STRATEGIC PLANNING and THE PRINCIPAL-AGENT ISSUE IN HIGHER EDUCATION LEADERSHIP

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I INTRODUCTION

Strategic planning is well entrenched in colleges and universities around the globe. It is not only essential for effective resource allocation but in some jurisdictions, legislation requires that strategic plans be submitted to government as part of the funding approval process. The difficulties associated with strategic planning and indeed planning in general in colleges and universities has not gone unexplored. It is our contention and the thesis of this paper that the failure to develop and execute strategic plans flows from the distinctive aspects of the principal-agent framework within which many higher education institutions work. Understanding and responding to the deficiencies that beset this model in higher education should improve the effectiveness of planning.

The principal agent issue in higher education has been explored in the past decade but not in the context of leadership and strategic planning. To set the stage for the development of our proof that the principal agent model impedes effective planning, we examine briefly the theoretical framework in the context of higher education planning. The next section explores the role of leadership in strategic planning and imposes the constraints associated with the principal agent challenge. Finally, since the resolution of problems within the agency model is addressed through the design of contracts, we suggest some alternative approaches to contract design the role of the president to enhance the effectiveness of strategic planning in colleges and universities. Our summary and conclusion are in the last section of the paper.

II PRINCIPAL AGENT THEORY

Principal-agent theory [PAT] in a corporate financial setting is defined as the theory concerning the relationship between a principal [shareholder] and an agent of the principal [a manager] and can trace its roots back to economic writing of the 1970s. Alchian and Demsetz, [1972], Jensen and Meckling, [1976]. Fama, [1980],Eisenhardt,[1989]. There are two major issues in principal agent theory: asymmetric information and motivation. In the context of private enterprise, the owners cannot monitor everything that employees do and in many respects, the employees are better informed than the owner. This asymmetry of information is a foundation of the PAT. Second and crucial to principal agent theory is the nature of the motivation associated with the principal and the agent. In the context of private
enterprise, the motivation of the principal, in it simplest guise, is to maximize shareholder returns. Managers may not always have the same goal and be motivated by more personal objectives such as maximizing the rate of growth of the organization which in turn leads to higher salaries and bonuses.

Initially, the PAT framework was applied almost exclusively to the private sector but there is a growing literature on its application to public enterprises including higher education. Managers of public enterprises may be motivated by ‘power and perks’ that come from expansion at the expense of efficiency. Such enterprises are often ‘owned’ by government where the goal of the principal is reelection. As we shall see later, the effectiveness of planning in higher education is well-suited to the principal agent framework. The principal, in this case one or more levels of government, expects universities and colleges, as the agents, to carry out its social and economic agenda which does not necessarily coincide with the objectives of higher education. A significant compounding complexity is defining the agent.

Research in higher education has focused primarily on the role that the college or university board plays as the agent. Toma, [1986, 1990], Lowry, [2001], Liefner [2003], Kivisto [2005]. Professor Toma first posed the question: why would politicians select one type of governing structure over another to exercise their role as the principal? In the context of most US public universities and colleges and higher education institutions in Europe where the board composition includes a significant number of political appointments, this is a critical question. Research on this question has led some scholars to conclude that the centralization of governance leads to lower costs for students. [Lowry ,2001]. Other studies imply that the role of agent can be transferred to the president, dean or department chair but this is not explored formally. Liefner [2003]. None of these focus on the role of the president in the strategic planning process.

While universities and colleges enjoy varying degrees of autonomy and academic freedom, a significant part of the relationship between government and the institution has been viewed as the board acting as an agent and the /state/federal government being the principal. While one might argue that such modeling applies only to public funded colleges and universities, there are very few private institutions of higher learning that do not depend significantly on the largesse of government for a variety of research and learning programs.

Universities and colleges did not emerge centuries ago because governments believed that the country would be better off culturally and economically if people received a university education nor were they creatures of businesses seeking a link between knowledge, research and competitive advantage. In many instances, they appeared as the children of various churches, albeit encouraged at times by politicians. However, due to the increasing demands for greater access to higher education and the realization that the contributions to society from higher education were substantial, a strong case was made for public support. Initially, funding for higher education was largely unconditional and institutions could pursue their own goals and objectives related to teaching, learning and research. Even so, there was from the beginning of public support, an unspoken but implied assumption that somehow, colleges and universities were responsible to government. Duryea, [2000].

III WHO IS THE AGENT? The governance structure of higher education institutions varies across countries, states and provinces but as noted above the literature focuses on the role of the board as the agent and for the most part, ignores the role of the head of the institution. In the context of leadership
and strategic planning it is our contention that the president is very much the primary agent and the government, the principal.

To examine this, we start from the premise that the mission statements of most universities or colleges say very little about political objectives and much about knowledge, learning, scholarship and commitment to society. While governments rarely quarrel with such lofty ambitions, the actual outcomes expected by government may not parallel the outcomes as defined by the institution. This can lead to potential conflicts which, if not resolved, result in less than efficient and effective outcomes as we shall see. If leaders in higher education ignore the fact they are functioning in a principal-agent framework where there very likely exists different objective functions for the principal and agent, they do so at their own peril.

IV LEADERSHIP AND PLANNING

The theory of principal-agent relationships in the financial sense views shareholders as principals and management as the agent. Assuming that individuals act as rational agents, each individual prefers her/his own self interests to those of another individual or corporate entity. The challenge for the corporate entity as principal is to ensure that the agent behaves in the best interests of the corporation, knowing that there exists an asymmetry between the principal and agent in terms of abilities and specialized knowledge. Ortmann and Squires, 2000.

The literature on principal-agent theory is somewhat limited in addressing the complexity of leadership and agency. The one exception is the treatment of principal agency theory and leadership in political institutions. Clucas [2006], Sinclair [1999]. The theory is rich in terms of mechanisms to resolve the problems in PAT but without leadership, didactic frameworks will remain as skeletal solutions. The resolution of real world conflicts requires leadership at both the principal and agent level. The focus here is on the leadership role for higher education planning. While not everyone would agree, it is our contention that for most institutions in the 21st century the president of the institution is not only the agent but must serve as the leader in developing and executing the strategic plan of the institution. Leaders in any organization must ensure that a strategy is well crafted, constitutes a reasonable level of shared vision and is executed efficiently. In performing these roles, the leaders of colleges and universities must be aware of the unique constraints imposed by the principal agent relationship in higher education.

The president of the institution plays the pivotal role in the process of strategic planning. She/he must perform roles as cheerleader, negotiator, communicator and evaluator. In executing this function, the president must be aware that to a significant degree the institution is being funded by the principal [government] to carry out certain activities that are important to the principal. Some of these government desired activities are couched in such general terms that measurement is difficult, especially in a world of asymmetric information flows. Governments often convey what they want agents to achieve by expressing their goals in statements to the general public and not necessarily as direct ‘instructions’ to the institution. In other cases there are explicit contracts between the principal and agent. Executing such responsibilities are costly to the agent to the extent they draw resources away from the university’s time-honored goals.

While the president must be passionate about the institution’s values and beliefs and convey this commitment to the board, she/he must be aware that board members may have agendas of their own,
especially when appointed or elected officials represent political interests. As noted above, much of the emerging literature about higher education and the principal agent problem focuses on the role of the board as the agent although a few studies have argued that the world of higher education is characterized by multiple agents and multiple principles. Toma, [1986], [1990], McLendon et al [2006], Liefner [2003]. Crafting a strategic plan that reflects the assorted and wide-ranging interests within the institution and attempts to meet the implicit and explicit contractual obligations related to the principal-agent relationship is a challenge.

The first stage of any strategic planning process involves renewing or rewriting the mission statement and vision for the future. It is at this stage the president must be at her/his best as a communicator not only within the institution but locally, nationally and internationally. The nature of higher education and especially the somewhat eclectic role of faculty can be a challenge to achieving a ‘buy in’ for the strategic plan. In the broader context of the usual corporate principal-agent framework, it has been argued that employees can be viewed as the agents along with management. Liefner [2003] It is unlikely that faculty see themselves as agents of the government. The president’s job is to demonstrate how a well planned strategy can enhance the faculty’s role as teacher and researcher. Academic support staff and the institution’s administration must also be participants in the planning process to ensure there is a shared vision throughout the community. The president must communicate to all the ‘agents’ that while the institution is committed to time-honored, independent goals and objectives, the university or college has an obligation to society in general and in response to the significant funding from government, an explicit commitment to be accountable.

Colleges and universities are today very much in the public eye: higher education institutions are often one of the largest employers in their community and their economic impact is significant. Within a given province or state, colleges and universities provide an increasing share of the labor force for both public and private institutions. This provides the president with an opportunity demonstrate how the agent is contributing to the principal’s objectives in a tangible manner.

However, it would be unwise for the president to highlight this issue as a priority in the institution’s strategic plan since it then casts the leader as the principal and may alienate the president from the faculty, staff and alumni of the institution. A significant leadership role in strategic planning therefore requires the ability to demonstrate how the goals of the institution, related to time-honored icons of scholarship, learning and education over-lap with the principal’s [government] political objectives. This requires some sort of implicit or explicit contract.

V RESPONDING TO CONTRACT DESIGN

In the context of the principal agent relationship and strategic planning leadership, pressing ahead with planning without an informal or formal contract may lead to inefficient outcomes. As noted earlier, because of the specialized nature of the core work in the university or college it is difficult for the principal to monitor the effectiveness of higher education informally. Liefner [2003] argues in favor of contracts that specify performance based funding. His empirical work concluded, however, that in many universities, long term success was independent of the method of resource allocation on the part of the principal. Gornitzka et al , [2004] examined contractual arrangements in three Nordic countries and concluded that a more finely tuned integration of the quality evaluation system with additional regulations reduces information asymmetries and improves efficiency.
The theory of principal agent design identifies four principles that should be incorporated in a contract to reduce inefficient outcomes. In the context of strategic planning and leadership, paying attention to these principals will likely produce results that are closer to an optimal outcome. Milgrom and Roberts, [1992]. These principles have been designed for employer-employee relationships but are developed in this paper to highlight conflict, examine unintended consequences of certain actions and link the process to performance and incentives.

The first principle, the Informative Principle, states that a measure of performance that reveals information about how much effort an agent puts into a problem should be recognized in the compensation relationship between the principal and agent. In the context of higher education, the government [principal] does not necessarily pay the president directly. However, the government does ‘reward’ institutions for performance with respect to goals established by the government. And, most employment contracts that presidents sign with their board include compensation above the base for achieving certain goals such as success in generating funding increases for the institution. Not all goals that the principal wishes the agent to achieve are structured to allow effort or outcome to be measured. The creation of a more learned society and a commitment to the transformation of technology to developing countries are goals of this nature. Achieving enrolment targets for specific socio-economic groups, generating employment rates for graduates and private funding-raising are clearly measurable.

The second principle relates to incentives: the Incentive Intensity Principle. This principle states that setting incentives as intense as possible is not always the best strategy for the principle. The level of detail/intensity for incentives should be set based on several factors: [1] the link between increased profits and effort [2] the accuracy of measuring desired activity [3] the agent’s level of risk tolerance [4] how agents respond to incentives. While this principle has obvious applications to making decisions about piece rate work, sales outcomes, etc., does it have any relevance for post secondary leadership and strategic planning?

Factors [2] and [4] have relevance for the issue addressed here. The greater the demand for detailed measurement of outcomes by the government, the more effort the college/university will have to make to keep records, monitor activity and micro management. These activities, while not the direct responsibility of the president, will sap energy and time away from the broad strategic planning for the institution. Factor [4], how agents respond to incentives, is also relevant for the intensity of incentives in higher education. If the incentives are sufficiently large, short-term and directly impact the president’s compensation, effort that may have been put into long term strategic planning or broader, non-principal related objectives may be short changed.

The Monitoring Intensity Principle states that if there are high levels of incentive intensity, monitoring must be at a high level. This is of course directly related to the Principle above. Just how this monitoring should be structured is a challenge. Overall there has to be a mechanism whereby the principal’s objective of gaining meaningful, comprehensible and even measurable information can be done without excessive bureaucracy at both the institution and government level. It is a matter of finding the balance between the principal’s desire for detailed accountability from the college or university and ensuring that the broader long term goals of the institution are accorded sufficient time to be successful.

The fourth principle, the Equal Compensation Principle, relates the value of activities from both agent
and principal perspective. In the context of the employer/employee relationship, activities of high value to the employer should be equally valued by the employee. If not, employees may focus incremental energy and resources in those areas where the marginal returns to the employee are higher. Conceptually, this is important for the relationship between the government ministry/agency responsible for higher education and the institution’s president as the agent. Knowing which of several of the principal’s goals are of equal value will help the president allocate her/his time more effectively in designing and implementing strategic goals. If extraordinary effort is made in areas important to the self-stated goal of the university at the expense of the government’s wishes for higher education, the stage is set for possible conflict.

VI SUMMARY AND CONCLUSION

In a perfect world, governments would value universities and colleges for their roles as educators, knowledge enhancers and the creation/expansion of human capital. While functioning within normal societal rules, institutions would have their charters reviewed on a periodic but not frequent basis. The government’s role as principal would be limited. However, increasing demands for accountability have led to far more complicated relationships between government and higher education and the accompanying growth of significant principal agent problems. Care must be taken not to force structural change on colleges and universities that would lead to a diminution of the core activities related the autonomy and the transmission of knowledge and pursuit of new knowledge. [Berdahl, 1990, Kivisto, 2007]

Earlier in section II above it was noted that

“Initially, the framework was applied almost exclusively to the private sector but there is now a growing literature on its application to higher education. The primary focus has been almost exclusively on the role that the college or university board plays as the agent.”

In many institutions today, the board expects the president to be accountable for the development and execution of the institution’s strategic directions. Recognizing this fact leads to the following suggestions.

1. Strategic planning in colleges and universities should recognize the existence of the principal agent dilemma and the president must design her/his leadership of the strategic planning process with this challenge in mind.

2. In addressing the aspirations of faculty and staff for the institution’s future and the time-honored goals of learning and scholarship, the president must also be acutely aware that the financial well-being, in part, is directly related to societal and other goals deemed important by government. This must be communicated effectively to the college/university community.

3. To minimize the inefficiencies that can arise from principal agent problems, it is prudent for the president to be aware of the implicit and explicit contracts between government and the institution. Indeed, it would be wise for a president to provide a clear understanding of such contracts and convey the essence of those to the institution’s students, faculty and staff and alumni.

In the broader context of the principal agent structure, a much more effective deployment of public
resources will result if government, in exercising it role as the principal, ensures that standards for accountability are meaningful, clearly defined and provide sufficient flexibility that colleges and universities can successfully fulfill their fundamental goals of learning, scholarship and research which in the end benefit society well beyond the mandate of any specific short term government agenda.

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