

An Economist's Tools of the Trade as President

By JAMES I. DOTI

I'VE OFTEN BEEN asked whether my academic background in economics serves me well in carrying out my presidential duties at Chapman University. No doubt, course work in accounting while I was an undergraduate has helped me to critically read and understand income statements and balance sheets.

But what about my many years of almost total immersion in the dismal science? Does it translate to executive leadership? Can economics help a chief executive be more effective, or is it only the stuff of dry mathematical models and esoteric theories, with little practical value?

In reflecting on those questions, I've concluded that my economic brainwashing has been instrumental in how I think about things and make decisions as a university president. I may not always be conscious of it, but economics rears its head in many telling ways. And the same holds true, I believe, for other university leaders, whether they know it or not.

Comparative advantage. In the early 1800s, the millionaire stockholder David Ricardo showed how the law of comparative advantage can be used to explain the gains of trade. That law is why most economists believe in the efficacy of free trade across international borders. I use the law of comparative advantage in a different way.

In strategic planning for a university, we are often confronted with many proposals for new academic programs. Making choices is difficult but choose we must, since resource constraints limit what we can do. About 10 years ago, we had to decide at Chapman whether to significantly expand our small department of film production or focus on alternative programs with great promise.

In the end, we concluded that Chapman had a comparative advantage in film over other universities because of our location in Southern California and because of a team of leaders in our nascent program who shared a compelling academic vision. That small department has since grown to

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become one of the leading film schools in the nation.

That is just one example. I believe we're making the right choices, but more important, I am confident that by placing great emphasis on comparative advantage, we're using the right decision-making process.

Incentives. Any discussion about the workings of a market economy ultimately falls back on the power of incentives. And any discussion about the workings of a vibrant academic community ultimately falls back on attracting and retaining the best and brightest faculty members and students. For that to happen, we must use an arsenal of incentives. The fact that people respond to rewards

is understood even by noneconomists. But economists tend to be obsessed with the connection between incentives and results.

Salaries and scholarships are certainly among the carrots we offer. But the market economy has been unfairly pilloried for dealing only with monetary rewards. Incentives can and do take many other forms.

For example, realizing how much faculty members value endowed chairs and professorships, we began creating more of them. The number of endowed positions at Chapman has grown from one in 1991 to 33 chairs and 19 professorships today.

Creating those endowed positions also relies on using incentives in our fund-raising efforts.

It always troubled me that donors who endow faculty positions get little recognition for their philanthropy. Naming a chair after a donor obviously lacks the panache that comes with giving money for a major construction project and seeing your name in large letters on a building.

One day, as I was jogging along the beautiful trails of the Borghese Gardens in Rome, I noticed busts of famous artists and scientists framing the paths. I'm not sure now, but probably because of my obsession with incentives, I was struck by the idea of creating a similar promenade on the Chapman campus. It would be flanked by busts of personages to represent the various disciplines of our endowed chairs and professorships.

and by each bust we could name the donor whose money had made the position possible.

Our campus now has busts of Abraham Lincoln, Wolfgang Amadeus Mozart, and many others. Most recently, we had a public ceremony to celebrate the creation of a new chair in Italian studies. On the pedestal of an exquisite bronze bust of Giacomo Puccini is a plaque that also commemorates Paul and Marybelle Musco, whose donation made the chair possible.

In tough economic times, when both donors and institutions are suffering under fiscal constraints, the arsenal of monetary incentives will be limited. But market incentives can be as simple yet powerful as giving praise and public recognition to professors, staff members, students, and alumni.

Sunk costs. Those are expenditures that, once incurred, cannot be recovered. Sounds simple enough, but those costs are oh-so-powerful in administrative decision making.

Recently, in evaluating an academic program created several years ago, we reached a point where it became clear we had a failure on our hands. Students and faculty members weren't engaged or interested. The program lurched forward but had few prospects for real success. When our discussion

turned to the possibility of ending the program, someone argued, "Yes, but what about all the money we've invested in this?"

That person was referring to sunk costs. But since these costs are "sunk," they should not be considered in evaluating whether to continue a program. Only its future prospects—both pro and con—are relevant.

Because of the long planning horizon for construction, the perceived benefits of a project often change during the time it takes to complete it. For example, we once spent close to \$1-million in architectural costs for a new classroom building. But by the time we were ready to break ground, we had come to the conclusion that we really needed a new student union more than a classroom building.

The \$1-million was already spent and, so, not directly relevant to forward-looking decisions. Let's say, for example, that the total cost (including architectural fees) for either the classroom building or the student union was \$10-million. In deciding between those projects, the relevant cost for the student union is \$10-million. But the relevant cost for the classroom building is \$9-million.

Clearly, an understanding of sunk costs is necessary for relevant cost-benefit analysis. In deciding what to do, presidents should not be swayed by sunk costs. The only relevant costs for decision making are the costs that

would be incurred from the present to the future.

Price discrimination. Private colleges and universities are price discriminators. Tuition grants in the form of financial aid, for example, can be used to make a college experience more affordable. They can also be used in the form of academic or athletic scholarships to attract better-prepared students or star athletes.

Our ability to charge different net (after-grant) tuition rates to different students is to be contrasted with businesses in which everyone pays the same price for a particular product.

Many experts in the economics of higher education argue that colleges and universities are losing their ability to effectively price discriminate. I made that argument myself in a November 2004 article I wrote in the *Journal of Higher Education Policy and Management* ("Is Higher Education Becoming a Commodity?").

In my research, I found that the ability to use price discrimination is declining at different rates for different types of institutions. I found that more-selective colleges had a greater degree of price-discriminating ability. That is consistent with economic theory that suggests that price discrimina-

tion is conducted more effectively when demand for a product or service does not vary much with price, which is certainly the case at selective institutions.

Strategically, the findings suggest that more-selective institutions will be better able to price tuition and grants at relatively high levels. Less-selective colleges would be better off with a low tuition and grant strategy.

At Chapman, recognition of that relationship helped us to significantly increase student selectivity. Not only would the recruitment of better-prepared students improve the intellectual life on the campus, but it would also place us in a stronger market position. As our selectivity increased, so did our net tuition. We found that being more selective made it possible for us to increase tuition at a faster rate than the rate at which we increased financial aid. In contrast, less-selective institutions generally have to give most of their tuition increases back in the form of scholarships and tuition grants.

I could go on. But there is something else I know about economics, in addition to its usefulness in decision making: The human mind is capable of absorbing only so much economics at one time. So let me end here before the dismal science becomes even more dismal.

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