



[Reading Room: Education](#)

## Beyond Competency Toward Capability

### *Toward A Capable Education Sector*<sup>1</sup>

***This paper was a keynote address to the "Beyond Competency Toward Capability Conference" sponsored by the Education and Training Support Agency in December 1997. It raises a number of questions, still relevant, regarding the governance and management of tertiary institutions.***

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### Introduction

The primary emphasis of this conference is on education for capability. This paper explores a complementary question; the nature of the capable institution. The perspective which I bring to it is that of someone who, for a number of years, has specialised in corporate governance and institutional design from what is sometimes referred to as a "comparative institutional" perspective. Put in simpler terms, this is a perspective which takes as its guiding principle that the design of any one particular institution or type of institution is best done from a broad based understanding of how different types of governance arrangements, and institutional structures, have dealt with similar matters.

I begin by stating what I regard as the guiding principle for organisational design; form follows function. To put this another way, when looking at questions of organisational design the first and necessary step is to understand the function(s) the organisation will be expected to perform. If its function is educating for capability, then its governance structure and accountability must be congruent with that function.

In an address to a New Zealand conference, seven years ago, Professor John Stephenson outlined the approach being taken within the Higher Education Capability project as:

*"Higher education for capability aims to find ways in which excellence in the traditional higher education virtues of knowledge acquisition and skills of analysis can be combined with excellence and equally important attributes such as doing, the use of skills and knowledge, organising, designing, communicating, working without supervision, working with others, creativity and imagination."*

Another guide explained the difference between competency and capability as: "you are competent when able to handle a familiar problem in a familiar

environment; you are capable when able to handle an unfamiliar problem in an unfamiliar environment."

For me, this way of expressing the difference came as a strong reminder of another project being undertaken by the sponsors of the Higher Education for Capability project, the London based Royal Society for the encouragement of Arts, Manufactures and Commerce otherwise known, confusingly for New Zealanders, as the RSA.

The project to which I refer is "Tomorrow's Company: The Role of Business in a Changing World". There is much about the background to the Tomorrow's Company project which will seem very familiar to those of you concerned with the capability movement. Both are set in a context of a rapidly changing world in which, increasingly, the need is for the ability to handle unfamiliar problems in unfamiliar environments.

There are, of course, differences. The focus of the capability movement is on individuals; what do they require of and how should they interact with the education system if they are to cope in tomorrow's world. The focus of Tomorrow's Company is on business organisations; what are the characteristics of the organisation which will succeed in tomorrow's environment.

The Tomorrow's Company Inquiry identified six major forces for change. It is worth setting them out in full as they are, very substantially, the same forces as are driving change in the education sector:

*Technological developments* are transforming markets, revolutionising information and communications, and creating new possibilities for what, how and where work is done.

*Globalisation* of markets, supply chains, work and capital, is racing ahead faster than ever before, demanding new sensitivity and a more rapid response from businesses. Global competition is producing changes in cost and quality on an unprecedented scale.

*New employment patterns* are emerging, with the rise in importance of the knowledge worker, the growing numbers of self-employed people and small businesses, the erosion of the traditional concept of the job as full-time, permanent and male, and the consequent changes in the role and outlook of trade unions.

*New organisational structures* are emerging, with the introduction of the networked organisation, the reduction and streamlining of corporate centres, the sub-contracting of whole functions, and the growing use of independent specialists.

*Environmental issues* are becoming of critical importance for business, not only because of the rising threshold of public concern and expectations, but also because of the need for business to fulfil a significant role in helping to solve global environmental problems.

*The death of deference* means pressure on companies from more demanding employees, customers and communities who expect their individual needs and values to be respected.

These forces emphasise the need for such things as flexibility, openness to change, the capability to react quickly to new information and to work in new and

very different ways.

In a very real sense, the Tomorrow's Company Inquiry was concerned with what makes for a capable organisation. The focus of that Inquiry was on the future of business organisations, specifically of United Kingdom companies, large and small. Many in this audience may wonder why an address concerned with the makings of a capable education system should start by drawing a parallel with the position of private sector companies. Surely companies are very different from the institutions which make up the education sector? After all the primary purpose of company is still recognised as being to maximise shareholder wealth; a very different purpose from that of an institution which has the objectives set out in Section 162 of the Education Act with its emphasis on research, teaching and the dissemination of knowledge.

For part of the answer go back to the six forces of change identified in the Tomorrow's Company inquiry. The objectives of an educational institution may be very different from those of a company but the forces acting upon them are much the same. For another part of the answer consider the following statement from the Tomorrow's Company Report:

*"As the world business climate changes, so the rules of the competitive race are being rewritten. The effect is to make people and relationships more than ever the key to sustainable success. Only through deepened relationships with - and between - employees, customers, suppliers, investors and the community will companies anticipate, innovate and adapt fast enough, while maintaining public confidence."*

I suggest that this paragraph establishes a theme which is common to educational institutions and to the corporate sector of an emphasis on people; of knowing and understanding the needs and interests of the key stake holders with whom you work and developing the organisational capability for responding quickly and effectively to those needs; ideally of developing the capability to anticipate and lead.

In the rest of this paper I want to build on the theme of what makes for organisational capability in a New Zealand educational institution; my focus will be on polytechnics and universities rather than on the primary and secondary system. In doing so I will:

- Briefly discuss the impact of forces such as globalisation and technology in order to set a context;
- Consider the limits on Government action in the current environment;
- Ask what it means to be a capable educational institution in late 20<sup>th</sup> Century New Zealand;
- Draw out the structural and organisational implications of this.

First, I want to note that this emphasis should not be seen as ignoring the role played by New Zealand's many Private Training Establishments. For the most part, they already operate with structures and processes which are consistent with the arguments in this paper. Precisely because they operate in a part of the education universe which is already highly contestable, they have had to develop institutional capability as a condition of survival.

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## Globalisation and Technology

First technology. It is dramatically changing the way in which people access and use information. My own firm employs a Research Librarian whose primary role is to operate our "virtual library" via the internet.

The exponential growth in the internet, the rapid development in interactive video conferencing and the continuing extraordinary decline in the cost of computing power all point to the probability of major changes in the way in which tomorrow's students will access educational services and in the structure and operation of the institutions which deliver them. It also points to a world in which life long learning will not only become almost a pre-condition of citizenship in the sense of being equipped to play a full role in civil society but also the natural, logical and simplest way to approach learning. My generation got its education in a world in which it was taken for granted that the student went to the physical location of the educator and presented at rigorously defined times to receive bits of knowledge intended, together, to provide a set of competencies.

Taken together, the constraints associated with this were a major factor not just in shaping the particular course of study and the timeframe in which that study was undertaken but also generally in limiting students to a single provider.

If technology is effective in removing the need for the student to be physically present, what will this mean for the future shape of our polytechnics and universities and the way in which courses of study are put together? Is it being unduly fanciful to predict a shift from the currently typical (but not universal) practice of studying for a certificate, diploma or degree within a single institution to building up a course of study by selecting components from different providers? Can we foresee a future in which the interface between the student and the provider is a broker whose specialisation may be assisting the student assemble a customised course? Indeed, may we see the emergence of specialist degree or diploma conferring institutions with relatively little teaching or research capability of their own but concentrating on buying in the best on offer from around the world?

## **Globalisation**

This last point, in a way, is no more than another aspect of globalisation; the gradual breaking down of barriers between national economies.

The term, though, has a much wider significance than just the impact of technology. It is really intended to encapsulate a series of changes which have taken place in the movement of goods, services and capital. The main cause for this has been the unsustainability of protectionist policies, whether measures designed to maintain fixed exchange rates, protect domestic industries from competition, or restrict foreign investment<sup>2</sup>.

In New Zealand, the policy shifts resulting from globalisation have been and remain controversial. There are still quite strong bodies of opinion which believe that we should be protecting our industries in order to create employment or that we should impose very strict constraints on foreign investment.

The reality is that we cannot do so. If we re-introduce protection for domestic industry then:

- We would immediately trigger retaliatory action against our exports. New Zealand's major primary industries, such as dairying, meat and horticulture, are continually battling against trade barriers in other countries. For New Zealand to revert to the use of trade barriers would be to give other

- countries the excuse they seek to restrict or exclude New Zealand's exports;
- Experience shows us that protecting our domestic industries against competition has the unfortunate side effect of making most of our manufacturers uncompetitive in international markets.

Nor do we have any real ability to impose restrictions on foreign investment. At the moment, New Zealanders' spending on consumption and investment is somewhere in the order of \$4 billion - \$5 billion per annum greater than our combined incomes. Unless we are prepared to reduce our consumption and/or investment to match our income, we need foreign investment to make up the gap. There is no way I know of in which New Zealanders can force foreigners to invest in New Zealand on our terms rather than theirs. The message is simple; if you do not like foreign investment, then stop relying on foreigners to make up for the gap between what we want to spend and what we earn. If you are not prepared to do this, then recognise the reality that satisfying our needs for investment, on terms we can afford, requires us to allow foreigners broadly the same freedom to invest as are enjoyed by New Zealand citizens.

What does all of this mean for education? The answer is actually quite straight forward. We need to be able to match or exceed the best on offer elsewhere and, where we cannot do so, make it as easy as we can for New Zealand to acquire skills and knowledge from elsewhere. Because of globalisation, we live in an increasingly competitive world. For New Zealand firms to compete successfully in this environment, they must be as or more efficient than their competitors, both firms in the countries to which we export, and firms in other countries which export to New Zealand<sup>3</sup>. If we cannot deliver equivalent or better value than our competitors, then we can expect to lose market share both in export markets, and in domestic markets in competition against imported products.

Let me give you a measure of how this impacts. Within the education sector there is very real concern if Government fails to increase funding to keep up with inflation. For most of our manufacturers the idea of maintaining prices in line with inflation is a dream of years past. The markets in which they operate demand continuing reduction in the real costs of production.

Consider another implication. New Zealand's tax burden, as a percentage of total income, is approximately 43%. A number of our competitors in international markets have total tax burdens of little more than 20%.

In business, tax is treated as a cost of production in much the same way as (say) wages or rent. Our comparatively high tax levels thus automatically put our producers at a disadvantage.

More to the point, this relativity explains why there has been so much discussion in recent times about the need to reduce the tax burden. For sectors such as health and education, this poses a very real dilemma. It is quite easy to see areas where more spending would seem likely to produce improved outcomes. Unfortunately, more spending means higher taxes (or forgoing tax cuts) which undermines our relative position in an increasingly competitive international market.

As educators, there is probably little you can do about this situation except learn how to work within it and recognise that what you do, and how well and efficiently you do it, is a critical element in New Zealand's ability to compete internationally and thus deliver better outcomes for all New Zealanders.

## Limits on Government Action

I have already spelt out one of the major limits on Government action; the need to recognise the role which tax plays in the cost structure of enterprise and the reality that tax rates out of line with those of our major competitors automatically place us at a significant disadvantage.

I now want to discuss some of the other limitations which I believe we need to recognise.

In the past decade or more we have seen a significant withdrawal of Government from activities which most New Zealanders had regarded as part and parcel of what Government naturally did. We took it for granted that Government ran railways, operated a telephone system, provided banking services, owned an airline, had major forest interests, was the country's largest farmer and so on.

We also expected Government to guarantee everyone a job, easy, and free to user, access to education and comprehensive health services, affordable housing and so on.

Much of this has now gone. Government has sold out of most its major business interests and has pulled back, substantially, from accepting that it can achieve in social services the range and level of outcomes which we had come to expect.

It is easy to label this set of changes as simply the consequence of "new right" ideology, thus suggesting that a Government of a different ideological persuasion could easily take us back to the New Zealand we used to know.

I suspect that this belief is particularly strongly held by many people in areas such as education and health. Certainly, it would be natural for this to be the case as these are areas which have carried some of the heaviest burdens of adjustment.

What I want to argue is that these changes have been at least as much the result of a growing recognition of the inherent limits on the capability of governments, as they have been of any particular ideological perspective.

New Zealand's major privatisations, and the associated restructuring of much of what remains in the public sector, have all resulted from changing understandings of the ability of governments (both politicians and their advisors) to use government interventions as the means of achieving desired outcomes.

Both in New Zealand, and in many other countries, governments have come to believe that they do not have the knowledge they need to decide which things should be done in order to get the outcomes they want. They have also come to recognise, from experience, that all too often bureaucratic systems operate on incentives which defeat the very purposes they are intended to serve.

This has become all the more apparent in a world which requires the ability to respond swiftly and flexibly to ever changing conditions.

There is an increasing awareness that government decision making processes, in which decisions grind their way through inter-departmental committees, officials reports, cabinet committee meetings, cabinet decisions and the legislative process, is simply incapable of dealing with the world in which we now live if it is to be the means through which we as a society decide what to do and how to do it in order to meet the needs of our fellow citizens.

Recognition of the mis-alignment between government processes and the need to act swiftly and flexibly in an ever changing world is supported by very considerable experience of how badly things can go wrong when done by governments or their agencies. Consider, as examples:

- The outcome of successive governments' incentive measures to encourage increased farm production in the late 1970s and early 1980s was destruction of sensitive habitats, a major increase in erosion problems (remember cyclone Bola), a temporary increase in production followed by collapse in commodity prices (for a period, Government subsidies exceeded in amount the net income of the farming community) and severe on-farm debt problems;
- Attempts by successive governments to encourage regional development through subsidies produced little in the way of employment gain and typically either encouraged "subsidy farming" (often by consultants for whom this became a lucrative source of income) or created businesses which proved to be non-viable;
- Think Big and its promise of 400,000 extra jobs which turned, instead, into a nightmare of debt for the taxpayer.

It is experiences such as these which have led successive governments to the view that their role should, primarily, be confined to:

- Setting the general legal framework within which people operate to make their own choices, whether in business or in the pursuit of social outcomes;
- Re-distribute income, through the tax system, to ensure minimum standards of access to desired social services such as education, housing, health and income itself through the welfare system.

This is a fundamental shift from the way in which we have expected our governments to act. I personally doubt whether it is yet understood or accepted by more than a minority of the population. Even those in the business sector who lead the call for smaller government are probably doing so more from pragmatic concerns, such as a wish to see their own tax burdens reduced, than from a genuine understanding of the influences which lie behind this change. It is also very clear that many New Zealanders see this apparent withdrawal as a breach of a long held social contract and regard both the levels of funding which Government is prepared to make available, and the approach it now takes social services, as unacceptable.

Governments are also becoming increasingly aware of another major constraint on their ability to intervene in order to achieve specific outcomes. It is of the very nature of bureaucratic systems that they are biased towards standardisation. Bureaucracy abhors discretion and prefers to rely on standardised services, formulae and entitlements. In contrast, we are becoming more and more aware that New Zealand is not an homogenous community but rather a collection of multi-faceted communities with different needs, perceptions and endowments. Increasingly, both in New Zealand and in many other developed countries, this is leading to the recognition of another form of specialisation within the public sector; that between central government as the entity best placed to levy and distribute tax revenue, and local governments or communities in other forms as the entities best placed to determine local priorities and how those should be met.

In summary, what I am outlining is a gradual loss of faith in the omniscience of government, whether dealing with the business or commercial side of governing or with the social or community side.

The point I wish to make here is that, notwithstanding both widespread public objection to the changing nature of government, and what I personally regard as the very ham fisted way in which the change has been managed, it is here to stay. It is simply not feasible for any New Zealand Government to revert to the practices of bygone years through what were our traditional practices of:

- Borrowing in order to pay for current consumption (which is really a form of deferred taxation);
- Increasing current taxes;
- Reverting to a process of "picking winners" either in the business sector or in areas such as education or health where those decisions are best left to professionals who understand the areas and face, at least for their own organisations, the consequences of their decisions.

What does this mean for a sector such as education? In my judgement, present and future governments will concentrate on the purchase/funding role (see this as part of Government's commitment to redistribution) rather than on determining exactly what providers should provide and how. This will see a gradual shift away from management of provider institutions for its own sake, or from Government making judgements as to how many providers there ought to be and where they should be located. Instead, Government's ownership interest will concentrate far more on ensuring that there exist systems, within the institutions it owns, which will contribute to good governance of those institutions and sound stewardship of their assets.

Specifically, I argue that this change in emphasis means that the Government will no longer be committed to the support of institutions which cannot survive, financially, within the Government's standard funding/purchase framework. Instead:

- Risk of failure will be seen as a necessary discipline to underpin efficient management of tertiary institutions - a willingness to "bail out" failing institutions will instead be seen as simply a signal to managements that you can stop worrying about bottom line efficiency as, if the worst comes to the worst, Government will simply write you another cheque;
- Support for a failing institution will be seen not as a judgement in the context of a national education policy on the need to ensure access (as, particularly with changing technology, potential students will have other access opportunities) but as a disguised form of regional development and as probably a negative in terms of educational outcomes by maintaining in place an institution which, by virtue of financial failure, would almost certainly be seen as having demonstrated that its educational services were not of sufficient quality, or sufficient relevance, to compete effectively with other providers.

This may seem a fairly bleak scenario. Elsewhere<sup>4</sup> I have put this in the context of the changing roles of central and local government. In that paper I argued that local government was increasingly becoming the government of the district for which it was responsible and that it was at this level, rather than as part of central government policy, that questions such as the survival of local institutions would be decided. I suggested that, as a working hypothesis, it was sensible to assume that perhaps as many as a quarter to a third of New Zealand's polytechnics would prove to be non-viable within current policy settings. Central government's concern would remain one of funding access (within budgetary constraints); in respect of individual institutions, central government's focus would be on managing its ownership interest but not on keeping institutions open for their own sake.



Instead, the question of whether a particular institution continued in existence or not would become primarily a matter for local decision. If it mattered locally (as it does in a number of communities) to maintain a tertiary institution in existence, then the appropriate option was for local interests to stand behind what I have termed a "community buyout" shifting responsibility for the ownership interest from central government to the local community; more of this later.

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## **The Nature of a Capable Educational Institution**

In this section I want to put forward some suggestions regarding the preconditions for being a capable educational institution. Here, I am talking about institutional capability rather than about the nature of educational practice - that is for other speakers and is well covered at this conference.

Instead, I want to talk about the characteristics of a capable institution. In doing so, I start by drawing together the themes of earlier parts of this paper as context.

First, consider the distinction between competence and capability cited in the introduction: "you are competent when able to handle a familiar problem in a familiar environment; you are capable when able to handle an unfamiliar problem in an unfamiliar environment."

Next consider the way in which the environment is changing. Technological change is going to affect New Zealand's educational institutions directly. It has the potential to change, radically, both the geographical and the demographic catchments from which they have been accustomed to drawing their students. Equally, it will mean that students who may have naturally turned to a particular institution - because of proximity or because it was recognised as a New Zealand specialist in a particular subject area - will themselves be able to choose from a huge range of potential suppliers.

Do not believe that such things as the difference in funding arrangements will necessarily protect against this kind of competition. First, there are suggestions in the recent green paper that funding should be attached to students rather than to institutions and, that, perhaps, students should be able to apply that to the purchase of services from providers wherever located. Secondly, students are becoming increasingly conscious of the cost: value relationship and may be prepared to pay quite high fees if they believe there will be commensurate value.

Again, I pause to note that New Zealand's PTEs already operate in an environment which requires them to understand the impact of technological change and be very aware of the preferences of their customers, both the agencies or businesses which formally provide much of their funding and the students whose choices underpin that.

In the introduction I quoted extensively from the report of the Tomorrow's Company Inquiry not because I believe that educational institutions and companies are interchangeable - they are not - but because I believe that increasingly both are operating in similar environments. To survive under the twin pressures of technological change and globalisation, educational institutions will face exactly the same needs as companies to be able to respond swiftly and flexibly to increasingly rapid change. In your environment, you have been used to long lead times for the design and approval of courses and to operating on a semester based cycle which by definition has meant that new products and

services are introduced only at very specific times during the year. These characteristics have been, largely, a function of the fact that educational services have been delivered in fixed physical locations coupled with traditional commitments to the mix of teaching and vocation (research and reading) time for staff.

I see no reason why these constraints should continue to apply if we are moving more and more to electronically based delivery systems. You may well find yourselves in the same situation as one case study company in the Tomorrow's Company Inquiry which reported that "a product improvement gave them an edge for a mere six weeks".

Consider what this means if you are to have the capability to handle unfamiliar problems in an unfamiliar environment, the situation which I believe will be typical of any institution operating under the scenario which I have outlined.

Section 160 of the Education Act reads:

*"The object of the provisions of this Act relating to institutions is to give them as much independence and freedom to make academic, operational and management decisions as is consistent with the nature of the services they provide, the efficient use of national resources, the national interest, and the demands of accountability."*

What I am suggesting is that you face a profound change in the nature of the services which you will be providing as compared with the nature of the services you provided at the time that section was written (1989). Specifically, I am suggesting that if you are to compete in the kind of environment which I have outlined, your institutions will need to be autonomous self-governing bodies. The demands of the environment in which you will be operating will simply not permit the luxury of long drawn out negotiations over the nature of courses, funding, terms and conditions of employment, the structure of your governing bodies or any other matter. There is a certain irony in this judgement. There has been a long standing tension between tertiary institutions and Government over issues such as autonomy and academic freedom. I find it fascinating to contemplate the possibility that tertiary institutions may finally have the autonomy they have sought, not because Government has finally yielded to traditional academic arguments but because changing conditions in the markets in which tertiary institutions operate give neither them nor Government any other choice.

This is the good news, but like all good news it comes with conditions attached. First, you will have not only autonomy but responsibility; specifically, responsibility for your own academic and financial viability. Leaving aside the arguments in an earlier part of this paper on the limits on government action, there is no way in which any government would be prepared to grant autonomy on the one hand but remain as underwriter of financial risk on the other<sup>5</sup>. Government will remain as the purchaser (unless it moves in the direction signalled by the green paper of attaching funding to students rather than purchasing through the EFTS system). It will also, for very good public interest reasons, continue to maintain (and hopefully improve) quality assurance measures.

To the extent that Government remains the owner of institutions, I would expect it to act towards them as it does towards (say) state owned enterprises by establishing a framework for the proper management of the ownership interest; largely this is a matter of setting performance targets, appointing or overseeing the appointment process for the governing body and monitoring performance.

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## The Structural and Organisational Implications

The scenario which I have outlined clearly implies some kind of structural and/or organisational change for tertiary institutions. The structure and governance of tertiary institutions has been a very live topic for some years now. It has been driven as a subset of issues within public sector reform with a focus on better stewardship of the Crown's ownership interest. This has a number of facets including:

- Mechanisms for ensuring good stewardship of the Crown's assets including the efficient use of resources;
- Means of managing risk to the Crown including financial risk (so long as the Crown is seen as in some sense the residual guarantor) and which includes the Crown's interest in being assured that proper attention is paid to institutional viability.

In 1995 a paper prepared for the New Zealand Vice-Chancellors' Committee by Graham Scott and Simon Smelt set out the Crown's interest in university (or for that matter tertiary) level education and its ownership interest in the following terms:

### Interest in Education

"The Government's interests in university level education focus on equity and subsidy concerns, research and the development and delivery of its strategic priorities. In New Zealand, as overseas, the state is seeking to improve accountability for the use of public resources and move from input controls to contractual ones and objective setting. The Crown as owner is liable to be more active in its ownership relations with universities than hitherto, rather than merely setting the regulatory framework and pursuing its so-called purchase interests in relation to research and funding student places" (note that this description of the Crown's interest in university or tertiary level education describes it as primarily a purchase interest).

### Ownership

With regard to ownership interests, its emphasis is primarily on containing the financial risk to the Crown and improving performance. Ownership, and ownership monitoring appear however to add little to the Crown's other interests in universities or to fulfilment of the broader objectives that a university may hold. Nevertheless, they offer the Crown reserve powers to intervene in order to safeguard its risk or to try to enhance performance. In part, this may be a means for the Crown to avoid explicit ex ante purchase contracting, by giving it the ability to intervene ex post".

More recently, the Ministry of Education has released the green paper "A Future Tertiary Education Policy for New Zealand; Tertiary Education Review". This document clearly signals the intention to introduce major changes. There are signals that:

- Funding may shift from an institutional to a student focus;
- Improvement in the quality of governance is a major priority (a particular concern is the size and composition of councils);
- A preferred option appears to be the establishment of tertiary institutions as

Crown owned companies broadly parallel to Crown Health Enterprises as they are expected to be at the end of the current round of health sector reforms, that is, not for profit companies which are nonetheless required to pay a capital charge.

This latter implication follows, amongst other things, from the extensive work done towards the development of a tertiary capital charge as a means of ensuring that tertiary institutions explicitly recognise the opportunity cost of the capital which they employ.

The Scott report took a somewhat different approach. It argued that there were three factors which needed to be balanced:

- The need for an effective system of governance;
- The wish by universities (and other tertiary institutions) for the maximum degrees of freedom necessary for pursuing their objectives effectively;
- The concerns of the Crown as a major funder to ensure suitable and reliable provision and to minimise risk to itself.

In Scott's view a trust or equivalent not for profit corporate form was seen as the most promising means of balancing these concerns "in part because of the useful distinction between settlor, trustees and beneficiaries together with the binding nature of the Deed of Trust. These features facilitate a relationship between parties which is fundamentally different from that between shareholders, directors, and managers in a public or private sector corporation in terms of the obligations they create for the parties".

From reaction so far to the green paper, it seems that Scott may have been a lot closer to an understanding of the preferences of the tertiary sector than the authors of the green paper. Specifically, the implication that tertiary institutions should become not for profit companies governed by Boards of Directors appointed substantially for their commercial skills has clearly not found favour.

My own view, and the argument which I wish to advance in this part of this paper, is informed by two things:

- A consideration of the context in which the tertiary institutions of the future will operate; specifically the impacts of technology, globalisation and the growing recognition of the limits of government action;
- My experience in advising on the design of organisational structures across a range of different entities from public companies through Crown and local authority owned companies to trusts, co-operatives and community organisations. This is an experience which has left me with two clear views:
  - form flows out of a close understanding of function;
  - governance matters and it is a very different thing from the expression of stakeholder interests.

Let me start with function. My first concern is that both the Scott report and the green paper place insufficient weight on the level of uncertainty which tertiary institutions will face in coming years because of factors such as technological change and globalisation. There is clear evidence, for example from the energy sector or from observing the major trusts which emerged from the restructuring of Trust Bank, that trust structures are not well adapted to the management of businesses operating in an inherently uncertain environment. The "prudent person" rule which governs trustees conduct is simply too inhibiting, as is what I term the "body language" of trusts as institutions.

The idea of a Crown owned company seems similarly flawed, especially if it is based on the Crown Health Enterprise model, given public dissatisfaction with that. The Crown owned company model does provide a better framework within which to manage business in conditions of uncertainty but it is not one which I would willingly apply in a context in which both academics and students have strong views about the relationship between governance and stakeholder interests, as well as clear concerns that the use of a company structure is simply a way station on the road to privatisation<sup>6</sup>. Design of the tertiary institution of the future must take account of:

- The fact that the institution will be managing a business under conditions of uncertainty; this means ensuring that those responsible for its management must face appropriate incentives and, in particular, in some form there is a direct relationship between management of risk and their own personal income and wealth (this is not an argument for privatisation; it is simply stating what seems to be a necessary pre-condition for effective management under conditions of uncertainty);
- A clear recognition that tertiary institutions should be driven by a commitment to academic values and not just financial returns - whereas for a company financial returns (maximisation of shareholder wealth) may be the primary reason for existence, for a tertiary institution meeting financial performance targets should simply be seen as a necessary precondition for survival rather than an end in itself;
- An appropriate means for incorporating long standing traditions of stakeholder involvement including staff, student, community and graduate interests.

This will require skill in organisational design. Effective management under conditions of uncertainty requires that somehow in some way capital is at risk in a form which has real consequences for those responsible for the organisation's governance. That is easily achieved within a company structure; shareholders carry residual risk and have the power to replace management; in turn it is increasingly common for management to be rewarded in relation to financial performance. I argue that, in a similar way, tertiary institutions will require risk capital as part their funding base and that management rewards should be related, at least in part, to the outcomes for the providers of that risk capital. Again, I stress that I am not arguing for privatisation as there are a number of other ways in which risk capital can be introduced into tertiary institutions without removing their essentially public character or, for that matter, needing to make any change to current legislation.

Responsibility for the academic leadership of the institution must remain in academic hands. In practice, this may ultimately lead to some form of internal purchasing with negotiation taking place between management and academic staff regarding level of funding and the course and other activity which the institution will undertake. Here, I am clearly signalling the need to achieve a delicate balance between the competitive reality which the institution will face in the outside world and the importance of maintaining academic values within the institution.

It is imperative that there be a proper separation between governance interests and stakeholder interests. Currently, the councils of tertiary institutions are a confusion of the two. The role of councils is to provide good governance of the institution, including good stewardship of its resources. Their composition all too often points in the opposite direction of satisfying particular stakeholder interests whether it is those of staff, students or community. All of these are significant interests. In my view they are better satisfied by being separately identified within their own form of structural expression. Elsewhere this is increasingly achieved through the use of specific stakeholder bodies whose role is to work with the

governance body for the institution and who are normally entitled to full information and the resource base need to make an informed contribution.

All of these principles can be put in place under current legislation. There is significant scope to restructure institutions so that they draw on a mix of capital appropriate for organisations which, on the one hand, have an inherently public interest purpose and tradition but, on the other hand, increasingly are operating in competitive markets and must apply market disciplines.

There is scope also for the necessary governance and management changes. These are required not just because of some sense of purity in the separation of function but because changing conditions demand this. In the world of tomorrow, there will simply be no substitute for autonomous self management with the capability to handle unfamiliar problems in an unfamiliar environment.

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## Conclusion

In this paper I have:

- Discussed the changing nature of the environment within which educational institutions function;
- Argued that, just as the educational priority is educating for capability, so the organisational priority is the development of capable institutions;
- Argued that the capable institution is both autonomous and self governing;
- Outlined some of the implications for existing governance, structure and stakeholder relationships.

I want to stress again the usefulness of looking at your future through an understanding of what is happening to the future of other key institutions within society. You will better understand your own future if you understand that the same forces as are acting on Tomorrow's Company are acting on the institutions with which you work. You will be better able to respond to these forces if you understand that many of the changes which have been taking place in the way in which we are governed, and the structure of our public and private sectors, are less a product of ideology than of necessity.

You will almost certainly feel more comfortable with these changes if you understand that ideology, rather than driving the changes, has often served to confuse consideration of possible outcomes. In the current debate over the structure of New Zealand's tertiary sector, the issue is not corporatisation or privatisation although many would have you believe that this is the case. The issue is, instead, how best to build the capable institution. My answer, which I urge you to share, is that of working towards the creation of the autonomous self-governing institution with a full understanding of what this means. It includes carrying responsibility not just for successful educational outcomes but also for successful organisational ones, an outcome which will require you to understand the relationship between risk and resources, the difference between organisational governance and stakeholder relationships and, above all, the relative powerlessness of any New Zealand Government to turn back the clock.

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## FOOTNOTES

1. In practice, this paper will speak largely to the circumstances of New Zealand's polytechnics and universities and most particularly those of their activities concerned with students who seek their qualifications as a means towards earning an (enhanced) income. In making this restriction I am very aware that the paper may be less directly relevant to other and important parts of the education sector ranging from the pre-school, primary and secondary sectors, to those parts of the tertiary sector concerned primarily with the pursuit of knowledge, to wananga and to the many private training establishments whose survival is already dependent on their ability to function as capable institutions in the sense in which that term is used in this paper.

2. The present turmoil in Asia is just the latest, and one of the most dramatic, examples of the inability of national governments to resist trends within the world economy.

3. In practice, if New Zealand's exporters, or firms which compete against imported products, are to be internationally competitive, then ALL New Zealand based activities need to meet international standards. Economists draw a distinction between what is called the tradable sector, comprising those firms which export or compete against imports, and the non-tradable sector delivering goods or services domestically with no apparent competition from offshore. Despite the apparent insulation from the international market, efficiency in the non-tradables sector is a critical element in our international competitiveness. Price rises or inefficiencies in that sector become part of the cost structure of firms in the tradable sector and affect their competitiveness. In the 12 months to September 1997, inflation in the tradable sector was zero but in the non-tradable sector 3.8%. The result is a cost squeeze on the tradable sector as it is forced to meet higher input costs which it is unable to recoup against international competition. The message of this analysis is that the local council, the plumber, or the polytechnic is just as much a part of our competitive effort in the international arena as the Dairy Board or Fisher & Paykel.

4. In a paper delivered to the Provincial Cities Conference in Napier on 31 October 1997.

5. It may be worth elaborating on this point. Autonomy must mean the freedom to decide the activities which an institution will undertake, the way in which it will do so, and the resources it will commit. Necessarily, in an uncertain environment, some decisions will prove successful in the sense that the activity generates a surplus for the institution but equally, some will be unsuccessful, perhaps to the extent of threatening the viability of the institution as a whole. If Government remains the risk bearer but has no influence over the activity of the institution, then this can amount to writing a blank cheque; institutions could experiment in the knowledge that, if they succeeded, then they gained the benefit but if they failed Government would bail them out. This is not only a matter of fiscal risk; it is likely also to lead to a somewhat lax decision making environment (a good but not exact parallel is the Saving and Loans debacle in the United States some years ago when Government guaranteed savings institutions produced collectively huge losses for the taxpayer as the result of ill-judged business decisions the product of an environment in which the S&Ls kept the gains but the Government got the losses).

If, under conditions of autonomy, Government does not bear the risk, then someone else will. The risk could be borne by the institution as a whole; it could be quarantined into faculties or departments by setting operating budgets and terms of employment such that, if they could not cover their costs then they bore the shortfall; it could be borne by introducing external capital as a cushion for any shortfall. Each option has different implications. Each requires a clear recognition

that the price of autonomy is appropriate arrangements for managing and bearing risk.

6. I have deliberately avoided discussion of privatisation in this paper as I regard it as peripheral to the main issue. I do note, however, that there is a case for privately owned educational institutions and that we can expect to see significant growth in this sector both domestically and internationally. This is most likely to be for institutions whose concentration is on the transfer of specific skills and capabilities rather than on research and the development of new knowledge. The US based investor owned university DeVry appears to be an example of a successful privately owned institution well regarded both by students and by the employers who take on its graduates.

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