

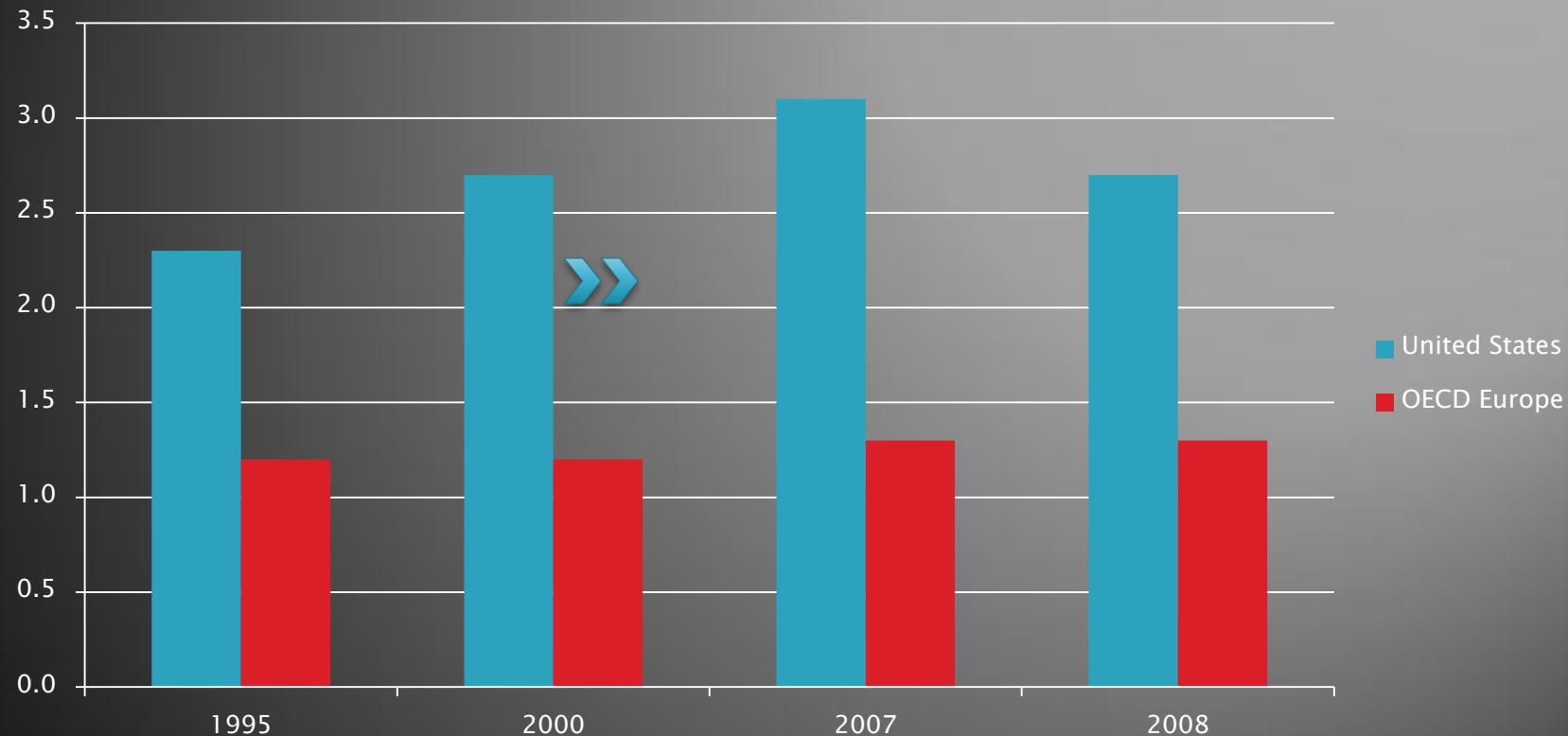
# H. R. Bowen's Rule (1980)

By  
Robert E Martin

# Bowen's Rule: Revenue drives cost.

- ▶ ***Bowen's Corollaries:***
  - Costs rise to fill vacuum created by higher revenue.
  - More revenue displaces need to use resources efficiently.
  - Obsolete activities have no sunshine date.
  - Students/parents associate high cost with high quality.
  - Reputation's rule.
- ▶ ***Observation:*** Bowen's rule and its corollaries are a list of observations about behavior in Higher Ed.
- ▶ ***Hypothesis:*** The cost problem is too much money, rather than too little.

# Higher Education Expenditures as Percent GDP



(OECD Indicators, Education at a Glance, 2011)

# Good news/Bad news

- ▶ ***Good news:*** The level of real resources currently flowing into higher education can support higher quality and lower cost per student, while increasing the number of students served.
- ▶ ***Bad news:*** A fundamental reset for all of higher education is required before the good news is possible.
- ▶ The fundamental reset must change the complex network of adverse incentives that currently lead to Bowen's rule and its corollaries.

# Bain's “Common Inefficiencies” (Jeff Selingo)

- ▶ Unneeded Hierarchy and Complexity.
- ▶ Fragmentation and Redundancy.
- ▶ Lack of Standardization.
- ▶ Misaligned Incentives.

These are the characteristics of “Bureaucratic Entropy” and Bowen’s Rule.

# Bureaucratic Entropy

- ▶ Defined: Tendency of overhead staffing to grow more rapidly than the number of people served; ensuring that costs must rise.
- ▶ Implication: The overhead complexity begins to interfere with the productive activities causing more increases in cost and decline in quality.

# Cost/Quality Theories: Which Theory Best Fits the Facts?

- ▶ Government mandates (external effect).
- ▶ Bundling services not previously offered (internal effect).
- ▶ “Baumol’s cost disease” (external effect).
- ▶ “H R Bowen’s rule” (internal effect).
  - Nonprofit (balanced budget model).
  - Experience good (market failure due to quality uncertainty).
  - Principal/Agent problem (monitoring issue).

# Two information problems

- ▶ 1. Too little information about value added at both the institution and instructor level (classic market failure).
- ▶ 2. Insufficient information to control agency abuse – weak natural mechanism, few oversight groups, too little performance regulation by government, natural performance metric perverted by the nature of experience good competition.

# The adverse incentive effect of student subsidies.

- ▶ Subsidies increase the student's ability to pay, while institutions' set the net price of attendance.
- ▶ Eventually, any increase in the student's ability to pay is recaptured by HE institutions in the form of higher prices.
- ▶ Public access policy is thwarted by this cycle and it just drives costs higher.

# Public versus Private Cost Control

- ▶ Public institutions do a better job of controlling costs than private institutions.
- ▶ Reasons:
  - ▶ Public's must compete for state budgets against K-12, prisons, Medicaid, unfunded pensions. Privates only have competition through household budgets.
  - ▶ Publics have more arms length cost monitoring.

# The center mass of the agency problem

- ▶ Agency problems always lead to costs that are higher than necessary; **high cost is the latent print of agency abuse.** Therefore, look for agency abuse where costs are rising the most.
- ▶ Staffing patterns reveal administrators and board members account for most of the agency problem.

# Can for-profit competition improve economic performance?

- ▶ Two reasons why that may not be possible:
- ▶ Poor economic performance is caused by an experience good market failure; changing all providers to for-profits will not change that fact;
- ▶ Current for-profit entry is at the bottom of the quality tier, all the rents are at the top of the quality tier, the industry looks to the elite institutions for “best practices.”

# A new “Manhattan Project:” Solve the dual information problems.

- ▶ The solutions do not have to be perfect in order to be efficient:
- ▶ 1. A system that measures institution and individual value added;
- ▶ 2. A system of economic performance metrics that reveals agency abuse.