Private operator of US public schools facing financial crisis

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Edison Schools, the for-profit company that was handed control of 20 schools in the city of Philadelphia only a month ago, is reported to be facing a severe cash crisis that imperils its plans for expansion and may even jeopardize its current operations.

The company has grown substantially in recent years, with the help of sympathetic local and state politicians. Its revenue for the fiscal year that ended in June 2001 was $375.8 million, compared to $38.6 million five years earlier. It currently manages schools enrolling some 75,000 students in 22 different US states, including nearly all the largest states—California, Illinois, Michigan, New Jersey, Pennsylvania, Texas and New York.

This rapid growth has not translated into profits for Edison, however. It has reported continuous losses, with its cumulative losses now amounting to more than $240 million. The shortfalls have been made up by infusions of cash raised primarily from sales of company stock. Its initial public offering in November 1999 raised more than $120 million, and second and third offerings, in August 2000 and March 2001 respectively, raised another several hundred million dollars.

Now, however, Edison must raise at least another $50 million at a time when its stock price has completely collapsed. Like some of the dot.com casualties and other high-flying firms from the late 1990s, its shares have fallen more than 95 percent from their high of several years ago. Edison stock traded at $35 a share in early 2001, fell to $20 by the beginning of 2002, and is now less than $1.50. Thus the sale of new stock is obviously not now an option, but other alternatives appear to be equally unpalatable. Edison had to pledge $61 million in assets last fall as collateral for a loan of only $20 million. It has also been paying as much as 20 percent interest on some loans.

The company may turn again to wealthy investors whose primary motive is an ideological one. Edison has become the standard bearer of the campaign, backed by growing sections of the wealthy and big business, to privatize the education system. Its supporters have argued that the introduction of the profit motive is necessary to provide a decent education. At the very least, they have claimed, the element of competition will shake up the “public school monopoly” and force the public schools to improve.

Edison Schools was founded by L. Christopher Whittle about 10 years ago. It first proposed a national network of private schools. It made a tactical shift, however, in response to critics who pointed out that simply shifting public funds to private schools via a voucher system or privately-run “charter schools” would leave the vast majority of students behind in public schools that were being essentially abandoned. The proposal to take over the management of public schools enabled Edison to present itself as the savior of all public school students, and the school system as a whole. Inveighing against bureaucracy, waste and poor teaching, the company claimed it would make a profit while operating schools for less money than currently budgeted.

Whittle recruited high-profile backers, most notably Benno Schmidt, the president of Yale University, who became president of Edison. Meanwhile, amid the increasingly desperate situation in many public schools, especially in urban and working class areas, parents were told that profit-making schools would introduce efficiency and dynamism into the system.

In an era of “welfare reform,” of the virtual demonization of government social programs and public services, the prevailing free-market dogma was that there was nothing in the world that couldn't be improved with a dose of the profit motive. Big-city mayors like Republican Rudolph Giuliani in New York and Democrat Ed Rendell in Philadelphia did their best to encourage privatization of mass transit, sanitation and other services, and if they had limited initial success it was not for lack of trying.

In this atmosphere Edison grew despite its lack of profits. Investors saw it as a potential profit center. What could be better than feeding off the dismantling of public services, a process that had already generated super profits in Latin America and other "emerging markets"? Government money would be used to directly reward the wealthy investors in Edison.

Edison enjoyed certain unique advantages. It was able to arrange for some of its schools to be assisted by private charities, giving it an advantage over public schools. It also charged fees that were based on an average of the money spent on all the students in a given district, thus getting higher fees based on high school spending, while running elementary and middle schools that require less funding.

Nonetheless, Edison never made a profit, and a number of careful studies showed that Edison students were not doing any better academically than their counterparts at public schools. One study of ten Edison schools published in 2000 found that students at only three of the ten schools were doing better than the comparison schools, while three others scored below public schools and the remaining four showed mixed results.

The collapse of Edison's stock price has led to a number of developments that are typical of other firms in desperate financial straits. Investors are up in arms, and the company has also suddenly attracted the interest and attention of regulatory authorities.

The Securities and Exchange Commission, for instance, announced last week that Edison had provided false information about its past revenues and had maintained inadequate financial controls. According to the SEC, Edison agreed to a settlement that, without admitting wrongdoing, committed the company to various changes in its financial methods and procedures.

In addition, at least three class-action lawsuits were filed against Edison last week in Federal District Court in Manhattan. The suits, similar to others involving companies whose stock price has collapsed, seek compensation for massive losses, and are sure to keep Edison tied up in court for some time.

Around the country, the skepticism of parents over Edison's promises is rapidly turning to worry and anger. The company was never able to turn all of its political backing into broad community support for its privatization plans. In New York City a year ago, a proposal to turn over five schools to Edison went down to a humiliating and overwhelming defeat in a local vote by parents. The deal to turn over 20 Philadelphia schools was imposed in the face of strong local opposition. Now the state commission overseeing the Philadelphia schools claims it will secure procedures safeguarding the schools if Edison is unable to fulfill its contract. One commission member suggested that the district would ensure that Edison did not remove computers and other equipment if it pulled out of its Philadelphia operation.

While Edison's financial crisis has exposed as a fraud the firm's claim that privatization is the solution to the schools crisis, the dismantling of public education continues apace. Recently in New York City, the Board of Education spelled out a "worst-case scenario" to local school districts, forecasting that proposed budget cuts will mean a loss of "almost a billion dollars in services to students compared to the funding levels of a year ago."