



# Profit Before Kids

An analysis of the performance and financial practices  
of for-profit, virtual charter schools

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By Meg Benner and Neil Campbell

October 2018

Center for American Progress



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# Introduction and summary

California Virtual Academies (CAVA) oversees nine virtual charter schools across the state of California. Virtual charter schools are public schools that provide online instruction. Students complete assignments individually rather than attending a brick-and-mortar school. State tax records and the schools' charters specify that CAVA schools are independent nonprofit charitable organizations, but these schools are moneymakers for K12 Inc., a publicly traded company and the largest for-profit virtual school provider in the United States. CAVA is a subsidiary of K12 Inc. and its schools run in lockstep with their parent company's deceptive and harmful business practices.<sup>1</sup>

K12 Inc. receives substantial scrutiny from the media and advocates given its market share and listing on the New York Stock Exchange. But a growing body of research and national media reports show that, on average, fully virtual schools perform much worse than brick-and-mortar schools serving similar populations.<sup>2</sup> For instance, students at CAVA schools significantly underperform the state average. In the 2015-16 school year, the CAVA @ Los Angeles' graduation rate was 66 percent, far below the Los Angeles School District's average of 92 percent and the state's average of 84 percent.<sup>3</sup>

In 2016, then-California Attorney General Kamala Harris announced a court-approved settlement in which K12 Inc. would repay California \$8.5 million—\$2.5 million for inflated attendance figures and \$6 million for costs ensured by the attorney general's office—regarding aggressive marketing campaigns and inadequate instructional supports. This settlement included no admission of fault, but Harris's office alleged that K12 Inc. and CAVA used misleading advertising to recruit students even if they were unlikely to be successful in a virtual program.<sup>4</sup> Once enrolled, many students did not receive adequate instruction. CAVA instructed teachers to mark a child in attendance if they logged in for at least one minute a day in order to maximize the public dollars allocated to each school.<sup>5</sup>

These types of concerning outcomes among for-profit virtual charter schools are not unique to California. Schools managed by K12 Inc. nationwide struggle to match student outcomes at other public schools, even as the company's executives receive multimillion-dollar compensation packages.<sup>6</sup> Rather than address these challenges

and rework instructional strategies to improve outcomes, K12 Inc. has misrepresented student performance—leading to shareholders filing multiple lawsuits.<sup>7</sup> They have also defended their outcomes, stating that policymakers use “broken” accountability measures to evaluate school performance and their schools serve struggling students.<sup>8</sup>

Virtual instruction takes many forms: virtual courses supplementing what is available at traditional brick-and-mortar schools, blended schools where students receive substantial instruction online while also having access to face-to-face teacher support, and fully virtual schools with no in-person instruction. The prevalence of all of these types has grown steadily.<sup>9</sup>

Limited online coursework can fill an important need in public education, especially within secondary schools. For example, 24 states develop their own virtual education content or partner with an outside entity that provides virtual material, in order to offer students greater flexibility to take additional credits.<sup>10</sup> These courses can help students make up credits or expand course options in districts or schools where there are not enough students or available staff to teach full classes on specific subjects, such as some languages. In fact, the enrollments in language courses have grown more significantly than any other subject offered among state virtual schools and now account for about 12 percent of all state virtual enrollments.<sup>11</sup>

Coursework in fully virtual schools usually entails students completing their work alone, at their own pace. Students in fully virtual charter schools interact in real time with a teacher for fewer hours in one week than students in brick-and-mortar schools do in one day.<sup>12</sup> Overwhelmingly, research shows that fully virtual schools underperform blended or brick-and-mortar schools.<sup>13</sup> Yet the number of students enrolled in fully virtual schools continues to grow. In the 2016-17 school year, virtual schools enrolled an estimated 295,518 students nationwide.<sup>14</sup> Of those students, 76 percent—or 223,634—enrolled in fully virtual charter schools.<sup>15</sup> Fully virtual public schools and fully virtual charter schools are both public, but virtual charter schools are operated by companies or nonprofits rather than public school districts or the state.

While K12 Inc. is well known as a for-profit company and their schools do not hide their affiliation, many independent virtual charter schools bury their connections to for-profit companies. Many states bar for-profit companies from receiving public education funding, so many of these schools establish nonprofit boards to accept the funds but contract operations and management to a for-profit entity.<sup>16</sup> For example, the Electronic Classroom of Tomorrow was Ohio’s largest fully virtual charter school until it closed in 2018 because it could not afford to repay funds to the state for students whose enrollments it could not verify.<sup>17</sup> While it was governed by a nonprofit organization, it had multimillion-dollar contracts with for-profit companies owned by the charter’s founder.<sup>18</sup>

Laws and regulations have not kept pace with the growth of virtual charter schools. While 27 states have online charter schools, there are significantly different policies in place from state to state to measure student attendance and engagement in fully virtual programs.<sup>19</sup> According to a 2015 report by the Center for Reinventing Public Education, only five states have different funding structures for online versus brick-and-mortar charter schools.<sup>20</sup>

As a result, many for-profit operators have taken advantage of fully virtual instruction to boost their bottom line, driving dollars away from instruction with little regard for student outcomes.<sup>21</sup> For instance, K12 Inc. awards its executives hefty bonuses if they can reduce the cost of the instructional program and increase profits.<sup>22</sup>

These practices aren't limited to elementary and secondary schools. Many for-profit colleges, such as the University of Phoenix and DeVry University, also have abysmal academic outcomes, employ deceptive marketing, and structure their tuition practices to maximize possible revenue from federal financial aid.<sup>23</sup> However, new policies to hold career training programs accountable for results and to help students navigate financial hardship as a result of their enrollment have been implemented over the past decade.<sup>24</sup> Similar protections do not yet apply to elementary and secondary schools.

To shed light on the performance and spending of virtual charter schools managed by for-profit operators, the Center for American Progress compiled a new analysis of for-profit virtual charter schools' outcomes and financial management. The authors of this report pulled the outcomes of the largest for-profit virtual charter schools in the five states with the greatest percentage of virtual charter school enrollment and compared them to the outcomes of their respective state as a whole and nearby urban school districts serving greater percentages of students who qualify for free and reduced-priced lunch.

For-profit virtual charter school operators and their supporters often rationalize troubling academic outcomes by claiming that these schools serve high-need students.<sup>25</sup> However, the analysis conducted by the authors of this report, multiple investigations, and research reports demonstrate that these schools perform worse than nearby student populations with significantly higher percentages of low-income students. Academic growth rates are also far below state expectations.<sup>26</sup>

If not positive academic outcomes, what do these dollars buy? The authors of this report reviewed the financial disclosures of K12 Inc. and found that the organization spent more than \$11 million on the compensation of five top executives in 2017 after spending over \$15 million in 2016 and nearly \$38 million on advertising in fiscal year 2018.

K12 Inc.'s executive performance-based compensation structure also does not consider student academic outcomes.<sup>27</sup>

The authors' findings are only one example among numerous reports and news stories highlighting the troubling academic outcomes and misplaced priorities of virtual charter schools managed by for-profit companies. CAP recommends that states ban for-profit operators from opening and managing virtual charter schools. States also should implement strict, differentiated oversight measures for fully virtual charter schools—such as enrollment growth caps based on performance and adjusted per-pupil funding levels for virtual schools—to ensure that schools use public funds to improve academic outcomes. These policies would help distinguish the outcomes and practices of fully virtual charter schools managed or closely tied to for-profit companies from the rest of the charter school sector, which offers many students innovative, high-quality programs.<sup>28</sup>

# Academic outcomes of for-profit virtual charter schools

CAP compared the outcomes of for-profit virtual charter school students with the outcomes of other students in the same state. The authors of this report selected the largest virtual charter school that is managed by or contracts the majority of its operations to a for-profit company in five states that have a for-profit virtual charter school and where at least 1.5 percent of the student population is served by virtual schools, based on National Center for Education Statistics data from the 2013-14 school year—Colorado, Idaho, Nevada, Ohio, and Pennsylvania.<sup>29</sup>

Given that enrollment in virtual schools is growing, these percentages are likely even larger in more recent school years.<sup>30</sup> The authors compared the performance of these schools to their respective state as a whole and the state’s largest school district.

**TABLE 1**  
**For-profit virtual charter school enrollment is small but growing**

Percentage of students served by virtual schools in the 2013-2014 school year, by state

State	Percentage served by virtual school
Idaho	2.40%
Ohio	2.20%
Pennsylvania	2.10%
Kansas	1.80%
Colorado	1.70%
Nevada	1.50%

Source: National Center for Education Statistics, “Number of virtual schools, total state enrollment, total virtual school enrollment, and virtual school enrollment as a percentage of state total enrollment, by state: School year 2013–14,” available at [https://nces.ed.gov/ccd/tables/201314\\_Virtual\\_Schools\\_table\\_3.asp](https://nces.ed.gov/ccd/tables/201314_Virtual_Schools_table_3.asp) (last accessed July 2018).

Three of the selected schools are managed by the two largest for-profit companies that operate virtual charter schools in the United States: K12 Inc. and Connections Education. As of the 2016-17 school year, K12 Inc. was the largest virtual charter school operator, serving an estimated 30 percent of all students enrolled in full-time virtual charter schools, while Connections Education served 17 percent.<sup>31</sup>

The authors pulled student demographic data as well as achievement and outcomes data that reflect key elementary and secondary school outcomes for the sampled schools, districts, and states from the 2016-17 school year. Poverty data are included in Table 2 and English language and disability status data are available in the appendix. The authors pulled data on third-grade proficiency in English language arts, considering that children who are not proficient by the end of third grade are significantly less likely to graduate; eighth-grade math, because it is a key measure in algebra readiness; and high school graduation rates, to measure long-term student achievement.<sup>32</sup>

The authors also sought out available data on the public funding allocated to the sampled schools by pulling from the charter board’s annual 990 forms, annual financial reports, and state funding data. These figures come from different sources and likely have variability in reporting, so these numbers have limitations and are only included in order to provide a general point of comparison.

**TABLE 2**  
**For-profit virtual charters mostly perform worse than nearby urban districts and their states**

Elementary and secondary outcomes for highlighted schools, districts, and states in the 2016-2017 school year

School/population	Enrollment	Economically disadvantaged students	Third-grade English language arts proficiency	Eighth-grade math proficiency	Graduation rate
Idaho Virtual Academy (operated by K-12 Inc.)	2,035	53%	41%	34%	44%
Joint District No. 2	38,206	28%	55%	51%	85%
Idaho Public Schools	295,738	47%	49%	39%	80%
Ohio Virtual Academy (operated by K-12 Inc.)	8,157	56%	57%	36%	57%
Columbus City Schools	50,063	99%	40%	32%	74%
Ohio Public Schools	1,803,461	47%	64%	55%	83%
Pennsylvania Cyber Charter School	9,723	32%	49%	25%	55%
School District of Philadelphia	134,129	71%	35%	25%	67%
Pennsylvania Public Schools	1,722,619	45%	65%	33%	87%
Nevada Connections Academy (operated by Connections)	3,091	26%	37%	14%	40%
Clark County School District	320,523	70%	46%	14%	75%
Nevada Public Schools	473,647	61%	45%	18%	74%
GOAL Academy	3,764	61%	--	3%	38%
Denver Public Schools	92,331	67%	38%	26%	65%
Colorado Public Schools	910,280	42%	40%	21%	79%

Note: Kansas is not included in the table because the state has no virtual charter schools explicitly run by a for-profit company.

Sources: A full list of sources is available at <https://cdn.americanprogress.org/content/uploads/2018/08/10130208/VirtualCharterAppendixTable2Sources.pdf>.

TABLE 3

**For-profit virtual charters receive significant public funding**

Public funding for virtual schools in fiscal year 2017

School	Public funding
Idaho Virtual Academy	\$12,807,130
Nevada Connections Academy	\$21,249,072
Ohio Virtual Academy	\$73,955,820
GOAL Academy	\$23,474,465
Pennsylvania Cyber Charter School	\$139,565,630

Notes: The public funding for GOAL Academy is the total of government grants and program expenses. The total public funding for Nevada Connections Academy is general revenue minus miscellaneous revenue.

Sources: A full list of sources is available at <https://cdn.americanprogress.org/content/uploads/2018/08/10130055/VirtualChartTable3Sources.pdf>.

In general, virtual charter schools operated by for-profit companies performed significantly worse than averages in their state, and also performed worse on key measures than large urban school districts within their states. This comparison to school districts that serve a higher percentage of students who qualify for free or reduced-price lunch shows that the poor performance of virtual charter schools operated by for-profit companies is not necessarily due to the fact that they serve students with greater needs.

Specifically, the authors found that:

- **For-profit virtual charter schools graduate about half of their students, which groups them among the lowest performing schools in their state.** All of the schools studied for this report failed to graduate more than 60 percent of their students. Under the federal Every Student Succeeds Act, all high schools that fail to graduate more than 67 percent of their students are grouped within states' lowest performing schools.<sup>33</sup> These schools must receive comprehensive support. All of the sampled for-profit virtual charter schools miss that target and, therefore, would be grouped among each respective state's lowest performing schools.

Extended graduation rates, or the percentage of students who graduate in 5 or 6 years—which is an alternative accountability measure for schools that serve high-need populations—were not much better. For instance, Ohio Virtual Academy's five-year graduation rate for the 2015-16 school year was 58.2 percent—an increase of only one percentage point from its four-year graduation rate.<sup>34</sup>

Interestingly, K12 Inc. has published graduation rates significantly higher than those calculated based on state and federal requirements. For example, for the 2014-15 school year, K12 Inc. reported that its graduation rate at Ohio Virtual Academy was 92 percent, but the graduation rate for accountability purposes was 53 percent. During her confirmation process, now-U.S. Secretary of Education Betsy DeVos, an early investor in K12 Inc., defended virtual schools by citing the inaccurate numbers reported by K12 Inc.<sup>35</sup>

- **For-profit virtual charter schools have much lower graduation rates than their respective state as a whole and nearby urban school districts that generally serve more low-income students.** The sampled virtual charter schools graduate significantly lower percentages of their students than the state average and a nearby urban school district. Take Pennsylvania Cyber Charter as an example. Its graduation rate is 32 percentage points fewer than the state average and 12 percentage points fewer than the School District of Philadelphia, which serves more than double the percentage of economically disadvantaged students. (see Table 2) With the exception of Idaho Virtual Academy, all of the sampled schools serve lower rates of low-income students than nearby urban school districts.
- **For-profit virtual charter schools underperform the state average for third-grade English language arts and eighth-grade math proficiency.** The sampled schools have lower proficiency rates for key academic benchmarks than the average rates for their respective state. The difference between the scores varied significantly across the five states studied for this report—from 4 percent to 19 percent—but the trend was consistent.
- **Most of the large virtual charter schools in CAP’s analysis also fell far below states’ expectations for students’ academic growth.** At Colorado’s GOAL Academy, the median student growth compared to students with a similar score history was in the 38th percentile, while the median student statewide was in the 50th percentile.<sup>36</sup> Ohio Virtual Academy received a component score of F for student progress in 2017, with significant evidence that “students made less progress than expected.”<sup>37</sup> At Nevada Virtual Academy, the elementary school’s overall rating was 1 star out of 5 stars and it received only 8 out of 35 possible points for student growth.<sup>38</sup> At Pennsylvania Cyber Charter School, there was significant evidence that the school did not meet the standards for Pennsylvania academic growth in both math and English language arts in 2017.<sup>39</sup> Academic growth data for Idaho Virtual Academy are not publicly reported, as the Idaho State Department of Education’s accountability system will include growth data for the first time for the 2017-18 school year.<sup>40</sup>

- **Virtual for-profit chart schools offer a poor return on public investment.** Virtual for-profit charter schools receive scarce public funding, but use these public dollars for marketing, lobbying, and exorbitant executive compensation packages, as well as siphoning off a portion of their public dollars for profit despite poor academic outcomes.<sup>41</sup>

K12 Inc. and Connections Education declined to comment on the conclusions of the report.<sup>42</sup>

In response to reports that shed light on GOAL Academy’s outcomes, Ken Crowell, founder and former executive director, warned critics against focusing on test scores. In an interview with *Education Week*, he said, “You’ve got to be really careful when you throw around statistics. . . . If we did not give an opportunity to those students who had not previously been successful, we’d be no better off as a society than just letting those kids hit the street.”<sup>43</sup> In response to public controversy related to Pennsylvania Cyber Charter School, CEO Michael Conti has said that the school “has been at the forefront of commonsense reform,” and has conducted internal evaluations to “maintain its strong reputation among state education officials, the general public, and our students.”<sup>44</sup>

Recent research on for-profit virtual charter schools is consistent with the authors’ analysis. Stanford’s Center for Research on Education Outcomes (CREDO) and the National Education Policy Center have both studied the achievement of virtual schools. Both organizations’ studies looked at different subsets of the online school market and reported that virtual charter schools have significant performance challenges.<sup>45</sup>

CREDO compared the academic progress of virtual charter school students to the outcomes of their peers in traditional public schools. The study found that students in all virtual charter schools, regardless of their management structure, had much lower academic growth compared with students in traditional public schools, while brick-and-mortar charter schools improved outcomes. Using CREDO’s days-of-learning calculation, attending virtual charter schools was equivalent to missing between 129 to 172 days of learning in math instruction.<sup>46</sup> The report does not disaggregate the effect of online charter schools by nonprofit and for-profit operators. However, a subsequent report using the same methodology, which looked at the effects of particular charter management organizations, found that charter schools operated by K12 Inc. averaged a learning loss of equivalent to -0.21 standard deviations—or 151 days of learning—in math, and 0.11 standard deviations—or 79 days of learning—in reading.<sup>47</sup>

Moreover, CREDO found that the mobility of these students was likely not the reason for these negative outcomes, as the mobility rates of these students before they enrolled in virtual charter schools is similar to the mobility rates of students in brick-and-mortar schools.<sup>48</sup>

The National Education Policy Center's analysis compiled state school performance ratings for virtual schools and found that state education agencies rated barely more than one-fourth—27 percent—of all virtual schools operated by for-profit operators—not just charter schools—as acceptable and a little more than half—53.8 percent—of district-operated virtual schools as acceptable.<sup>49</sup>

While this report's authors' analysis focused on for-profit virtual charter schools, the above studies show that all virtual schools have significant challenges.

# Why for-profit virtual charter schools are plagued with poor outcomes

Almost by conception, virtual schools have challenges providing adequate instruction and needed supports, but for-profit operators' incentive to lower instructional costs exacerbates these problems.

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## Too few teachers and not enough support

Virtual charter schools advertise their ability to serve struggling students who need more flexibility, such as over-age, under-credited students or those with serious medical conditions.<sup>50</sup> Yet a series of recent studies has confirmed that low-performing students in fully virtual courses perform worse than students in blended or in-person courses.<sup>51</sup>

It is not surprising that virtual charter schools operated by for-profit companies have particularly poor outcomes for struggling students. Most for-profit virtual schools are devoid of critical supports for student learning and motivation.<sup>52</sup> For example, the average student-to-teacher ratio in these virtual schools is significantly higher than in brick-and-mortar schools: The national average ratio in public schools is 16 students to 1 teacher for the 2015-16 school year, while virtual schools reported a student-to-teacher ratio of 45 to 1.<sup>53</sup> Some virtual for-profit charter schools have much higher ratios. The Florida Center for Investigative Reporting released a confidential document from K12 Inc. showing that in 2010 the student-to-teacher ratio for some of their high school courses was as high as 275 to 1.<sup>54</sup> Charter schools are mostly exempt from state maximums for student-to-teacher ratios, so for-profit virtual charter schools are not obligated to meet certain criteria. Teacher compensation represents the largest share of school budgets, so increasing the student-to-teacher ratio offers the greatest potential for cost savings.<sup>55</sup>

Outside of teacher support, only nine states require that virtual charter schools provide necessary technology.<sup>56</sup> Outside of these states, the decision to provide a computer and access to the internet is up to each school. Only a little more than half of virtual charter schools provide computers to all students, and less than a third of all virtual charter schools provide or subsidize internet service to all students.<sup>57</sup> Without these tools, virtual education may be out of reach for low-income families.

It is important to note that there is a subset of virtual school students for whom a traditional school setting may not work, such as students with serious or chronic illnesses. The answer to these students' needs, however, should be addressed with virtual schools that provide more intensive support rather than schools that offer largely independent, self-paced learning and do not provide services to support unique student needs.

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## Focus on increasing enrollment to drive up profit

Operators and researchers agree that fully virtual instruction is not suitable for all students; however, operators' actions don't support this sentiment.<sup>58</sup> K12 Inc. argues that it provides comprehensive information and counseling on the front end to ensure that enrolling students are a strong fit for virtual instruction.<sup>59</sup> And yet many for-profit virtual schools focus on growth to maximize revenue rather than diligently identifying students who have the potential to succeed.<sup>60</sup> In 2011, *The New York Times* reported that K12 Inc. even provides recruiters paid commissions based on how many students they enroll, a practice that is prohibited in post-secondary education.<sup>61</sup>

Since the reauthorization of the Higher Education Act in 1992, incentive compensation has been banned for higher education institutions that are eligible to offer federal grants and student loans.<sup>62</sup> Prior to legislative action and subsequent regulatory efforts to eliminate "safe harbors" that permitted some incentive payments, enrollment representatives from some for-profit colleges, acting more like salespeople, tried to persuade candidates who would qualify for financial aid or education benefits from the G.I. Bill to enroll even if they were not well-suited for the program.<sup>63</sup> Once a school received the federal aid, it would wash its hands of the student. Some newspapers reported egregious incidents, including two for-profit colleges trolling homeless shelters in Dallas, San Antonio, New Orleans, and Houston that persuaded individuals to enroll and, afterward, provided little follow-up.<sup>64</sup> The federal government attempted to take action to ensure that higher institution enrollment officers act as counselors and help students determine if they are a good fit for the program.<sup>65</sup> The same premise should also apply to elementary and secondary schools that accept public dollars.

K12 Inc.'s 2018 annual report acknowledges that it still uses incentive compensation and new laws or regulations that would prohibit this would "negatively impact our operations and financial results."<sup>66</sup>

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## Ineffective metrics to measure student participation in virtual schools

Currently, most public virtual schools report attendance rates in the same way as brick-and-mortar schools even though attendance and participation within a virtual program looks different. Virtual charter schools managed by both nonprofit and for-profit operators average three or four hours per week, depending on grade level, of synchronous instructional time—or time that teachers are working in real time with students.<sup>67</sup> This means that a student in a brick-and-mortar school has more real-time interaction with a teacher by lunch on Monday than a student in a virtual charter school does in a full week.

As a result, attendance and participation metrics that have been developed and used to regulate and fund traditional brick-and-mortar schools do not align with virtual school models; however, many states have not adequately adjusted policies to account for how attendance looks different in virtual schools. Most states with virtual schools have vague guidelines for how these schools should report attendance and student engagement, if guidelines exist at all.<sup>68</sup> Colorado, which has some of the most rigorous guidelines for virtual school attendance, requires virtual schools to measure attendance using one of three methods: login time, task completion, or unit completion.<sup>69</sup>

Recent audits and investigations show that in states with significant flexibility in the way that virtual schools report participation, some virtual charter schools do not adequately engage with students.<sup>70</sup> For example, in 2016, the Ohio Department of Education changed the way it would provide funding to virtual schools. Previously, the state allocated money to virtual schools based on school-reported enrollment numbers. Now the state will only allocate funding for students who have documented coursework for at least five hours a day, either by being logged in to the online platform for five hours or self-reporting independent work offline.<sup>71</sup>

Many virtual schools, both for-profit or nonprofit, as well as charter schools or schools run by public school districts, were unable to provide the needed documentation for many of the students enrolled in their schools. As a result, many had to repay the difference between the per-pupil funding calculated from enrollment numbers and the per-pupil funding calculated from participation data.<sup>72</sup>

The difference was significant in many virtual schools. The Electronic Classroom of Tomorrow (ECOT) was once the largest virtual school in Ohio and had substantial contracts with for-profit companies tied to the school's founder.<sup>73</sup> ECOT had a significant difference between the students it claimed it enrolled and those for whom it could document participation through login data. For the 2015-16 school year,

the school could only account for a little more than 40 percent of its students—only 6,300 of its 15,300 total enrollment.<sup>74</sup> In the 2016-17 school year, ECOT could only account for a little more than 80 percent of its total student enrollment. ECOT is liable to repay \$60 million for overcounting enrollment in the 2015-16 school year and \$19 million for the 2016-17 school year. The school closed in January 2018 because it was unable to repay these funds.<sup>75</sup>

Similarly, the Ohio Virtual Academy, a for-profit virtual charter school included in the authors' analysis, must repay \$1.6 million for enrollment discrepancies for the 2016-17 school year.<sup>76</sup>

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## Fraudulent practices

Finally, outside of structuring academic programs to increase profit, news reports continually highlight fraudulent behavior in some virtual schools, which demonstrates that many of the operators do not keep student outcomes at the forefront of business decisions. *Education Week* compiled many of these stories, including a story of the owner of the Pennsylvania Cyber Charter School, one of the for-profit virtual charter schools included in the authors' analysis for this report, who was convicted of tax fraud after spending almost \$1 million of the school's publicly allocated funds to purchase a condo in Florida.<sup>77</sup>

# K12 Inc.'s financial practices

To better understand how one for-profit company manages virtual charter schools, the authors of this report reviewed K12 Inc.'s annual report and proxy statement to the U.S. Securities and Exchange Commission, also known as Form 10-K (from 2018) and Schedule 14A (from 2017), respectively. K12 Inc. and Connections Education are both publicly traded, but since Connections Education is a subsidiary of a larger corporation, financial reports do not provide a similar level of detail.<sup>78</sup> A recent K12 Inc. press release stated that “ensuring academic excellence is the top priority,” but information in the company’s public filings suggest that the company prioritizes profit and executive compensation over student outcomes.<sup>79</sup>

Notably, K12 Inc. accrues revenue by creating and managing virtual schools and content for other entities, including traditional school districts. While the management of public school programs represents 85 percent of their revenue, K12 Inc.'s financial records are not exclusive to the company’s operation of virtual charter schools.<sup>80</sup> Yet K12 Inc.'s annual financial documents describes the priorities and business practices that drive the operation of its virtual charter schools.<sup>81</sup>

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## Prioritizing growth and profit over outcomes

Despite concerning outcomes across many of K12 Inc.'s virtual charter schools, the company’s 2018 annual report demonstrates that it continues to divert resources to grow enrollment, thereby limiting funds to improve academic programs.<sup>82</sup> For example, the company spent 32 percent of its revenue, or \$290 million out of \$918 million, on “selling, administrative and other operating expenses” while public elementary and secondary schools spend around 7 percent of their funding on central administration.<sup>83</sup> Within those costs, K12 Inc. spent almost \$38 million on advertising and marketing to recruit new students.<sup>84</sup>

K12 Inc.'s annual report does not specify the amount it spent on political contributions and lobbying, but reports estimate that K12 Inc. has spent more than \$12 million on political contributions and lobbying in the past decade.<sup>85</sup> *Education Week* has reported that K12 Inc. officials say that these costs are necessary “to stay in compliance with myriad regulations that differ from state to state. And monitoring what’s happening in statehouses . . . is another benefit in the suite of services they provide to schools they manage.”<sup>86</sup>

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## Exorbitant executive compensation

K12 Inc. also devotes a significant portion of its revenue to executive compensation. Based on K12 Inc.'s Schedule 14A from 2017, in 2016, compensation for the top five executives exceeded \$15 million, with the executive chairman's compensation approaching \$7 million.<sup>87</sup> This is nearly 16 times the salary of the chief executive officer of KIPP Foundation, a national, high-performing charter management organization that served 87,000 students across 209 schools in the 2015-16 school year.<sup>88</sup>

To put this in perspective, the compensation of K12 Inc.'s top five executives is comparable to the national average cost of educating almost 1,300 public school students and the pay of K12 Inc.'s executive chairman is equal to the cost of educating more than 600 students.<sup>89</sup>

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## How executive performance compensation considers student outcomes

In 2016, K12 Inc. revised its executive compensation policies. Executives now earn an annual base salary and are eligible for different forms of performance-based bonuses, such as an annual incentive bonus and—new in 2016—an “ambitious long-term incentive plan.”<sup>90</sup>

While the company's marketing materials declare that “we put students first” and that “we have an unwavering commitment to our students' academic achievement,” the structure of executives' annual bonuses and the long-term incentive plan are focused on a different set of incentives.<sup>91</sup> Bonuses are based on corporate performance management objectives that do not consider student performance unless it jeopardizes the ability of a school to remain open.

The value of the annual incentive compensation is calculated based on meeting targets within categories that include:

- Revenue
- Adjusted operating income
- Adjusted earnings before interest, taxes, depreciation, and amortization margin
- Student retention
- Average enrollment<sup>92</sup>

Academic performance is not considered.

Long-term incentive plan rewards are not granted annually. Academic performance is a factor for these rewards but the way the company measures academic performance does not capture student success; rather, the company's market share is the focus. The company rewards executives for academic performance if schools in their network do not "have a high probability of being closed within 12–18 months . . . if performance does not improve," not if students in the schools are meeting or achieving grade-level standards.<sup>93</sup> This condition does not assess the adequacy of schools' proficiency or graduation rates or provide increased rewards to executives for high levels of student achievement, but instead focuses solely on the company's ability to protect revenue by keeping schools open.

Based on these metrics, K12 Inc. has created financial incentives for executives to increase the number of students served and do just enough for them academically to keep them enrolled and the school open. As a for-profit, publicly held company, K12 Inc. is focused on profit, not on student outcomes. Given the academic outcomes of the vast majority of other virtual charter schools operated by for-profit companies, it is likely that other operators have a similar focus.

K12 Inc. did not provide a comment.

## An element of the performance-based pay structure: ambitious long-term incentive plans

The “ambitious long-term incentive plan” creates stock grants to executives of “performance share units” with levels of awards determined based on two conditions: academic performance and student lifetime value.<sup>94</sup>

### Academic

Academic performance is given a 70 percent weight in determining awards of performance share units, which would suggest that the company values academic outcomes. But academic performance is defined as it is in the calculation of annual cash bonuses. Executives are eligible to receive 100 percent of the award even if as many as five percent of K12 Inc. schools are in jeopardy of closure or “have a high probability of being closed within 12–18 months . . . if performance does not improve.”<sup>95</sup>

### Student lifetime value

Thirty percent of the performance share unit award is based on the growth of student lifetime value, a figure that is calculated by multiplying the average duration of enrollment by the difference between funding and cost of sales. This means that growth in lifetime value can be achieved by increasing student retention so that more students stay in K12 Inc. schools, finding ways to increase average revenue per student, or reducing the costs of recruiting and educating students.

TABLE 4

### Executive awards are tied to market share and profit rather than academic performance

Rates of academic jeopardy and awards at virtual schools, by performance level

Performance level	Percentage of schools not in academic jeopardy	Percentage of award earned
Below threshold	<90%	0%
Threshold	90%	70%
Target	95%	100%
Outperform	100%	150%

Source: U.S. Securities and Exchange Commission, “Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934,” available at <https://www.sec.gov/Archives/edgar/data/1157408/000104746917006617/a2233596zdef14a.htm> (last accessed July 2018).

Growth of LTV and awards for virtual schools, by performance level

Performance level	LTV growth	Percentage of award earned
Below threshold	<16%	0%
Threshold	16%	70%
Target	33%	100%
Outperform	52%	150%

Source: U.S. Securities and Exchange Commission, “Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934,” available at <https://www.sec.gov/Archives/edgar/data/1157408/000104746917006617/a2233596zdef14a.htm> (last accessed July 2018).

# Policy recommendations

The authors' analysis, as well as the growing body of research on the negative outcomes of virtual charter schools, suggest that profit maximization is incompatible with providing a high-quality education. When traditional public schools or non-profit public charter schools achieve cost savings as a result of innovative practices, they reinvest those savings in additional services that students need rather than padding the pockets of the operators.

New technologies have the potential to better serve elementary and secondary school students. Online coursework can be an important aspect of this effort, but only if it is delivered in a way that adequately supports students. For example, virtual courses offer flexibility. Rural and other small schools can offer world languages or advanced electives even if they don't have a qualified teacher or enough students to fill a traditional class. Students can make up credits outside of normal school schedules to remain on track to graduate. This flexibility, however, makes careful oversight and accountability incredibly important for virtual education.

Instituting the following policy recommendations would ensure that all virtual charter schools prioritize student achievement and protect taxpayer dollars.

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## Ban for-profit companies from opening and operating virtual charter schools

States should prohibit the operation of virtual charter schools operated by for-profit companies, as the profit motive and the flexibility of the virtual framework drive perverse incentives that hurt student outcomes and misuse taxpayer dollars. This ban should extend to turnkey management contracts where for-profit companies operate ostensibly nonprofit schools. To accomplish this, states must closely evaluate the extent to which for-profit entities will manage a charter school in the authorization process. Most states bar for-profit companies from receiving public education funds, but, as described above, many for-profit virtual charter schools establish a nonprofit board that acts as a mere figurehead for operations.

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## Implement rigorous transparency and accountability for all virtual charter schools

Given the outcomes of virtual charter schools and the abundance of scandals surrounding them, various organizations have championed rigorous policy recommendations to reign in troubling practices at fully virtual charter schools.<sup>96</sup> For example, the National Alliance of Public Charter Schools, the National Association of Charter School Authorizers, and 50CAN— the 50-State Campaign for Achievement Now— released a report in 2016 with multiple proposals, including:

- Enrollment growth caps and restrictions based on operators' performance
- A modified per-pupil allocation for virtual schools that recognizes the cost savings of an online instructional model
- Greater reporting of student login and course completion
- A requirement that only statewide authorizers can oversee schools serving students across an entire state<sup>97</sup>

States and districts should implement these strict, differentiated accountability principles for all virtual schools, whether they are public charter schools or traditional public schools. There is no bright line between virtual instruction/schools managed by nonprofits and those managed by for-profit organizations. Many nonprofit organizations or traditional public schools hire for-profit companies to manage a portion or all of their virtual instruction. As such, policymakers should impose rigorous oversight measures to ensure that all forms of virtual instruction deliver quality instruction and prioritize student outcomes rather than profit.

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## Prohibit incentive compensation for student enrollment for all public elementary and secondary schools

In 1992, the federal government banned incentive compensation for student enrollment among higher education institutions. Congress should ensure that a similar ban with robust protections applies to public elementary and secondary schools.

# Conclusion

Online instruction can increase access and leverage new technologies. Yet fully virtual charter schools run by for-profit companies have an incentive to divert dollars from instruction in order to maximize profit. News stories report that many of these operators cut corners on instructional materials and allocate public dollars to marketing, political contributions, executive compensation, and profits. The analysis conducted by the authors of this report, along with a growing number of other studies, demonstrates that student outcomes suffer. Even when serving populations with lower percentages of low-income students than nearby urban school districts, for-profit virtual schools perform worse.

Laws and regulations have not kept pace with the rapid growth of fully virtual charter schools. More stringent accountability provisions are needed to ensure that innovative instructional models improve student outcomes. Specifically, policymakers should prohibit for-profit organizations from opening and managing virtual charter schools. These schools have a perverse incentive to maximize enrollment and reduce instructional costs rather than maximize student outcomes. Additionally, all virtual schools must be held to policies explicitly designed for this new type of instructional model.

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# Appendix

TABLE A1

## For-profit virtual charters produced worse student outcomes than nearby urban districts and their states

Elementary and secondary outcomes for highlighted schools, districts, and states in the 2016-2017 school year

School/population	Enrollment	Economically disadvantaged students	Limited English proficiency	Students with disabilities	Third-grade English Language Arts proficiency	Eighth-grade math proficiency	Graduation rate
Idaho Virtual Academy (operated by K-12 Inc.)	2,035	53%	0%	11%	41%	34%	44%
Joint District No. 2	38,206	28%	5%	9%	55%	51%	85%
Idaho Public Schools	295,738	47%	5%	9%	49%	39%	80%
Ohio Virtual Academy (operated by K-12 Inc.)	8,157	56%	0%	14%	57%	36%	57%
Columbus City Schools	50,063	99%	14%	16%	40%	32%	74%
Ohio Public Schools	1,803,461	47%	3%	14%	64%	55%	83%
Pennsylvania Cyber Charter School	9,723	32%	0%	18%	49%	25%	55%
School District of Philadelphia	134,129	71%	10%	16%	35%	25%	67%
Pennsylvania Public Schools	1,722,619	45%	3%	16%	65%	33%	87%
Nevada Connections Academy (operated by Connections)	3,091	26%	1%	8%	37%	14%	40%
Clark County School District	320,523	70%	19%	11%	46%	14%	75%
Nevada Public Schools	473,647	61%	17%	11%	45%	18%	74%
GOAL Academy	3,764	61%	14%	2%	--	3%	38%
Denver Public Schools	92,331	67%	32%	11%	38%	26%	65%
Colorado Public Schools	910,280	42%	9%	10%	40%	21%	79%

Note: Limited English proficiency numbers are from 2015–2016; students with disabilities numbers are from 2013–2014.

Sources: A full list of sources is available at <https://cdn.americanprogress.org/content/uploads/2018/08/10130208/VirtualCharterAppendixTable2Sources.pdf>.

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- 89 The first calculation was obtained by dividing the total K12 Inc. value of the executive compensation amount for 2016 of \$15,119,016 by the national average per-pupil spending of \$11,222 for the 2013-14 school year. The second calculation divided K12 Inc. executive chairman Nathaniel A. Davis's 2016 compensation of is valued at \$6,905,832 by the national average per-pupil spending of \$11,222. National Center for Education Statistics, "Fast Facts: Expenditures," available at <https://nces.ed.gov/fastfacts/display.asp?id=66> (last accessed July 2018).

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