

University of Florida

DONALD CAUSEY

Post Doctoral Bridge Program Research Proposal

PROBLEM:

As part of the educational process, a university may seek to implement a program which gives students the opportunity to put into practice theoretical knowledge gained in the classroom. One way to do this would be to have students operate student run enterprises, also known as SRE's. Ideally, this program would accommodate varying groups of students (undergraduate and graduate), across multiple time periods, yet provide sufficient continuity to allow for sustained growth and productivity of the firm over time. How should such enterprises be governed?

Research Question: What is the optimal governance structure for a student run enterprise at particular academic institution given its' unique structure and resource constraints?

OBJECTIVES:

There are many ways in which an SRE can be structured. So many ways, in fact, that centralizing on an optimum structure could be a daunting task. The many needs of a diverse group of individuals within the institution must be considered. What does executive leadership of the university require? Department chairs will want certain learning outcomes brought forward. Students have expectations around the type of learning experience and instructors want the process to reflect the teaching goals of the program. Customers, understandably, expect value from trade and exchange with the group. No doubt some interests unique to specific stakeholders will cause conflicts among group members that will have to be balanced and resolved.

This paper will seek answer the above research question and explore the broader issue of corporate governance by investigating contemporary approaches to optimal governance structures. Various student run

enterprise structures will be researched at a number of academic institutions with a view towards determining which approach has been optimal given the various choices. Ideally, this work seeks to develop a framework for decisions regarding the appropriate structure at a specific institution.

It is recognized that the environment, structures, resource allocations and goals of the various institutions will vary considerably. This will make the process of seeking optimal structure complex because differing enterprises will seek goal maximization in multiple ways based on their unique needs. An attempt to address this problem will be made by seeking to identify important objectives that would be common to all SRE's at most institutions, and then extract the most appropriate operating systems and methodologies from the multiple organizations.

To highlight the nature of the problem, consider the following approach: The University could own the firm in various forms such as an LLC or C-corp. Then the school could establish a board to operate the firm which would be comprised primarily of students. As students come and go, the board could be rotated. Each group of students would be assessed using certain key metrics for the applicable time period.

This approach, while it has many advantages (University has a long-term orientation and institution has direct ownership of resources, etc.), there are also shortcomings. The students may be more limited in the types of ventures undertaken, students may face restrictions regarding control and risk and this approach seems more closely related to that of an incubator. Depending on the learning objectives for the student, this approach may create false conditions that are unrealistic, given the sometimes harsh, unpredictable and unforgiving nature of the business environment. The realistic conditions of the business environment may not be present, because related parties may view themselves as doing business with the University, as opposed to a nascent firm operated by student entrepreneurs. For example, a potential client that would view the resources of a student run firm as too limited (risky) to utilize for a long-term business relationship may incorrectly perceive that failure is not an option, because the university would not allow that to happen. The client, based on a faulty assumption, chooses to engage in a long-term business relationship with the enterprise.

LITERATURE REVIEW:

Lank et al. provide an interesting perspective from the point of view of organizations which face the problem of dealing with communication barriers due to geographic and organizational boundaries that block the flow of information. The lack of effective communication causes duplication of effort, inconsistent implementation and general inefficiency. Rather than restructure the organization, it is suggested that communities of practice be established to enhance knowledge sharing across “silos” within the firm.

Governance of the organization takes place at two levels: a sponsor and a facilitator. The sponsor acts in a supportive, not directive, role to provide resources and connectivity within the overall organizational structure. Additionally, the sponsor seeks buy-in from persons or groups that may feel threatened and works to assure focus toward achieving management objectives. The facilitator manages the more microscopic details associated with the day-to-day operation of the community in collaboration with the sponsor. Even, taken to the extreme, one could envision viral communities of practice that may be spawned from the initial group.

Think of the embedded nature of the SRE within the overall university structure. How does it effectively communicate outside its' silo to advance the overall goal of experiential learning for students? The approach of a learning community could be applied by identifying a sponsor and facilitator who fulfill the necessary requirements of a community of practice. The sponsor and facilitator become part of a practice council (PC). The PC would have leaders elected by its' members, who would report to the council which in turn would report to a management board established by the institution. This approach is illustrated in figure 1 below. At the board level a strategy is defined to achieve overall objectives unique to the institution. The council provides the management structure necessary for day-to-day oversight of operations, which are run by p.c. leaders with the collaboration and cooperation of p.c. membership.

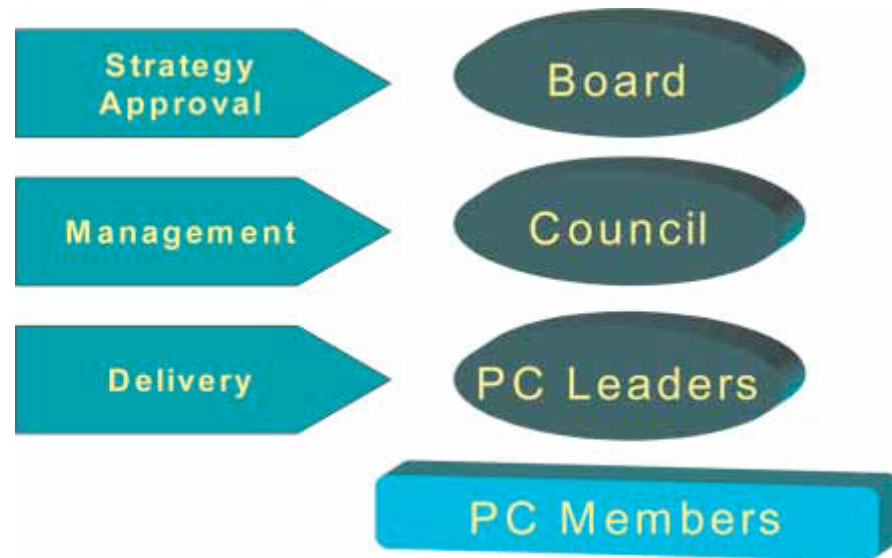


Fig. 1 P.C. Model adapted from Lank et al.

Using the approach of Terblanche, the overall contribution of the SRE to the academic institution may be valued according to the change in the firm's cash flows for different PC leaders. As noted by Terblanche, the importance of marketing to a firm must be directly assessed by using measures which link marketing expenditures to measures of firm performance and more directly firm value. He provides a model of customer value that is based on life-time cash flows provided to the firm as a result of marketing efforts to obtain the customer. The SRE may be thought of as groups of students which over the life-time of the university provide effective marketing and general management that provide sustainable value to the university not just in a single period but multiple ones. Hence, the value of the SRE is not just in the immediate accounting measures of profitability of the firm, but in tangible and intangible measures of value of time, not easily captured by accounting measures. It is even possible that student performance may be assessed according to the relative creation of value across respective periods of operation.

If the history of corporate governance is surveyed, it may be noted that the corporate form of governance originated as an instrument to facilitate

financing and has evolved into a standard legal model (Segrestin and Hatchuel, 2008), which is unsuitable to meet the current governance needs of the firm. Indeed, one may go so far as to say the model is flawed because it does not adequately address collective activities and their value creation process. The value creation activities of the firm differ greatly from the legal framework of the public corporation. Firms are more than mere legal structures as highlighted by Segrestin and Hatchuel (2008) in a new framework that incorporates activity flows, individual and collective potentials and management systems. This new slant recognizes the contributions of many stakeholders beyond shareholders and includes anybody whose input conforms to the requirements of the framework. Can the success of the firm depend on more than financial investment? Could it require community, societal, and other external inputs?

This view of governance seems much more applicable to an SRE model of enterprise development, as many individuals, especially students, would make contributions that are both tangible and intangible. Furthermore, the ownership of the entity would not be vested merely by virtue of shares owned, but in the broader view of the “Enterprise for Collective Progress” or ECP framework. It should be noted that this methodology is fresh and likely has not gained widespread application. This may provide some issues in adoption, but should not impede the continued progression toward new approaches in corporate governance.

Yet another view of corporate governance is outlined by Aglietta (2008) adapting the corporation as the owner of the firm and using team theory to frame control of the corporation with shareholder interests being overseen by a Board of Directors. It is again emphasized that intangible assets provide significant value to the firm that creates a greater diversity of claimants on the firm’s value. Suitable forms of governance may exist in several ways, but financial markets, if they rely only on maximization of shareholder value, may not pick the best one, i.e. non-financial contributions of value created by the enterprise. Institutional investors, which have increased in prevalence, take a longer-term view to value creation and are concerned with extra-financial risks. They are likely to be more activists in expressing their views to effect change. Clearly, substantial learning outcomes add non-financial value in the short-run but long-term economic growth prospects in the long-run that are not easily captured in financial measurements.

Certainly, the SRE has a very diverse set of claimants on its assets and values. Thus, the university controlling student outcomes will likely take a long-term view making the application of team theory appear relevant to the question of control and decision making authority. Indeed the university may be more interested in externalities that require long-term strategic planning, apart from measures of financial value.

It is not altogether assured that an institution can adopt a framework of corporate governance viewed as successful elsewhere, once the operating parameters have changed. Path dependence may be one factor, but the question is a complex one. The case of developed versus developing countries in adopting forms of corporate governance is instructive. For example, Afsharipour (2009) reviewed recent corporate governance reforms in India, a particularly useful example because it is a rapidly developing nation seeking to become a global economic power and, therefore, needs increased access to world capital markets, especially the west, to sustain growth. Recent works have claimed global convergence of corporate governance to the U.S. model, so analyzing India would serve as an interesting test case as to whether such convergence is indeed possible. As Afsharipour found, “traditional theories predicting convergence or lack thereof fail to fully capture the trajectory of actual corporate reforms.” The change was unsuccessful because India was unable to effectively implement and enforce its new rules owing to the complexity and difficulty of installing this type of change across varying social, political and institutional environments.

The Indian example suggests that social, political, and institutional factors may be at play in the adoption of various governance schemes for SREs at different universities. This provides additional support for the study of the settings in which SREs have operated, before adoption is considered in a new locale. This is not to suggest that the comparison of implementation among differing institutions in the U.S. is equivalent to cross-country comparisons between developed and developing nations. Only that the context in which implementation is achieved is a relevant factor for consideration.

The issue of pay-for-performance is also an important one in determining a corporate governance scheme. A recent meta analysis by Rost and Osterloh (2009) shows that pay-for-performance has not been successful. Their research shows that variable CEO income contributes very little to firm

performance. This management fashion does not solve the problem it is intended to solve. Borrowing from theories based on self-interest and psychological economics, Rost and Osterloh (2009) state:

“Psychological economics challenges agency theory’s basic assumptions by proceeding from the ideas of bounded rationality and bounded self-interest (Baker, 1990). These theories distinguish between extrinsic and intrinsic motivation. An action is intrinsically motivated if it is performed for its own sake, i.e., out of interest or pleasure or to maintain an internalized norm. An action is extrinsically motivated if it is done instrumentally for the purpose of achieving a result other than the action itself, e.g., for the purpose of money. The differentiation between intrinsic and extrinsic motivation dates back to Atkinson (1964), DeCharms (1968) and Deci (1975). Under certain conditions, external incentives, particularly money, crowd out intrinsic motivation and have a negative effect on performance.”

This suggests that if students working in an SRE receive a high level of intrinsic reward (a likely outcome), it may be unnecessary to implement pay-for-performance programs to achieve management operational objectives. I As a matter of fact, it may be even be counter-productive. This is not to imply that there shouldn’t be a balance between effort and reward for each contributor to the enterprise, only that the outcome for some may be non-financial. In all cases, each participant should be treated fairly, that is not subject to exploitation because of a high degree of intrinsic value.

The United States is unique in some respects in that most shareholders of large corporations will own less than 2% of the firm; whereas, in most other countries there are only a few principal shareholders who generally have operational control (Balasubramanian, 2009). This poses a different problem in that absentee shareholders may need protection from not only executives but also other principals who have operational control. There are many variants of the protection problem when block shareholders such as institutions and others are considered. In essence, the primary problem, however, remains that interests of absentee shareholders must be protected from other owners, irrespective of ownership structure. According to Balasubramanian, that is the appropriate goal of corporate governance.

Shareholders’ residual claims in Europe and the United States are given primacy, but in India the claims of other stakeholders are given considerable

weight as well. This further raises the question of competing priorities on primacy and whether the claims of all stakeholders should be met or just those of shareholders? The board is uniquely charged with the responsibility of protecting shareholders' interests; therefore, any formula for optimal governance must address the role of boards and their constitution. A suboptimal structure could include a subordinate (to the CEO) executive who is included on the board but acts in a constrained manner due to the presence of a superior. The impact of this situation will depend partly on whether ownership is concentrated or not. In cases of concentrated ownership executive directorship is likely to be prevalent, creating serious potential for interference in decision-making processes. This is likely to be less common where ownership is highly dispersed.

Clearly, this is a broad issue of great import, but further exploration of the topic could pose too much of a digression for the work at hand. The SRE under consideration would likely have a board which operates under the guidance of the leadership of a non-profit educational enterprise which will provide some constraint and, hopefully, avoidance of conflicts typically addressed above.

At this point, it would not seem possible for the SRE to foresee and contract for all potential business outcomes resulting from exchanges with various enterprises. This may be viewed from the perspective of incomplete contract theory (ICT). Such exchanges, according to this theory, are beset by unforeseen contingencies and cannot receive the benefits of a complete contingent claims contract (Alvarez and Parker, 2009). The theory further states that rather than attempt to specify all possible contingencies, the parties to the transaction should allocate the unknowns as residuals and assign them to the party that has the most to give (if such a determination can be made).

In the case of an SRE, the consideration that the university would be the residual may be subject to revision.

HYPOTHESES:

H₁(0): There is no difference in the frequency of the corporate form of governance between small and large universities.

H₂(1): There is a significant difference in the frequency of the corporate form of governance between small and large universities.

H₂(0): There is no difference in the frequency of the corporate form of governance between HBCU and non-HBCU universities.

H₂(1): There is a significant difference in the frequency of the corporate form of governance between HBCU and non-HBCU universities.

H₃(0): There is no difference in the frequency of the corporate form of governance between private and public universities.

H₃(1): There is a significant difference in the frequency of the corporate form of governance between private and public universities.

METHODOLOGY:

The study will be conducted using content analysis in which a detailed and systematic review of at least fifty SRE's will be examined. The number of SRE's is expected to be large enough to obtain a sample of fifty, but a smaller sample will be used if this not the case. From this examination, a list of the prevalent governance forms will be made. Then the various SRE structures will be researched for three subgroups: small and large (based on undergraduate student enrollments), HBCU and non-HBCU, as well as public and private institutions. A public institution is defined as one receiving at least 25% of its direct funding from government sources. HBCU are well-noted and easily identifiable from the web-sites of the respective institutions.

A descriptive analysis of the subgroups will be undertaken first and then statistical comparison to determine if there are significant differences related to size, character and public or private charter in terms of the structure that is selected and implemented at a given institution.

DATA COLLECTION:

Extensive descriptive data, performance measures and program outcome data will be collected from the different institutional web-sites to facilitate comparison. Such data will include the number of students, corporate structure, manufacturing versus non-manufacturing type facility, types of products or services provided and financial measures of performance. The institutions themselves will also be asked to provide a description of the performance measures used to evaluate the success of their programs. If the web-site is not quite clear regarding the governance structure, an institutional representative will also be contacted to provide a written description. Particular emphasis will be placed on Stanford University, as it is noted for its' prior SRE expertise.

The Chi-Square test for differences in frequencies will be used to initially assess the variation in corporate structure for the three sub-groups.

VALIDATION:

A follow-up study will be conducted to examine the student outcomes after the enterprise has operated for a period of three years. This work will assess whether the objectives of the SRE were met and the relative importance of the organizational structure in meeting them.