaching

charter schools. Most states provided financial support for facilities and the IRS ruled that charter schools could issue tax-exempt securities. The ruling spawned a boom in charter school construction for small investment banking firms. Typically, these companies charged 5 points, a 5 percent fee and held a 10 percent reserve, all conveniently capitalized into a package that one inner-city charter school principal described as "usury."

Scenario 3—Every School a Contract School

In the 1990s, New Zealand's decentralization of school authority started an international trend. In an unexpectedly short time, 23 states and two cities in the United States followed suit. During the first 10 years of the new millennium, every public school and most private schools became contract schools in these states and cities. Using public funds, local school boards selected private providers to operate individual schools under formal contracts specifying the type and quality of education. Local school boards were freed from operating schools, and concentrated on improving educational policy. Parents were free to choose the best school for their children, which made the new system work. Contractors had complete control over budgets and staffing. Each local school board is party to many different contracts. Like a mutual fund manager dumping low-performing stocks, dozens of contracts with failing schools have already been terminated.

Not all went smoothly according to Paul Hill, Secretary of the U.S. Department of Education. Contracts have been difficult to terminate, he admitted. Contractors successfully argued that it would take years to show good progress. Failing private schools proved the most difficult to hold accountable. For a variety of reasons, schools did not have complete autonomy over staffing. Although traditional labor contracts became a thing of the past, teacher unions preserved a centralized wage scale and benefit structure just like the unions in New Zealand, The Netherlands and other countries with extensive school

choice. Most Catholic schools had been incorporated into the public funding system. Technically private—so they are allowed to teach religion—they nevertheless had to pay prevailing teacher wage rates to qualify for funding. Private "back office" companies rescued the system from a management talent shortage and sure failure. "Full-service" management companies specialized in the takeover of failing contract schools. The reforms had some unexpected results. Surprising some, the schools with the best reputations were rather conventional and multi-purpose schools located in good neighborhoods proved the exception. Education quality in poor urban areas declined even further as parents gravitated towards schools with a higher socioeconomic status.

Scenario 4—Huge Education Companies Dominate Education

Charter school and voucher experiments in the late 1990s proved unsuccessful at improving education quality. The most significant educational change in the new millennium began in an unlikely place—Inkster, Michigan. Lightbulb Schools, Inc. won the first contract to manage an entire school district from wall to wall. Washington, D.C. was the first major city to follow suit when a disappointed Congress replaced the scandal-ridden charter school system with a single contract to Lightbulb Schools, Inc. Benefiting from the enormous economies of scale and its ability to select low-cost students, the company proved highly profitable. Within a year, the public school system dissolved and many of the best schools merged with the company. Public schools serving the neediest children survived on philanthropy and government programs dedicated to needy students.

Under contracts with state governments, huge companies dominated the education industry by the end of the decade in all rural states except North Dakota. From humble beginnings as a fragmented cottage industry in the charter school movement, management companies merged and consolidated to reduce market fragmentation. Following the lead of Lightbulb Schools, Inc., management companies

established "chains" of schools, in effect creating their own interstate districts. Funding for a parallel set of traditional public schools was eventually eliminated so that taxpayers would not have to pay the high costs of running two separate systems. The companies now provide all aspects of education—teacher services, school facilities, special education services, and after-school childcare.

Management companies promised efficiencies, but like healthcare in the 1990s, the result from a consumer standpoint was degradation of the quality of education at the teacher-to-student level. As the millennium dawned, it was hoped that education reform would improve efficiency and that the savings could be used for those children most difficult to educate. Instead, the companies squeezed teacher salaries, reduced labor costs through use of less skilled personnel, closed small schools and merged others. The "savings" were channeled into shareholder profits, marketing and overhead. The diminutive public school system now served only poor students.

V. Conclusion

Which scenario is more likely? Continuation of current trends (scenario 2) is the safest bet, although a sour economy (scenario 1) both inhibits public funding for privatization efforts and damages the allure of private sector solutions. The every-school-a-contract-school concept (scenario 3) probably underestimates administrative and monitoring costs, and ignores the vary serious issue of inefficiency caused by small-scale operations. Furthermore, current contracts with management companies demonstrate little concern with academic performance which would have to change for Scenario 3 to work. An industry run by big companies (scenario 4) is least likely for numerous reasons, primarily the tradition of local governmental control of education that is still firmly embedded in both rural and suburban areas. Reaching the full potential of privatization, however, is unlikely without scale.

For all the heat and lightening surrounding vouchers and management companies in public K-12 education, very little privatization currently exists. Voucher programs currently enroll about 10,000 students nationwide and approximately three out of four voucher students are served in traditional nonprofit religious schools. The business of contracting with public school districts suffered after the initial failures of several efforts by management companies. Management companies multiplied only under the provisions of state charter school laws.

Despite early setbacks for privatization in K-12 public education, any look at education's future must include an assessment of the role of management companies. The attractiveness of public education for private investors remains unchanged. The public K-12 education system is a huge, stable industry. The virtual absence of private sector management allows for astronomical growth rates. The companies argue that they can bring much needed capital to the schools, contain runaway costs, reduce administrative overhead, and change academically dysfunctional schools into world class learning institutions.

In order to present a balanced picture, this chapter grounded scenarios for the future of private sector involvement in K-12 public education on current practices of the private sector. The diseconomies of small scale work against the notion of management efficiency (one of our scenarios, however, allowed companies to operate at a large scale). The relatively big schools and standardized education programs of charter schools run by management companies duplicate the urban education models attacked by education reformers. Other evidence indicates few striking differences compared to other public schools. Most importantly, no independent evaluation of student achievement in schools managed by companies has shown superior student academic performance.

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Table I
Education Industry Profile, 1998

	Childcare/ Preschool	K-12	Post-secondary	Training/ Development	Products/ Services	Total
Market size (billions)	$35	$340	$225	$60	$30	$690
Schools/providers (thousands)	90.0	111.5	10.0	3.0	12.3	226.8
Students (millions)	$10	$52	$14	$55	N/A	$131
Publicly traded (billions)	$0.3	$1.0	$2.0	$1.9	$18.0	$23.2
Publicly traded (companies)	3	5	16	15	33	72
Aggregate Market Cap (billions)	$0.3	$2.2	$4.9	$1.9	$28.7	$38.0

Source: U.S. Department of Education (1999); Evereen Securities (1999).

Table 2
Characteristics of Management Company Schools, 1997-98

	Surrounding District	Management Companies	N	Management Companies Minimum	Management Companies Maximum
School Size	[a]	397	36	60	1077
Special education students	10.2%	3.8%	29	0	15.8%
Economically disadvantaged	47.9%	32.8%	34	0	81.9%
FTE teachers					
Kindergarten	4.7%	10.3%	25	0	62%
Elementary	39.9%	46.4%	25	0	90%
Secondary	42.3%	38.4%	25	0	100%
Ungraded	13.1%	5.0%	25	0	20%
Total	100%	100%	25	0	100%
Pupil to teacher ratio	16.9	16.8	29	9.8	28.5
FTE staff per 100 students					
Teachers	5.9	6.0	25	10.2	3.5
Instructional aids	1.4	1.2	25	0.0	5.0
Instructional supervisors	0.1	0.1	25	0.0	0.3
Guidance counselors	0.2	0.0	25	0.0	0.5
Library/media	0.2	0.1	25	0.0	0.6
Administrators	0.4	0.8	25	0.3	2.9
Admin. support staff	0.7	0.6	25	0.0	1.5
Student support staff	0.8	0.3	25	0.0	1.7
All other support staff	2.9	1.4	25	0.0	5.9

[a] Public schools in the U.S. average 475 students and charter schools average 137 students (RPP, 2000).

Source: U.S. Department of Education, National Center for Education Statistics, Common Core of Data Survey, 1997-98 and state department of education web pages.

Notes

[1] Publicly traded companies sell stock to the public, which is then traded on stock exchanges. In order to sell and trade stock, these companies must comply with the public reporting requirements of the Securities and Exchange Commission.

[2] A report on the Cleveland voucher program (Murphy, Rosenberg and Nelson, 1997) contains a description of state aid for private schools in Ohio, the state with the most generous public support of private schools.

[3] The $12 million estimate is based on a cost of $4,000 per voucher student as calculated in Murphy et al (1997). Other details of the Cleveland program are in the state auditor's report (Petro, 1998).

[4] In 1999-2000, no new schools were added to the voucher eligibility list. Every low-performing school flagged for participation in the voucher program raised test scores high enough to be removed from the list.

[5] This generalization ignores dozens of small private and nonprofit specialty schools serving special education and at-risk students that contract with school districts. Typically, these schools are considered private schools rather than privately managed public schools.

[6] For the 1999-2000 school year, there were approximately 200 for-profit schools—about 13 percent of 1,500 charter schools. For-profit school estimate from, "For-Profit Schools." *Business Week*, Feb.7, 2000. Page 65. Charter school data from RPP (2000).

[7] In 1998-99 charter school size averaged 137 students compared to 475 for all public schools in the U.S. (RPP, 2000 at p. 20). In 1997-98, the average size of a management company school was approximately 400 students (see Table 2).

[8] Five of the first 15 charter schools in Ohio were run by White Hat Management Company. Two of the five were the Hope Schools that had started as voucher schools in Cleveland.

[9] Most comparisons include five Leona schools, four Edison schools, two SABIS schools, nine Beacon schools, one Mossaica school and five National Heritage Academy schools. School size, pupil-to-teacher ratio, and enrollments for special education and economically disadvantaged students are available for nine Edison schools operating under contracts with school districts. Many schools were excluded from the analysis because they did not provide information to the Common Core Data Survey.

[10] Arthur Anderson audit of EAI schools in Baltimore, 1993-94. Breakdown also presented in Nelson (1997, p. 69).

[11] Chain schools spend a much larger percentage on administrative expenses (33 percent compared to 22 percent in single entity charter schools, and 11 percent in host school districts). They spend much less on instruction (35 percent compared to 51 percent in single entity charter schools, and 54 percent in host public school districts). However, these figures overstate administration costs for both chain and single entity charter schools because facilities leases and payments to private contractors for instructional support are misleadingly classified as business and administration expenditures by the state uniform accounting system.

[12] These investigations focused primarily on Massachusetts. A preliminary analysis of Arizona, Massachusetts, Michigan, North Carolina and Texas indicates that the Massachusetts findings may extend to other states (Muir, Drown and Nelson, 2000). Using the Common Core of Data, the study finds that company-run charter schools have significantly less special education enrollment than other charter schools, and that charter schools in general have less special education enrollment than surrounding districts.

[13] SFA is a widely admired reading program designed to raise student achievement in low-performing schools that have high concentrations of disadvantaged children. SFA was developed by researchers at Johns Hopkins University and is also used in approximately 500 traditional public schools throughout the U.S.

[14] Direct instruction is a highly prescribed teaching technique in which students learn reading and math through recitation. This instruction method has been used in many traditional public schools nationwide, and like Success for All was rated highly in a recent comprehensive study of school-wide reforms.

[15] This review of management contracts by the Charter School Friends National Network reveals that some companies keep the surplus (i.e., the excess of revenues over expenditures) as their fee. Other contractors charge a percentage of revenues or expenditures, usually in the 7 percent to 12 percent range, but many of these contracts allowed the contractor to keep the surplus anyway. Only a few contracts have incentive bonuses (in the 2.5 percent to 3.5 percent range) for improving student achievement or meeting other performance standards.

[16] In charter school states that do not provide facilitates funding, however, cost containment is forced on all charter schools including those managed by companies. Only Arizona, The District of Columbia, Florida, Massachusetts, and Minnesota provide substantial funding for facilities. The reluctance stems primarily from unwillingness to increase state appropriations (most states finance charter schools by redirecting money from other public schools), and states' unwillingness to redirect school district facilities funding, which is primarily financed from local property taxes to charter schools.

[17] Companies running schools under contract with school districts face the same cost-cutting incentives as charter schools. During the first two years of EAI's contract in Baltimore, 56 of 205 teaching positions were cut (Ascher et al, 1996). Typically, half of the teachers in an Edison school have fewer than five

years of experience (Nelson, 1998b) in contrast to the national average in public schools of 16 years of experience (NEA, 1997). High teacher turnover rates in Edison schools results, in part, from their inexperience. The company revealed a 23 percent turnover rate in 1997–98 (Edison Project, 1998), twice the national average for urban public schools in 1994-95 (NCES, 1997). Alternative Public Schools (now Beacon Education Management) replaced the 24 school district teachers with only 15 teachers in Wilkinsburg, Pennsylvania (Clune, 1998; AFT, 1999).

[18] See "Edison Schools File to Make Initial Public Offering," *Wall Street Journal*, Aug. 23, 1999 for information or private investors. See "Education Pays Off Royally." *New York Times*, Nov. 17, 1999 for information on proceeds of the public offering.

[19] "For-Profit Schools." *Business Week*, Feb.7, 2000. Page 65.

[20] Charter schools in Colorado, Michigan and Texas have secured tax-exempt financing to build or purchase facilities. Since the investments are viewed as risky, interest rates are higher than for school districts. Points, fees and reserve requirements can add up to 20 percent of the amount borrowed.

[21] Over the three years of EAI management in Baltimore, standardized achievement test scores for EAI schools decreased, and then increased to about the pre-program level (Williams and Leak, 1995). Edison Schools, Inc. has issued two glowing self-reports (Edison Project, 1997, 1998), but the few available independent studies show otherwise (see Nelson, 2000, 1998b).

[22] In a state with a large number of private operators, Arizona showed few patterns, no consistency across grade and subject matter, and few statistically significant differences (Mulholland, 1999). In Massachusetts, newspapers generally carried negative stories about the performance of charter schools on statewide tests (For example, see Jordana Hart, "MCAS Score Fail to Met Expectations." *Boston Globe*, December 12, 1998). The PSC/MAXIMUS (1999) study of Detroit area charter schools

concluded that the average charter school performed lower than surrounding school districts. In another evaluation of charter schools in Michigan, evaluators found that charter schools scored lower than host districts and also gained less over a two- or three-year period (Horn, and Miron 1999).