

## Profiting on America's Youth? A Study of Educational Management Organizations

Sean Sandoloski

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## Profiting on America's Youth? A Study of Educational Management Organizations

SEAN SANDOLOSKI\*

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*The Role of Government in Education*, Milton Friedman's seminal 1955 article about America's schools, is widely credited as introducing the argument that free market principles can and should be used to administer our children's schools.<sup>1</sup> In his piece, Friedman advocated for voucher programs and tax credits that would allow parents more freedom to choose

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\* Yale Law School, J.D. expected, 2011; Stanford University, B.A., 2008. My thanks go out to Stephen Gilstrap and the wonderful staff of the *Ohio Northern University Law Review*.

1. Milton Friedman, *The Role of Government in Education*, in, *ECONOMICS AND THE PUBLIC INTEREST* (Robert A. Solo ed., Rutgers University Press 1955).

which school to send their children to.<sup>2</sup> The Nobel laureate's ideas struggled to take hold in the United States until the 1990s, but now several cities – including Washington D.C., Milwaukee, and Cleveland – have experimented with voucher programs.<sup>3</sup> But vouchers were not the only innovative fiscal tool to be implemented in the nineties to fund education; the decade also saw the creation of new organizations created with the goal of utilizing free market principles to improve education: the educational management organization (“EMO”).<sup>4</sup>

Section I describes EMOs' unique characteristics, and Sections II through IV then explore many of the arguments for and against the creation of EMOs. Some scholars posit that the schools' economic benefits— like their supposed ability to take advantage of economies of scale and to create positive economic externalities – should lead to the widespread implementation of EMOs. However, others argue that scale economics and outside corporate control have no place in education. Sections V and VI present two case studies – the School District of Philadelphia and the nation of Chile – and explore their experiences with for-profit education. Finally, the Article discusses the larger policy implications of EMOs. In short, while imperfect, the need for innovation in education and the danger of placing too much emphasis on short-term results support the expanded implementation of these organizations for the near future.

## I. WHAT ARE EMOs?

EMOs are public-private hybrid education corporations, colloquially known as “for profit public schools.” School charter holders and public school districts, like The School District of Philadelphia discussed below, typically hire EMOs to provide one of two services. They are either asked to deal with: (1) specific aspects of school administration, such as payroll, or (2) run the day-to-day operations of the school in exchange for a fee, usually a percentage of the school's budget.<sup>5</sup> In the latter case, EMOs'

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2. *Id.* at 144.

3. See U.S. GEN. ACCOUNTING OFFICE, REPORT TO THE HONORABLE JUDD GREGG, U.S. SENATE, SCHOOL VOUCHERS: PUBLICLY FUNDED PROGRAMS IN CLEVELAND AND MILWAUKEE (Aug. 2001); *Future of D.C. School Vouchers Worries Parents*, WASH. TIMES, July 29, 2007. Washington D.C.'s unwillingness to embrace school reform, however, contributed to the 2010 electoral loss of Mayor Adrian Fenty and the dismissal of his chancellor of D.C. Public Schools Michelle Rhee. Diane Ravitch, *Why Michelle Rhee and Adrian Fenty Lost*, BRIDGING DIFFERENCES (Sept. 20, 2009, 8:40 AM), <http://blogs.edweek.org/edweek/Bridging-Differences/>.

4. ALEX MOLNAR, ET AL, PROFILES OF FOR-PROFIT EDUCATIONAL MANAGEMENT ORGANIZATIONS. ELEVENTH ANNUAL REPORT 2 (Sept. 2009).

5. Katrina E. Bulkley & Jennifer Hicks, *Managing Community: Professional Community in Charter Schools Operated by Educational Management Organizations* 41 EDUC. ADMIN. Q. 306, 307 (2005).

obligations include virtually all the tasks of running a school, including staff hiring and firing, crafting curricula, and furnishing meals for students.<sup>6</sup>

While private consultation is an option for underperforming schools under the No Child Left Behind Act,<sup>7</sup> EMOs are most often affiliated with charter schools. Perhaps this is because charter holders frequently have little to no experience as educators.<sup>8</sup> Often, these social entrepreneurs are simply concerned members of the community who want to make a difference in the education of children.<sup>9</sup> Moreover, these for-profit organizations can help provide extra startup capital to charter holders that would not otherwise be available to them.<sup>10</sup> This increased capital flow stems from EMOs' ability to leverage corporate assets in order to access funds.<sup>11</sup>

EMOs generally serve communities with student bodies that are more diverse and disadvantaged than the average public school, but less diverse and disadvantaged than nonprofit charter schools.<sup>12</sup> African Americans make up approximately thirty-five percent of EMO enrollment, as compared to approximately thirteen percent of national enrollment.<sup>13</sup> Additionally, over half of students at schools run by EMOs are eligible for government lunch subsidies.<sup>14</sup>

#### A. Teaching Style and School Culture

Most EMOs use a similar pedagogical approach, placing a heavy reliance on "traditional drill and practice" or "direct instruction" methods.<sup>15</sup> They rely on such traditional practices because, they argue, these methods often lead to marked improvements in students' basic skill levels, which often correlates with higher scores on state standardized tests.<sup>16</sup> Moreover, these methods keep costs down and can be easily and consistently

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6. *Id.*

7. No Child Left Behind Act of 2001, Pub. L. No. 107-110, 115 Stat. 1425 (2002); Frederick M. Hess & Chester E. Finn Jr., *Held Back*, 144 POL'Y REV. (Aug.-Sept. 2007), available at <http://www.hoover.org/publications/policy-review/article/5905>

8. See *infra* Section IV for more on EMOs and charter schools.

9. Henry M. Levin, *The Potential of For-Profit Schools for Educational Reform*, 2 INT'L J. ENTREPRENEURSHIP EDUCATION 1, 3 (2003)

10. *Id.* at 2.

11. *Id.*

12. John E. Chubb, *Should Charter Schools be a Cottage Industry?*, in CHARTER SCHOOLS AGAINST THE ODDS 148, 148 (Paul T. Hill ed., Hoover Institution Press 2006).

13. *Id.*

14. *Id.* at 148.

15. Levin, *supra* note 9, at 11.

16. *Id.* This Article will not address the issue of whether or not placing such a heavy reliance on test scores is a wise educational policy.

implemented across schools, and even states, by a removed corporate presence.<sup>17</sup>

It is worth noting that these organizations' methods of evaluating personnel differ from those of traditional schools. They place a greater emphasis on assessing teachers in an individual and holistic manner and, as such, EMOs rely on performance incentives more than the average public school.<sup>18</sup> This aspect of the for-profit model helps combat some of the negative aspects of providing public school teachers with tenure after only a few short years in the classroom.<sup>19</sup> By providing teachers with stronger incentives to perform, EMOs are attempting to avoid some of the negative consequence associated with providing public school teachers with near absolute job security – pitfalls that include flagging teacher motivation and the stagnation of innovation.<sup>20</sup>

Most EMOs deal with the same challenges, with many stemming from the difficulty of balancing off-site corporate control with on-site school management.<sup>21</sup> EMOs must balance a number of factors that the typical public school might not. What role do teachers and staff play in designing and implementing classroom policy from both an academic and behavioral standpoint?<sup>22</sup> What amount of building-level leadership is appropriate and effective?<sup>23</sup> Are teacher and staff allegiances tied to the school and its students or to the corporation and its shareholders?<sup>24</sup> The answers to these questions are discussed in more depth in the following sections. However, to preview, Katrina Bulkley found in *Losing Voice? Educational Management Organizations and Charter Schools' Educational Programs* that, while EMOs have different approaches to dealing with these tensions, more of these struggles are settled in favor of outside, corporate control than in favor of local autonomy.<sup>25</sup>

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17. *Id.*

18. Henry M. Levin, *Thoughts on For-Profit Schools*, 1, EDUC. MATTERS 6, 14 (2001)

19. As with standardized testing, this Article will not address the issue of whether or not giving elementary, middle, and high school teachers tenure is in the best interest of children.

20. Of course, it can be argued that by using the traditional “drill and practice” pedagogical model, EMOs are simply replacing one manifestation of stagnation with another. *See* Levin, *supra* note 18, at 8.

21. *See generally* Katrina E. Bulkley, *Losing Voice? Educational Management Organizations and Charter Schools' Educational Programs*, 37 EDUC. & URBAN SOC'Y, 204-23 (2005)

22. *Id.* at 25.

23. *Id.*

24. *Id.*

25. *Id.* at 27.

*B. A Brief Case Study: EdisonLearning*

To put all of this information in perspective, it may be helpful to look briefly at the nation's largest EMO: EdisonLearning (formerly Edison Schools).<sup>26</sup> Edison, headquartered in New York City, was founded in 1992 by proponents of the for-profit education movement.<sup>27</sup> It opened its first schools in 1995 and now runs schools in sixteen states, including California, New York, Ohio and Pennsylvania.<sup>28</sup> Approximately 63,000 students are taught in Edison schools.<sup>29</sup> Currently, the Florida Retirement System – somewhat ironically the pension fund for Florida's public school teachers – wholly owns Edison.<sup>30</sup> It purchased the corporation in 2003 for \$180,000,000.<sup>31</sup> Recently, Edison has begun to diversify its operation as they have started to provide a variety of educational services, including an expansion into online learning and the creation of a new research and development practice.<sup>32</sup>

## II. ECONOMIC ARGUMENT FOR EMOS

Educational management organizations' most vocal supporters often tout the companies' ability to erode public education's insulation from market forces.<sup>33</sup> Proponents point to EMOs use of economies of scale, the advantages of competition, corporations' ability to raise capital, and the ability of EMOs to produce a positive, economic externality – namely profits.<sup>34</sup>

One of the simplest and most compelling arguments put forth by EMO proponents is that these corporations' size and scope allow the schools to take advantage of economies of scale.<sup>35</sup> For example, by buying computers and textbooks in bulk or purchasing food and service for nationwide use, these companies are able to expend less money per pupil.<sup>36</sup> With the very notable exception of teachers, the-per pupil cost of every item in a school's

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26. Levin, *supra* note 18, at 8.

27. About EdisonLearning, *available at* [www.edisonlearning.net/about](http://www.edisonlearning.net/about) (last visited Oct. 10, 2010).

28. Our Locations, EdisonLearning, *available at* [www.edisonlearning.com/about\\_us/our\\_locations](http://www.edisonlearning.com/about_us/our_locations) (last visited Jan. 19, 2011).

29. See EdisonLearning, *available at* [www.edisonlearning.com](http://www.edisonlearning.com), (last visited Dec. 28, 2010).

30. Lisa Fratt, *Edison Buyout Draws Ire in Florida*, 40 DIRECT ADMIN. 2 (Feb. 2004) 2004 WLNR 21876259.

31. *Id.*

32. Catherine Gewertz, *Edison Schools Retools Itself as Online-Learning Provider*, 27 EDUC. WEEK 7, 7 (July 16, 2010).

33. Levin, *supra* note 18, at 3.

34. See generally Chubb, *supra* note 12.

35. Chubb, *supra* note 12, at 138.

36. *Id.*

budget shrinks as schools grow larger.<sup>37</sup> EMOs are also more likely to achieve scale than Charter Management Organizations (“CMOs”).<sup>38</sup> The two types of organizations are identical in all respects but one – CMOs do not operate for-profit.<sup>39</sup> Without the pressure to generate profits, CMOs are less likely to expand to the point of economic efficiency. However, many argue that this economic pressure to grow is one of the largest deficiencies of EMOs, an argument discussed in more depth below.

Those arguing in favor of EMOs for economic reasons also point to the fact that the competition will lead to efficiency.<sup>40</sup> Allowing companies to seek profits related to education will, in theory, lead to a higher quality product at lower costs.<sup>41</sup> A comparison to for-profit hospitals is illustrative. Both EMOs’ proponents and detractors often draw comparisons between education and the healthcare industry.<sup>42</sup> While each side makes seemingly plausible arguments, history and statistical analysis seems to favor the EMOs in their drive to improve education via the market.<sup>43</sup> While many expected for-profit hospitals to see lower quality care after the healthcare industry was deregulated, their hypotheses did not hold when studied empirically.<sup>44</sup> Studies actually found no differences between the quality of care in nonprofit and for-profit hospitals.<sup>45</sup>

During the recent economic downturn, supporters have also been quick to point out that EMOs have traditionally had greater access to capital to deal with budget deficits.<sup>46</sup> Simply put, “[o]rganizations that can promise investors a return on their money usually have a far easier time attracting funds than organizations looking for gifts.”<sup>47</sup> While a great deal of money is being routed to education as part of President Barack Obama’s attempt to

37. *Id.*

38. *Id.* at 140.

39. *Id.*

40. Cynthia D. Hill & David M. Welsch, *Is There a Difference Between For-Profit Versus Not-For-Profit Charter Schools?* 2 (Oct. 2007) (unpublished manuscript, on file with the National Center for the Study of Privatization in Education at the Teachers College, Columbia University).

41. *Id.*

42. *Id.* at 3.

43. *Id.* at 5-6 (citing GARY MIRON & CHRISTOPHER NELSON, *WHAT’S PUBLIC ABOUT PRIVATE SCHOOLS?* (Corwin Press 2002)).

44. Hill & Welsch, *supra* note 40, at 4 (citing Frank Sloan et al, *Hospital Ownership and Cost and Quality of Care: Is There a Dime’s Worth of Difference?* 20 *JOURNAL OF HEALTH ECONOMICS*, 1 1-21 (2001)). It remains to be seen what effect the recently enacted health care bill will have on this calculus.

45. *Id.*

46. It should be noted that this analysis assumes that the current economic crisis will not have long-term effects on the availability of capital to large corporations. While this may be erroneous, I have not seen any data or information that would make me think otherwise. See Chubb, *supra* note 12, at 141.

47. *Id.*

raise the United States out of economic morass,<sup>48</sup> states are still looking at massive budget deficits, notably Connecticut and California.<sup>49</sup> The hybrid, public-private nature of EMOs gives schools access to loans acquired by their parent corporation as well as the more traditional methods of raising school funds such as the property tax base and municipal bonds. As such, schools run by EMOs have one more tool to raise funds and bolster their budget.

EMOs also provide positive economic externalities. Profits derived from running public and charter schools are placed back into the economy. Money that would otherwise be “wasted” to inefficiency is pulled into the free market in the form of corporate profit. These resources are allocated more efficiently in the market than they can be by the government. As such, EMOs might not only lead to higher quality education, but also may produce a net benefit to the entire economy. So long as there is no detriment to the quality of our children’s schooling, it seems preferable to choose an option like for-profit education that produces an economic as well as social benefit.

Finally, EMOs’ proponents argue that those who recoil at the commoditization of our nation’s public schools can and should take comfort in the intrinsic power of the market.<sup>50</sup> Simply put, in a free market system, an organization that pushes too hard towards the bottom line and sacrifices quality for profit will be punished by the market as interested parties - i.e., charter holders, school districts, and parents - shift their resources to more successful and efficient actors.<sup>51</sup> If this is the case, underperforming EMOs are likely to be replaced by organizations that provide a higher quality of education such as another EMO or local government.<sup>52</sup>

### III. OTHER ARGUMENTS IN FAVOR OF EMOS

There are many other arguments in favor of allowing EMOs to run schools. I explore some of these in more depth below.

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48. Recovery Act Highlights, U.S. Department of Education, <http://www.ed.gov/recovery> (last visited Oct. 11, 2010).

49. See, e.g., *Connecticut Budget Deficit Doubles to More than \$300 Million*, REUTERS, available at <http://www.reuters.com/article/domesticNews/idUSN2234129620080922>. This article also includes further information on state deficits.

50. See Chubb, *supra* note 12, at 131.

51. *Id.*

52. *Id.* See *supra* Section III.c (on the concept of “exit”).



### A. *The Professional Community*

First, EMOs have established new professional norms. As relatively new organizations, they lack the entrenched bureaucracy and procedures of most public schools and thus have more room to experiment. A healthy professional community, achieved by preventing teacher isolation and improving staff morale, can have positive effects on student performance.<sup>53</sup> By tinkering with program design and improving the informal relationship between school and corporation – essentially serving as “cheerleaders” – EMOs are able to use their resources to create a happier teaching staff and a better-educated student body.<sup>54</sup> Moreover, Katrina Bulkley and Jennifer Hicks found that EMOs have higher expectations for student success.<sup>55</sup> This had led, in turn, to higher levels of achievement at some for-profit schools.<sup>56</sup> Classes of typically underachieving students have seen improvements in classroom morale and performance because of the simple projection of a systemic belief that these kids will succeed.<sup>57</sup> Providing positive reinforcement for underachieving students can have strong and real effects.<sup>58</sup> Further, Bulkley and Hicks posit that the outside vision provided by EMOs creates a stronger community within the school.<sup>59</sup> A shared vision of a school’s objectives allows teachers to feel as if they are working together toward a common goal, increasing teacher morale, and, as a result, improving student performance.<sup>60</sup>

It should be noted that the outside control of schools provided by EMOs may also lead to the alienation of some teachers who might resent being directed by an outside corporation that has little knowledge of the day-to-day workings or unique traits of a particular school.<sup>61</sup> As such, EMOs must use their resources to guard against this potential problem by creating positive working environments for teachers and allowing a nontrivial number of decisions to be made at the school or classroom level.<sup>62</sup> Simply providing avenues of communication between teachers and those in the

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53. Bulkley & Hicks, *supra* note 5, at 306 (citing K.S. Louis, et al, Professionalism and Community: *What is It and Why Is It Important to Urban Schools?*, in PROFESSIONALISM AND COMMUNITY: PERSPECTIVES ON REFORMING URBAN Schools (K. S. Louis & S. D. Kruse eds., Sage Publications 2001)).

54. *Id.* at 325.

55. *Id.* at 334.

56. *See generally id.*

57. *Id.*

58. *See id.*

59. Bulkley & Hicks, *supra* note 5, at 332.

60. *Id.* at 313 (citing K.S. Louis, et al., *supra* note 53).

61. *Id.* at 312-13.

62. *Id.*

national offices of EMOs will go a long way toward dampening the potential alienation of a school's faculty and staff.<sup>63</sup>

### B. Variety

Another benefit of EMOs is inherent in their variety. Many different types of organizations are available to charter holders and public school systems. In Bulkley's study, EMOs displayed varying levels of flexibility.<sup>64</sup> When looking for an EMO to contract with, charter holders and local government actors can choose the one with the education style that they are most comfortable with, varying from some with rigid, lock-step curricula to others with a great deal of classroom-level decision making.<sup>65</sup> In fact, if a district wanted to, it could bring in several different organizations and see which styles worked best for their particular district.

However, it should be noted that Bulkley also found that EMOs were trending toward "isomorphism."<sup>66</sup> Moreover, this variety of education styles has some downsides. For instance, employees may push back against the style of the specific EMO they work for.<sup>67</sup> However, this is a problem in all workplaces in which employees disagree with decisions made by superiors; this occurs in almost all commercial operations and traditionally run public schools as well.

### C. "Exit"<sup>68</sup>

On a related note, charter holders and school districts that turn to EMOs can exercise a great deal of control over the outside companies running the schools via "exit": the ability to breach the contracts with EMOs.<sup>69</sup> If parents or administrators are unhappy with a particular management decision or the direction that a school is going in, they can express their displeasure by either threatening to breach or by cancelling their agreement with the EMO and contracting with new management.<sup>70</sup> This ability to exit gives charter holders and school districts the ultimate "stick" in terms of control over the EMOs. Parents with children in traditional public schools

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63. Bulkley & Hicks, *supra* note 5, at 312-13.

64. Bulkley, *supra* note 21, at 212.

65. *Id.* at 224.

66. Katrina Bulkley, *Charter School Authorizers: A New Governance Mechanism?* 5 EDUC. POL'Y 13 (1999); Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOC. REV. 147, 147-60 (1983)).

67. *Id.*

68. See ALBERT HIRSCHMAN, EXIT, VOICE, AND LOYALTY 4 (Harvard University Press 1970).

69. Bulkley, *supra* note 21, at 227-30.

70. See *id.*

have a much weaker exit threat as their only options of exit are to move to a new school district or send one's child to a private or parochial school. However, it should be noted that the high psychological and administrative costs of exit might lead to bureaucratic entrenchment.

A school district exercising its right to exit made national headlines recently when the City of Philadelphia revoked the charters of five for-profit schools – four run by Edison Schools – in 2008.<sup>71</sup> Whether this was a good decision as well as more information about the School District of Philadelphia's foray into for-profit education is detailed below.<sup>72</sup>

#### *D. Federalism*

The federalist justification for EMOs is rooted in the long held belief that education is, at its core, a local issue.<sup>73</sup> Simply put, what works for students in one state may not necessarily work for students in another. Supporters of EMOs argue that, given the current state of American public education, states should be allowed to try new, innovative methods to alleviate the dual problems of inadequate funding and low student performance.<sup>74</sup> Federalists find great strength in Justice Brandeis's dissent in *New State Ice Co. v Liebmann*:

To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the nation. It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.<sup>75</sup>

While some may argue that it is rather perverse to defend large, interstate corporations by invoking a federalist argument, supporters of EMOs are quick to point out that not all for-profit educators are nearly as large as the most well known organizations such as Edison. Smaller EMOs,

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71. Paul E. Peterson & Matthew M. Chingos, Impact of For-Profit and Nonprofit Management on Student Achievement: The Philadelphia Intervention, 2002-2008, at 11 (unpublished manuscript, on file with the Program on Education Policy and Governance, Harvard University Kennedy School of Government). An abridged version of this piece was published in *Education Next* and is available at <http://educationnext.org/for-profit-and-nonprofit-management-in-philadelphia-schools/>.

72. *Infra* Section V.

73. Kenneth K. Wong, *Federalism Revised: The Promise and Challenge of the No Child Left Behind Act*, PUB. ADMIN. REV. (Dec. 2008) at S175.

74. *Id.* at S181-83.

75. *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

or ones that maintain local and regional ties, allow for relatively local control over schools while still reaping the economic benefits of private management.<sup>76</sup>

#### IV. ARGUMENTS AGAINST EMOS

Many of the arguments against educational management organizations focus on the economic ramifications of for-profit education. Some argue that one cannot port economies of scale into the realm of public education; others express a concern that placing a greater emphasis on whether a school is profitable will lead to a lower quality of education. Moreover, some opponents of EMOs simply express discomfort with the incursion of corporate entities into a relationship that has traditionally existed between parents, children, and the state. In this Section, I explore these opinions, and others, in more detail.

##### *A. Economies of Scale Do Not Work in Education*

EMOs' detractors are quick to undercut the economies of scale argument in support of for-profit public education. For one, they highlight the fact that an increase in size has generally had a negative effect on education – bigger districts, bigger schools, and bigger classrooms have not led to smarter, more engaged children.<sup>77</sup> Henry Levin encapsulates this argument in *Potential of For-Profit Schools for Educational Reform*, by asking this simple question: if economies of scale port over so well to the realm of education, why did for-profit schools only begin popping up in the early 1990s?<sup>78</sup>

What specific arguments do opponents make against economies of scale? For one, they point out that studies have shown that bigger does not necessarily equal cheaper.<sup>79</sup> Empirical evidence shows that the lowest average cost per student is reached in a district with around 6,000 students.<sup>80</sup> Edison schools enroll more than 63,000 students.<sup>81</sup> The drive for profits,

76. Levin, *supra* note 9, at 14.

77. *Id.* at 13 (citing GARY MIRON, & BROOKS APPLIGATE, AN EVALUATION OF STUDENT ACHIEVEMENT IN EDISON SCHOOLS OPENED IN 1995 AND 1996 (The Evaluation Center, Western Michigan University 2000); GARY MIRON & CHRISTOPHER NELSON, WHAT'S PUBLIC ABOUT CHARTER SCHOOLS? LESSONS LEARNED ABOUT CHOICE AND ACCOUNTABILITY (Corwin Press 2002)).

78. Levin, *supra* note 9, at 1.

79. *Id.* at 8.

80. *Id.*

81. See Edison Learning Proposal Submission for RFSP SBE-Illinois Partnership Zone: Lead and Supporting Partners, Reference No. 22018022, available at [www.isbe.state.il.us/apl/pdf/ipz/proposals/edisonlearning\\_lead.pdf](http://www.isbe.state.il.us/apl/pdf/ipz/proposals/edisonlearning_lead.pdf).

they argue, has created school systems so large that their purported economic advantages have eroded or disappeared.<sup>82</sup> However, it should be noted that the *average* EMO enrolls just over 9,000 students<sup>83</sup> – a number that is surely inflated by the presence of large companies like Edison in the market. As such, one must be careful before damning EMOs as too large to take advantage of economies of scale based on this information alone.

They also argue that schools must deal with “high variable costs.”<sup>84</sup> Schools are labor intensive and teachers are already underpaid.<sup>85</sup> In their attempts to cut labor costs, which is the only budget item that does not shrink on a per pupil basis in larger schools, EMOs have pursued three strategies.<sup>86</sup> First, they are hiring less experienced teachers who command a lower salary.<sup>87</sup> While cheaper, these teachers are most likely to quit and are least likely to be able to handle a difficult classroom environment.<sup>88</sup> Second, some have tried to standardize procedures to reduce the need for extra personnel by allowing teachers to follow a standard script.<sup>89</sup> This, in turn, leads to less creative and, potentially, less happy teachers.<sup>90</sup> Further, this rather basic method of teaching is unlikely to work for all students at a specific school site.<sup>91</sup> Defenders of this teaching style argue that this “bare-bones pedagogy” allows EMOs to more efficiently allocate staff as they can easily move teachers between schools.<sup>92</sup> Third, EMOs have tried to recruit and retain the least demanding students to keep labor costs down.<sup>93</sup> This is somewhat paradoxical because these students are those that are the least likely to be falling behind in a traditional school system. As such, this strategy limits the abilities of EMOs to help those who need it most.<sup>94</sup> This criticism, however, is not applicable to all schools. Natalie Lacireno-Paquet’s 2004 study of for-profit schools found that while smaller EMOs tended to target a lower percentage of minority students who are more expensive to educate, there was no difference between the ethnic makeup of schools run by large EMOs and the average charter school.<sup>95</sup> Still, Chile’s

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82. See Levin, *supra* note 9, at 8-9.

83. Chubb, *supra* note 12, at 146.

84. Levin, *supra* note 9 at 7.

85. See *id.*

86. *Id.* at 8.

87. *Id.*

88. *Id.*

89. Levin, *supra* note 9, at 8.

90. See *id.*

91. *Id.*

92. See *id.* at 8-9.

93. *Id.* at 8.

94. See Levin, *supra* note 9, at 8.

95. Natalie Lacireno-Paquet, *Do EMO-operated Charter Schools Serve Disadvantaged Students? The Influence of State Policies*, 12 EDUC. POL’Y ANALYSIS ARCHIVES 17 (June 2004).

experience with for-profit education, discussed in more depth below, seems to support the claims made by EMOs' detractors.<sup>96</sup>

Finally, some argue that scale cannot be achieved because schools must provide an infinite array of different "products" that must be "produced simultaneously."<sup>97</sup> Nearly every student is unique with regard to how they learn both inside and outside of the classroom. A single student may require dozens of different "products" on a daily basis. The pedagogical method that works best for one student in math class may not work or, worse yet, have deleterious effects on the same student in history class. Thus, critics argue that the commoditization and mass production of education by these EMOs hurts individual students.<sup>98</sup>

It should be noted that economies of scale have yet to be tested within the free market. Rather, all of the above arguments assume some form of government control. EMOs may be perfectly suited to reap the benefits of scale without harming our youths' education if they were allowed to exist in a perfectly free market.<sup>99</sup> Of course, critics point out that this ideal free market is nearly impossible.<sup>100</sup> And so the argument goes *ad infinitum*.

#### *B. Other Economic Arguments Against*

The economic argument against EMOs does not end with a discussion of economies of scale. As Henry Levin points out, EMOs have larger cost structures than the average public and charter school.<sup>101</sup> The simple expenses associated with running a business drain money from the schools and toward the corporate bottom line.<sup>102</sup> Because of their overhead, EMOs are unable to funnel more money into the classrooms, which contrasts sharply with what some of their champions posit that EMOs are able to do using economies of scale.<sup>103</sup> Many of these costs, such as the need for corporate offices, are unique to EMOs because of their public-private nature and are not incurred by the average public or even private school. The National Education Association ("NEA"), a leading public school teachers

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96. Martin Carnoy & Patrick McEwan, Privatization Through Vouchers in Developing Countries: The Cases of Chile and Columbia, in *PRIVATIZING EDUCATION* 151-77 (Henry Levin ed., Westview Press 2001).

97. See generally Levin, *supra* note 9, at 4.

98. See Levin, *supra* note 9.

99. See Chubb, *supra* note 12, at 141.

100. See *id.*

101. See *id.*, at abstract.

102. See *id.* at 5-6.

103. See *id.* at 3.

union, posits that somewhere between ten and twenty percent of EMOs funds are spent on administrative costs.<sup>104</sup>

Moreover, other costs, such as marketing expenses, seem completely out of place in the realm of education.<sup>105</sup> Why is it necessary for EMOs to advertise? Besides ensuring that charter holders and school board members are aware of their existence, the corporations must also quell doubts that the average school administrator may have about them – namely, the notion that EMOs are able to make money because they cut services or lower the quality of education as opposed to their economic advantages.<sup>106</sup> Ironically, the money spent on these advertisements is money that would otherwise be spent on students.

Other detractors, notably the NEA, fear that greed and a desire for profit will drive the EMOs and overshadow the main purpose of schools – to educate children.<sup>107</sup> As a result, they posit, the emphasis will be solely on creating profits for shareholders and the education of the students will be harmed.<sup>108</sup> However, supporters of for-profit education point to the ability of the market to discipline bad faith actors.<sup>109</sup> They also champion the ability of charter holders and school districts to cancel their contracts with EMOs that sacrifice achievement for larger dividends.<sup>110</sup> Regardless of which side is correct, this argument highlights an underlying, intrinsic tension with regard to for-profit education and profit-seeking generally: society simply does not trust corporations to avoid maximizing profit at the expense of those it serves.

### C. “Exit” as a Negative

On a related note, what Katrina Bulkley views as a positive<sup>111</sup> – the ability of people to “exit” out of the relationship with EMOs – Henry Levin sees as a deficiency.<sup>112</sup> Levin argues that the contracts between EMOs and schools are often short term and points out the difficulty of turning around our nation’s worst schools in such little time.<sup>113</sup> Sometimes, a dissatisfied

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104. NATIONAL EDUCATION ASSOCIATION, *The Case Against Privatizing School Support Services*, <http://www.nea.org/home/ns/29420.htm> (last visited Oct. 10, 2010).

105. See Levin, *supra* note 9, at 5-6.

106. *Id.*

107. *Id.* at 5.

108. See *id.*

109. See Brian Gill, et al., STATE TAKEOVER, SCHOOL RESTRUCTURING, PRIVATE MANAGEMENT, AND STUDENT ACHIEVEMENT IN PHILADELPHIA xi (RAND Corporation 2007).

110. See Chubb, *supra* note 12, at 141.

111. See Part III.c (for a more thorough discussion of “exit”).

112. See Levin, *supra* note 9, at 6.

113. *Id.*

charter holder or school board will terminate these contracts after only a few years.<sup>114</sup> Simply put, the option of exit is, in Levin's mind, sometimes exercised prematurely and to the detriment of an EMO that has begun to make progress.<sup>115</sup> One might liken this to a college football coach getting fired for not taking a chronically underperforming team to a bowl game after two years of coaching. This is what happened to a handful of Edison schools in Philadelphia.<sup>116</sup> Moreover, early exit has economic consequences for the EMOs.<sup>117</sup> If they are unable amortize their costs over many years, start-up costs for each school are sunk and it is more difficult for them to turn a profit nationwide.<sup>118</sup>

#### *D. The Current Economic Crisis*

Several of the arguments that EMOs' supporters make in defense of for-profit schools do not hold given the recent major economic crisis. And given all of the changes that are occurring, it remains to be seen whether they will continue to. For instance, the difficulty in raising new capital neutralizes the advantage that EMOs have when it comes to fundraising.

Moreover, EMOs' fundamental reliance on free market principles may become less politically desirable. For-profit public education may become less feasible as public distrust of market solutions increases. People may be reluctant to trust their children's educations to outside, for-profit companies based on the idea that they are best able to take advantage of the a market which is viewed as less stable than the government.

On a related note, education is a sensitive issue. People are more likely to resent the idea that profit is being derived from their children's education than from their purchase of commercial goods and services. Therefore, these corporations must be careful to avoid actions that seem driven by profit with little or no positive effect on education. This is likely to limit their range of activities and prevent them from taking full advantage of the market.

#### *E. Role of EMOs*

The debate around EMOs raises the question of who should decide what goes on in the nation's schools. Where do corporations fit in the parent-

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114. *Id.*

115. *See id.* at 6, 9-10.

116. *See* Peterson & Chingos, *supra* note 71.

117. *See* Levin, *supra* note 9, at 6, 9-10.

118. *Id.*



child-state spectrum?<sup>119</sup> It is very difficult to square the paradox of national corporate control with parental autonomy. One of the most frequently cited benefits of charter schools is their close parental control. EMOs, on the other hand, centralize power in a corporation that is often not part of the local community.<sup>120</sup> Critics of EMOs argue that outside corporations should not be making decisions that should be rightly delegated to parents or the state.<sup>121</sup> Some even take the argument a step further, fearing that EMOs will eventually replace our nation's traditional public schools.<sup>122</sup> However, in *Should Charter Schools Be a Cottage Industry?*, John Chubb points to the fact that very few states allow EMOs to hold charters directly and that many states have a one charter-per-organization limit.<sup>123</sup> Regardless, to EMOs' critics, corporations clearly should not be setting education policy.

#### F. Comparisons Between EMOs and Other Charter Schools

It is somewhat ironic that many charter schools, which were created to provide parents with more autonomy and control over their children's education, have turned to outside, for-profit organizations to run the schools. Does EMO control change the charter experience?

Jeffery R. Henig and Thomas T. Holyoke found significant differences between traditional charter schools and those run by EMOs.<sup>124</sup> According to their work, *The Influence of Founder Type on Charter School Structures and Operations*, schools run by EMOs are generally larger and less likely to cater to specific groups of children.<sup>125</sup> For-profit schools are also less likely to offer high school level courses than traditional charters.<sup>126</sup> Finally, they found that while EMOs are more likely to spend money on marketing than the average charter school, they are no more likely to advertise "aggressively" or "monitor their competitors."<sup>127</sup> This last finding is surprising given EMOs position within the flow of the market and contrasts with some opponents' criticisms about the influence of the market on the schools.

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119. See generally, AMY GUTMANN, *DEMOCRATIC EDUCATION* (Princeton University Press 1987).

120. See NATIONAL EDUCATION ASSOCIATION, *The Case Against Privatizing School Support Services*, <http://www.nea.org/home/ns/29420.htm> (last visited Oct. 10, 2010).

121. See GUTMANN, *supra* note 119, at 41-42.

122. See *id.* at 116.

123. Chubb, *supra* note 12, at 129.

124. See Jeffrey R. Henig, et al., *The Influence of Founder Type on Charter School Structures and Operations*, 111 AM. J. EDUC. 487, 514-17 (2005).

125. *Id.*

126. *Id.*

127. *Id.*

Most significantly, EMO-run charter schools are less likely to have or comport to a mission – a characteristic that some see as one of the most appealing aspects of charter schools.<sup>128</sup> This inherent tension between a charter holder's ideals and the commoditization of education leads one to seriously question the role of profit-driven EMOs in running smaller, mission-oriented schools. That being said, it is possible that going forward, the differences between the two types of schools will have more to do with external factors than the differences in their internal workings.<sup>129</sup>

#### V. PHILADELPHIA (AND OTHER STUDIES)

##### A. Background

In the early part of the 2000s, Philadelphia's public schools underwent massive reform. The State of Pennsylvania took control of the city's main school district, the School District of Philadelphia (SDP), and adopted a "diverse provider" model in which management of forty-five of the SDP's worst schools was given to seven different organizations, including three EMOs: Edison Schools, Victory Schools, and Chancellor Beacon Academies.<sup>130</sup> Over the last few years, how have these EMOs performed?

##### B. RAND Study

A study undertaken by the RAND Corporation found that students in EMOs saw "no statistically significant effect, positive or negative, in math or reading in any of the first four years after takeover."<sup>131</sup> Only one individual EMO, Victory Schools, saw any statistically significant difference in performance.<sup>132</sup> Unfortunately, this was a substantial drop in the level of math achievement.<sup>133</sup> However, the "Sweet 16" – a group of sixteen schools that were assumed to be improving by the State and that had received increased funding – and schools taken over by universities and nonprofit providers achieved similar, disappointing results.<sup>134</sup>

While a critic of EMOs may look at these results as proof that outside management of public schools by private companies is not effective; a supporter may look at the results and ask another question. If the

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128. *Id.*

129. Hening, *supra* note 124, at 514-517.

130. Temple University and the University of Pennsylvania were among the non-profits selected. Gill, *supra* note 109, at xi.

131. *Id.* at 32.

132. *Id.* at 37, 40.

133. *Id.*

134. *Id.* at 32-34, 40.

circumstances were such that not a single “diverse provider” could produce results, why would the SDP not favor the only option that produces a positive economic externality? To put it another way: if, as this study seems to indicate, nothing has been effective in improving the quality of our children’s education, why not choose the only method that allows others to turn a profit? One might recoil at this latter view as it obviously represents the commoditization of our nation’s youth and the underlying assumption that the children of the SDP will remain at the same, low level of achievement for the foreseeable future. On the other hand, the efficient option of allowing EMOs to run schools for profit truly does seem like the most favorable out of all the others.

### *C. Kennedy School of Government Study*

A more recent study by Paul E. Peterson and Matthew M. Chingos at the Kennedy School of Government at Harvard University, which included two more years of data than the RAND study, produced different results.<sup>135</sup> Peterson and Chingos found that schools that had been taken over by for-profit managers saw significant improvements in math achievement – an increase in approximately sixty percent of a year’s worth of learning.<sup>136</sup> They also found statistically insignificant increases for students in reading, which over the course of the study would amount to thirty-six percent of a year’s worth of learning.<sup>137</sup> These results contrast rather starkly with their finding that students in schools taken over by non-profit managers saw statistically significant *decreases* in both math and reading achievement in the year that the programs began.<sup>138</sup>

This study found that for-profit schools were, simply put, better for the SDP than non-profits. The different results found by this study undertaken in 2008 and the RAND Corporation’s work, which incorporated test scores achieved through spring 2006, can be attributed to the fact that, according to Tim Sass, test scores are unlikely to improve in charter schools until the fifth year of operation.<sup>139</sup>

The study also looked at the performance of six schools, five of which were controlled by for-profit companies and that the SDP resumed control of in 2008.<sup>140</sup> Peterson and Chingos found that there was little support for

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135. See, Peterson & Chingos, *supra* note 71, at 3-4.

136. *Id.*, at 3.

137. *Id.* at 4.

138. See *id.*

139. Tim R. Sass, *Charter Schools and Student Achievement in Florida* 1 EDUC. FIN. & POL’Y 91, 107-08 (2006).

140. See Peterson & Chingos, *supra* note 71, at 26-27.

the State's decision to cancel their contracts with the for-profit management companies.<sup>141</sup> Four of these schools were run by Edison and one by Victory.<sup>142</sup> While school's reading scores were slightly worse than what would be expected if they were under SDP management, students were performing much better in math.<sup>143</sup> Moreover, the increases in math were over twice as large as the decreases in reading.<sup>144</sup> Peterson and Chingos's findings underscore Levin's discomfort with the concept of "exit" when applied to for-profit education. As Levin predicted, the SDP ended the contract prematurely to the detriment of both the EMO and the children of those five schools.<sup>145</sup> Again, these results comport with Sass's finding that charter schools do not begin to show positive gains until around their fifth year of operation.<sup>146</sup>

#### *D. Other Studies*

Studies of EMOs in other states also shed light on the potential efficacy of for-profit schools:

- Tim Sass's 2006 study of Florida (discussed above) found that charter schools underperformed in their first years of operation, but by their fifth year, they produced math results similar to those of public schools and reading results equal to ten percent higher per year than the average public school.<sup>147</sup> He found no difference in student test performance between for-profit and nonprofit schools.<sup>148</sup>
- In Michigan, for-profit schools have begun to see lower test scores compared to other types of schools.<sup>149</sup> However, when controlling for expenditure per pupil, studies have shown no difference in performance, so one cannot attribute lower scores to cutting corners or cost.<sup>150</sup> It is also worth

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141. *See id.* at 5, 26.

142. *See id.* at 20.

143. *See id.* at 19-21.

144. *See id.* at 20.

145. *See* Peterson & Chingos, *supra* note 71, at 5.

146. *See* Sass, *supra* note 139, at 107-08.

147. *Id.* at 119.

148. *Id.* at 120.

149. *See generally* Hill & Welsch, *supra* note 40.

150. *See id.* at 15-16.

noting that in the Michigan study smaller EMOs tended to do more poorly than larger ones.<sup>151</sup>

#### VI. INTERNATIONAL PERSPECTIVE: CHILE

Chile's education system underwent systemic reform during the 1980s under the rule of the nation's military government.<sup>152</sup> The schools were decentralized and the financing of the school system was completely overhauled.<sup>153</sup> Municipalities began receiving funding on a per-student basis and private schools, which did not charge tuition, received similar payments.<sup>154</sup> A plurality of Chilean students attend schools in the latter category, which includes Chile's for-profit voucher schools.<sup>155</sup>

For-profit schools take several forms in Chile.<sup>156</sup> "Network" schools, which have largely been founded in the last decade, are the most similar to American EMOs.<sup>157</sup> They are controlled by off-site owners and are usually comprised of multiple campuses known as a "network" of campuses.<sup>158</sup> Some of these network schools have private shareholders.<sup>159</sup> There are also many small, family-run for-profit schools in Chile. Most of these are based in neighborhoods and were founded in the 1980s. In fact, former public school teachers that were expelled by the military government run many of these schools.<sup>160</sup> For-profit schools make up approximately twenty-four percent of Chilean schools and account for about a quarter of enrollments.<sup>161</sup>

Data on Chilean for-profit schools seems to comport with scholars' theories about American EMOs. For instance, for-profit schools enroll six percent fewer "vulnerable" students than Chilean public schools.<sup>162</sup> However it must be noted that this figure is still higher than the percentage of "vulnerable" students in other types of schools, notably religious and other private voucher schools.<sup>163</sup> That said, scholars believe that for-profit schools are gaining traction in both "low and middle-income

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151. *See id.* at 16-17.

152. Gregory Elacqua, Enrollment Practices in Response to Vouchers: Evidence from Chile 7 (Aug. 2006) (unpublished manuscript, on file with the National Center for the Study of Privatization in Education at the Teachers College, Columbia University).

153. *Id.*

154. *Id.*

155. *See id.*

156. *Id.* at 8.

157. Elacqua, *supra* note 152, at 8.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.* at 9.

162. Elacqua, *supra* note 152, at 12.

163. *Id.* at 15.

communities.”<sup>164</sup> The similarities do not end there. Like their American counterparts, Chilean for-profit schools have been paying their teachers lower salaries and placing their children in larger classes as well as hiring part-time teachers.<sup>165</sup>

With regard to EMOs efficacy, studies have shown that Chilean students in for-profit voucher schools perform slightly worse than students in non-profit and religious schools.<sup>166</sup> However, it must be noted that for-profit schools have indeed been cost effective in Chile.<sup>167</sup>

## VII. CONCLUSIONS

The question that must be asked is not one about the economic effects of EMOs, but rather about their effect on classroom learning. Are students succeeding in EMO-run schools? There seems to be no consensus on this issue. A study in Florida shows improving test scores while a study in Michigan shows declining scores. Several studies of Philadelphia provide very different results.

Given the mixed results, we should continue experimenting with for-profit public education. We must give these schools time to achieve satisfactory results, and only if we do not see an improvement over a number of years should we end the outside, private management of public schools. Studies have shown that while it takes time, these schools are capable of making a real difference in their students' lives. While it seems unfair to those students who go through the schools while they are experiencing “growing pains,” schools will never achieve results if we are not willing to let them try.

Moreover, the current model of American public education is broken. As American schools continue to see a decline in their performance, we need innovative and new ideas to stimulate our children and shrink the achievement gap between the United States and other countries. While EMOs have their deficiencies, they help serve as a model for the type of radical changes that are needed in our current educational scheme. Those who dismiss it as a “commoditization” of our nation's youth or worry that children's educations will simply become another factor going into the bottom line underscore this general fear of movement away from the status quo that does a disservice to education.

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164. *Id.*

165. Levin, *supra* note 9, at 12.

166. *Id.*

167. *Id.*

States can and should do more to regulate EMOs in an effort to dampen some of their negative effects. By shifting the emphasis to the *public* aspects of these public-private hybrid organizations, the government can better ensure that the students are being well served by the schools. For instance, governments could cap the size of EMOs to prevent the emphasis of the corporation from shifting too far away from the children. This would have the dual positive effect of allowing the organizations to better reap the benefits of economies of scale, given that efficiency is maximized when EMOs' schools enroll approximately six thousand students. States could also prevent these corporations from operating schools that are outside of certain regions; all of the important decisions would still be made in the local community and not by some executive in another city or state.

Finally, the state should encourage school districts and charters to structure their contracts with EMOs in a way that minimizes their desire to give up on the EMOs early while still allowing the community to retain an "exit" option. Perhaps the parties could arrange for the charter holder or school district to exercise a no-penalty buyout of the contract if EMO-controlled schools fall below a certain achievement threshold. To quell opponents' fears that the corporation's drive for profits will lead them to spend only enough to ensure that they maintain the minimum threshold, raise the achievement threshold so high that even a minimum level of slippage is unacceptable to the community. Further, the contracts could call for the minimum achievement level to rise over time to allow EMOs leeway in the first four to five years that they are running a particular school.

Schools and other organizations can use market tactics to achieve both private-sector profits and educational results. The key is to structure the market in such a way that maximizes the benefit to both the EMOs and students. By limiting the size and scope of the market that EMOs operate in, the state can help these innovative educational organizations achieve their stated goal – to help our nation's youth achieve.