

Full length Review Article

Cost Structure, Cost Trends and Strategy in Community Colleges

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Received 21st February 2016; Published 31st March 2016

Controlling costs is a major higher education issue that has become more visible as citizens have become more concerned with college affordability. This paper reviews literature on cost control and discusses why the topic is difficult to address. Accounting for cost of instruction, costs incurred by the community colleges themselves to provide services, cost structures, and cost management in higher education are discussed in the context of strategic management theory. Delta Cost Project data are analyzed to uncover meta-level insights about strategic decisions made by community colleges.

Key words: Higher Education, Community Colleges, Cost Management, Strategic Management.

INTRODUCTION

Community colleges, like all higher education institutions (HEIs), operate as open systems; they interact in critical and necessary ways with their environment (Katz and Kahn, 1978). Students, faculty and staff, and financial and other resources are acquired from the environment and the community colleges, in return, provide products like educated students, knowledge, and other services to entities in the environment. In this complex environment community colleges must compete on the input side for resources and on the output side to place their “products.” Organization success, in such a complex environment, is determined to a great extent by the ability of the entity to gain control over resources to minimize their dependence on other organizations and the cost of those resources, and to simultaneously maximize the dependence of other organizations on themselves (Pfeffer and Salancik, 2003). The environment within which community colleges operate contains scarce and limited resources from traditional funding sources (federal, state and local), and there is a great deal of competition for those resources. This can result in a zero-sum game; if one entity receives a larger percentage of the funding pie, then other entities by necessity will receive less.

Not only can this environment lead to financial hardship, it also can result in uncertainty about future funding levels and resource allocation. Katsinas (2003) noted decisions by state legislatures to fund public higher education institution (HEI) operating budgets are often considered only after other major programs have been funded. Not only must community colleges compete with other public HEIs for funding, they must also compete with programs like Medicaid that have required state-to-federal matches, K-12 public education, and corrections. Uncertain funding has led to a resource dependency approach to budgeting and cost management, as HEIs seek to maximize their financial resource inflow and then spend all of the resources that they were able to obtain. The sustainability of this model is unlikely due to pressures to control consumer prices for higher education and increasing demands for accountability.

Public HEIs, including community colleges, have been under pressure for some time from both politicians and the press to control cost (College Board, 2008, 2013; USA Today, 2007). The need to control costs has been exacerbated by the current economic downturn that has resulted in unprecedented declines in state tax revenues, even as demands to fund Medicaid, the largest single budget item in state government, are increasing (Kaiser Commission, 2009). These revenue declines are on a scale that surpasses past experience (Moody's, 2010), and have resulted in a negative outlook for

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U.S. higher education (Moody's, 2014). The percentage of states that were forced to implement mid-year community colleges budget cuts has increased from eight percent in the 2006-07 fiscal year to an anticipated 80 percent in 2011 (Katsinas and Tollefson, 2010).

Defining Costs

Higher education "cost" has different meanings to different people. Consumers of higher education services think of "cost" as the tuition, fees, and room and board costs that they pay. It is well known that this "cost" of higher education has been increasing faster than the consumer price index for goods and services. State legislatures and policy makers often view "cost" as the state-provided support of public HEIs. This cost, too, has been increasing. The Delta Cost Project (hereafter, Delta) released an 11-year matched data set of public HEIs shows a 57% increase in state support of higher education over the period from 1998 to 2008. What is less well known is that when this cost is adjusted for inflation and increases in FTE enrollments, the total ten-year increase in state appropriations for higher education per FTE student is only 6%. Reductions in the rate of increase of the price by public HEIs can only occur if the internal cost of providing education services is reduced or controlled (Delta, 2008, 2010).

We argue that rather than addressing the consumer and legislative views of "cost", it is important to view cost from an internal perspective. The costs addressed in this study were the costs that community colleges incur to provide educational services and their relationship to an institution's strategic focus. Specifically, we examine whether an institution's strategic focus can be implied from cost structure relationships and changes.

Budgeting and Cost Management

Milano (2000) noted that internal cost reporting in HEIs is dominated by the use of static budgets. These budgets focus on the control of line-item spending through actual vs. budget variance reporting. Such tools are effective for maintaining the status quo because existing programs and activities are normally funded at prior year levels plus an inflation adjustment increment and budgetary increments for new programs, activities, and faculty and staff. This approach also ensures that all budgeted resources are expended (the spend it or lose it paradigm).

However, static budgetary focus does not provide the information or the administrative focus needed to reduce costs or to improve the quality of service. It appears that more needs to be done at institutional levels to manage internal costs without compromising quality. Furthermore, traditional budgeting does not provide the incentive or information needed to identify and eliminate non-value-adding activities. It does not provide a clear linkage between activities and their associated cost and institutional strategy. Public HEIs in general are under increasing pressure from budgetary constraints, requests for increased accountability and outcome measurement, and market forces (Edginton and Hensely, 1994; Friedman, 1997; Hardy, 1995; Kerr, 1995). College administrators must balance demands for cost containment with those for improved education quality, greater access,

responsiveness to the needs of nontraditional students, and expanding services (Edginton and Hensely, 1994). In short, college administrators are increasingly expected to do more with less. Nemetz and Cameron (2006, p. 38) note that in such an environment "Efficiency is far more important the high-mindedness..." and efficiency becomes an important institutional performance evaluation criterion. Unfortunately, the lack of true competition in public higher education, some argue, means that there has been little real pressure for cost-control in an environment of constant mission creep and expanding bureaucracy (Palfreyman, 2007).

Cost Management Strategies

Community College administrators may take several approaches to cost management in a period of declining resources. These include budgetary reductions, cost shifting, cost cutting (also referred to as cost restructuring), cost substitution, and productivity increases. Budgetary reductions are usually short-term, temporary reductions in planned spending. These reductions may take the form of across-the-board percentage or dollar spending reductions, hiring freezes, or reductions in force (furloughs). Such efforts, although painful, do not result in long-term changes in cost structures and, when funding increases, the reductions are usually reversed.

Cost shifting does not result in changes to cost structure, nor in reductions in expenditures. Rather, it results in the substitution of one funding source for another. For example, a community college may substitute the loss of state funding with a tuition increase and make no attempt to reduce costs or restructure. The funding for planned expenditures is more easily shifted from one revenue source to another (state to individual students and families). In a period of decreasing public resources and increased competition, cost shifting at best perpetuates the resource dependency approach to budgeting and does not lead to structural changes that will reduce or control future costs.

Cost cutting, unlike budgetary reductions, results in a permanent reduction in expenditures. Cost cutting may be implemented in any functional area. Cost substitution occurs when a lower priced cost element is substituted for one with a higher price. Price is often, although not always, an indicator of quality. Thus the substitution of a higher priced component with one with a lower cost may also result in unintended quality substitution. The most common approach to cost substitution in higher education is to substitute part-time, adjunct faculty members for full-time tenure track faculty. Citing 2011 data from the National Center for Education Statistics (NCES) Digest, Cohen, Brawer, and Kisker (2014, p. 93), indicate that of the 373,778 faculty employed at U.S. community colleges in 2009, the number of full-time faculty totaled 112,824 (30%), while 260,954 (70%) were part-time. In sharp contrast, in 2003, the number of full time faculty totaled 138,300 (37%) and part-time faculty totaled 240,400 (63%). Not only are wage rates usually lower for part-time faculty members but public HEIs are also able to avoid paying for benefits for part-time faculty. Productivity is usually measured in terms of the output generated by a given level of inputs. In higher education output may be measured by the number of graduates generated given a specific input, say the

number of full-time equivalent faculty, years to graduation, average credit hours to graduation, or total operational expenditures. Productivity increases arise when the output increases per unit of input. While the total number of measured inputs does not need to remain constant, in fact it may increase, the input required to produce an output (an academic degree for example) decreases. It is important to recognize that cost cutting may not result in productivity increases. In community colleges, productivity increases usually result when the average number of credit hours taken towards a degree decreases.

Strategic Management Theory

Public community colleges, like all entities that compete for resources, must choose and implement a strategy that provides them with a competitive advantage. The theoretical framework used in this study was based on the competitive strategy model developed by Porter (1980, 1987) and Oster (1999). In this model, competitive advantage results from the value that an organization provides to customers either in terms of low prices (cost leadership) or unique benefits (differentiation), the two generic competitive strategies.

Table 1. Summary Demographic Data (All Dollar Amounts in 2010 Constant Dollars)

Sector	Average Operating Expenditure			Expenditure	Average Fall FTE Student		Fall
	N 2010	Per Fall FTE Student 2000		Growth Rate	Headcount 2000	2010	FTE Growth Rate
Rural – Small	101	\$17,007	\$15,699	-7.7%	634	935	47.4%
Rural – Medium	268	\$12,661	\$11,907	-6.0%	1,663	2,439	46.7%
Rural – Large	123	\$11,672	\$11,323	-3.0%	4,150	6,081	46.5%
Suburban - Single Campus	105	\$11,352	\$10,804	-4.8%	3,903	5,727	46.7%
Suburban – Multi Campus	79	\$11,382	\$10,273	-9.7%	5,760	8,711	51.2%
Urban – Single Campus	29	\$12,278	\$11,101	-9.6%	4,058	6,400	57.7%
Urban – Multi Campus	83	\$10,945	\$10,796	-1.4%	8,155	12,520	53.5%
All Community Colleges	789	\$12,471	\$11,700	-6.2%	4,046	6,116	51.2%

Table 2. Percent Change from 2000 to 2010 in Total Operating Expenses Allocated to Expenditure Categories in Constant 2010 Dollars

Expenditure Category	Rural			Suburban		Urban	
	Small	Medium	Large	Single	Multi	Single	Multi
Instruction	-6.6%	-5.1%	-6.7%	-6.1%	-4.9%	-0.2%	10.6%
Research	33.1%	203.7%	5.9%	10.4%	153.2%	213.4%	-49.3%
Public Service	-12.7%	-17.0%	-21.1%	-28.7%	-16.9%	-2.6%	-4.9%
Academic Support	51.6%	76.5%	55.9%	43.5%	52.0%	58.7%	-23.0%
Student Services	4.7%	51.5%	-1.6%	2.5%	6.9%	3.8%	-27.0%
Institutional Support	-6.6%	0.2%	0.0%	-6.8%	3.9%	-11.4%	58.6%
Operations and Maintenance	8.6%	-0.6%	-6.3%	-2.1%	-40.5%	-6.7%	-27.7%
Grants and Financial Aid	-5.7%	-0.9%	19.1%	19.4%	27.8%	-12.4%	23.7%

Table 3. Expenditure Growth from 2000 to 2010 by Expenditure Categories in Constant 2010 Dollars

Expenditure Category	Rural			Suburban		Urban	
	Small	Medium	Large	Single	Multi	Single	Multi
Instruction	86.2%	86.9%	90.5%	89.4%	85.8%	90.2%	88.2%
Research	122.9%	210.2%	102.7%	105.1%	228.6%	283.3%	50.0%
Public Service	80.6%	75.9%	70.7%	67.9%	75.0%	88.0%	93.8%
Academic Support	140.0%	141.4%	151.2%	136.6%	137.1%	14.4%	154.5%
Student Services	96.6%	92.1%	95.5%	97.6%	96.5%	93.9%	94.4%
Institutional Support	86.2%	94.2%	97.1%	88.7%	93.8%	80.1%	97.4%
Operations and Maintenance	100.2%	96.6%	90.9%	93.1%	53.7%	84.4%	99.1%
Grants and Financial Aid	87.0%	100.7%	115.5%	113.6%	115.3%	79.2%	121.4%

Cost management decisions should be congruent with an institution's strategic plan. Lack of congruence impedes the achievement of long-term strategic goals and objectives. Cost management decisions are often made out of a sense of urgency or expediency without regard to their long-term effect on the attainment of strategic goals. Within an institution, the level of congruence between cost management decisions and strategic goals and objectives can often be assessed by following the money. The funding of specific activities can serve as an indicator of what is really important to an institution, whether or not those activities are tied to strategic goals and objectives.

Cost leadership strategies are used to target broad market segments, by seeking to provide a competitive advantage through cost reduction. Institutions with lower costs, and hence lower tuition, should gain a competitive advantage in student recruitment if they are able to maintain their cost advantage. The key for community colleges that pursue this strategy is to reduce costs without sacrificing value to key stakeholders (students, parents, faculty members, future employers and other buyers). Community colleges have a cost advantage over other higher education institutions. Average community college operating expenditure per FTE student in 2010 was \$10,020, while the average expenditure in public

research, masters and bachelors institutions was \$26,971, \$13,785, and \$14,141 respectively (Delta, 2010). Cost leadership strategies require control over cost drivers, the activities that create costs, and the ability to substitute lower cost inputs for higher cost inputs. This in turn requires the development of tight controls over all expenditures and especially variable costs, the costs that vary directly and proportionally with changes in enrollment. The successful implementation of cost leadership strategies requires an institutional culture that values frugality, minimizes overhead expenses, develops economies of scale, and focuses on standardizing the means of production (Card and Card, 2007). Product differentiation strategies rely on the development of a unique product which appeals to a sufficiently large market segment to be economically viable.

For public HEIs, the key to implementing this strategy is to design educational programs or services that satisfy the needs and wants of a particular market segment. Unlike cost leadership strategies which result in lower consumer prices, product differentiation strategies often provide the perception of a premium product that commands a premium price. This strategy may be seen in HEIs that rely on highly selective admissions standards or that offer specialized programs. Product differentiation strategies do not necessarily imply higher education quality. Zemsky (1998) differentiates between medallion and outlet universities. Medallion universities are large institutions that have successfully created an image of educational quality. Outlet universities-the majority of public HEIs-are the mainstay institutions that must focus on cost leadership. Medallion universities, according to Zemsky, focus on brand name marketing rather than instructional activities, with increasing expenditures for image-building activities.

This paper asserts that, by analyzing financial data one can make inferences about institutional strategy. To the extent that there is congruence throughout the planning and control process, financial data will accurately reflect the broad strategy of an institution. Resources tend to be allocated to activities that really matter, at the moment, to an institution, whether or not those activities lead to the attainment of strategic goals and objectives. By analyzing financial data, both at institutional and meta-levels, insights into relative importance of various educational activities and potentially draw conclusions about implied strategic decisions can be gained.

Community College Cost Structure

An institution's cost structure can be viewed as the relative proportion of resources allocated to standard expense categories. The common functional or standard expense categories reported by community colleges include instruction, research, public service, academic support, student services, institutional support, operations and maintenance, and grants and financial aid. Instruction includes all expenses reported by a public HEI for credit and non-credit general academic instruction, occupational and vocational instruction, community education, preparatory and adult education and regular, special and extension activities. It also includes expenses for departmental research and public service not separately budgeted (Delta, 2010). Research includes all expenses for externally funded, or internally funded and

separately budgeted and accounted for, research activities. The public service category includes the expenses incurred to provide non-instructional services beneficial to individuals and groups outside the HEI (Delta, 2010).

Academic support includes the expenses related to the support of HEI instruction, research, and public service activities. Support activities include library, museum related expenses, academic administration, separately budgeted personnel development and course and curriculum development, operations and maintenance, interest cost attributable to academic support, and all other activities that support an institution's academic functions (Delta, 2010). Student services include the expenses related to admissions, registrar activities, and all other activities whose primary purpose is to contribute to students' emotional and physical well-being and to their cultural, intellectual and social development (Delta, 2010). Institutional support includes the expenses for the day-to-day operational support of the HEI. This includes the expenses related to general administration, central executive-level activities related to long-range planning and management, legal and fiscal operations, space management, human resource management, logistics and public relations. Operations and maintenance includes the expenses incurred to provide services and maintenance related to buildings and grounds used for educational and general purposes (Delta, 2010).

Analysis

This study was conducted using data for public, community colleges from the 2010 Delta database.¹ This publicly available data base was developed using the data reported to the federal government through the annual Integrated Postsecondary Education Data Set (IPEDS). The IPEDS data set surveys institutions on higher education finance, enrollments, completions and student aid. The Delta IPEDS database (2010) includes 11 years (2000-2010) of matched set data from more than 2000 institutions (about 90 percent of two- and four-year institutions). Summary demographic data about the institutions included in this study are included in Table 1.

As shown in Table 1, the average inflation-adjusted operating expenditure per FTE student decreased for all public community college classes over the 2000 to 2010 time period except for the urban, multi-campus colleges. At the same time community college enrollment almost doubled. The obvious question then is how community colleges have been apparently able to do so much more with less. Table 2 shows the percent change from 2000 to 2010 in total operating expenditures by expenditure categories for each community college. Table 3 shows expenditure growth from 2000 to 2010 by each major expenditure category. Research and public service expenditures are not discussed in the analysis that follows because of their total low dollar amount and

¹ The College of the Marshall Islands was coded in the IPEDS data as a small, rural community college in 2000 through 2002 (three years). The College had a fall FTE student enrollment of 459 students and reported instructional expenditure of \$353,063 per FTE student in 2000. This outlier greatly distorted the financial analysis of small, rural community colleges and was consequently omitted from analysis.

significance. A small dollar changes in research expenditures can result in disproportionately large percentage increases. An examination of Table 2 indicates how funds have moved from one expenditure category to another. For example, in 2000 41.2% of operating expenditures were allocated to instruction at small, rural community colleges. That allocation decreased to 38.5% in 2010 resulting in the 6.6% decrease in funds expended for instruction as shown in Table 2.²As shown in Table 2 the decrease in expenditures for instruction may indicate that increases in FTE faculty head counts have not kept pace with increases in FTE student enrollments.

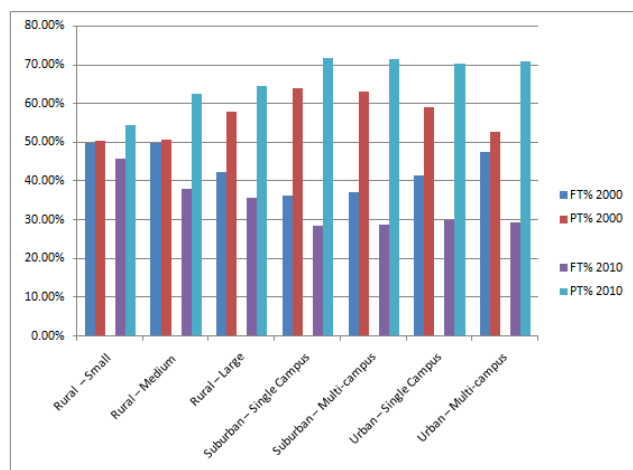


Figure 1. Faculty Composition by Community College Carnegie Sector 2000 and 2010

It may also indicate community colleges have been using more, lower-cost part-time instructors to meet additional faculty needs. It thus appears that community colleges have been using a cost-substitution strategy by substituting higher-cost full time faculty with lower cost part-time faculty members. Figure 1 shows relative changes in faculty composition from 2000 to 2010. For example, in small, rural community colleges the faculty mix was approximately 50% full time and 50% part time. That had changed by 2010 to about 45% full-time faculty and 55% part-time faculty.

Institutional support is the second largest operating expense, measured per FTE student count, at all community colleges. Average instructional expenditures per FTE student decreased in all Carnegie classes between 2000 and 2010. In addition, except in the cases of suburban and urban multi-campus community colleges, institutional support expenditures also evidenced a material decline. It appears that a cost substitution strategy may also have been employed in the management of institutional support costs.

For most community colleges it appears that funding reductions in instruction and institutional support have resulted in a transfer of funds to academic support. The increase in funding academic support may have come at the cost of decreases in funds expended for instruction and institutional support.

Trend Analysis

Trend analysis, as summarized in Table 3, shows the growth or decline in expenditures relative to a base year (2000 in this case). For example, Table 3 shows that instructional expenditures in 2010 in rural community colleges were only 86.2% of what they had been in 2000 in constant dollars. At the same time FTE student enrollment was 147.8% of the FTE student enrollment in 2000. Most, but not all community college Carnegie classes have experienced decreases in all expenditure categories from 2000 to 2010. Academic support had the highest percentage growth in all community colleges, followed by grants and financial aid. Essentially all other expenditure categories experienced expenditure declines from 2000 to 2010. All community colleges experienced negative growth in instructional expenditures. Again, as Figure 1 shows, the decline in expenditures for instruction may be the result of substituting part-time for full-time faculty.

Conclusion

This research was not designed to test research hypotheses but rather to uncover insights, at a meta-level about category-level strategic decisions made by public HEIs as they face increasing revenue and budgetary pressure. It appears community colleges have been forced to implement cost substitution strategies by substituting part-time for full-time faculty members. This has enabled community colleges to maintain their cost leadership position. The growth in part-time employees has far outstripped that of full-time faculty, executives and administrators. While cost substitution may be an effective means of addressing tight budgets and budget shortfalls, it begs the question of the effect of the practice on education quality. Benjamin (2002) suggested that overreliance on part-time faculty may undermine successful student integration. Integration is essential for persistence and college graduation (Astin, 1993; Bailey and Alfonso, 2005; and Pascarella and Terenzini, 1991, 2005). Jacoby (2006) asserts that the part-time system fails to provide incentives that would lead to rich interactions between faculty and students, and that it thus undermines the campus-learning environment. Thus the challenge that faces community college administrators may be how to achieve the cost savings and program flexibility associated with increased use of part-time faculty and staff while maintaining academic quality. Part-time faculty need to be integrated into the educational and service culture of their institutions, a point made by many community college scholars over the years. This study has demonstrated that it is possible to rationalize an institution's strategic choices by analyzing and comparing its cost structure with those of comparable institutions. It has also demonstrated the use of cost analysis to analyze expenditure patterns and growth rates to direct attention for strategic decision making. Community colleges, like all HEIs, are under increasing pressure to control costs. The traditional focus on the management of funding sources needs to be supplemented by an increased focus on cost management in a manner that maintains the value of higher education.

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² More detailed tables for each public community college classification showing expenditure amounts for 2000 and 2010 with common-sized and trend percentages are available from the first author.

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