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Data envelopment analysis, endogeneity and the quality frontier for public services*

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Abstract Applying Data Envelopment Analysis (DEA) to real-world public policy issues can raise many interesting complications beyond those considered in standard models of DEA. One of these complications arises if the funding levels of public service providers, and their ability to attract and retain clients and able staff, depend upon the quality of the output which they produce. This dependency introduces additional inter-relationships between inputs and outputs beyond the unidirectional Production Possibility Frontier (PPF) relationship considered by standard DEA models. The paper therefore analyses the multiplier effects which can be generated by these additional relationships, in which key resource inputs become endogenous variables subject to the external environmental variables which the public service provider faces across these different relationships. The magnitude of these multiplier effects can be captured by focussing DEA on the estimation of an Achievement Possibility Frontier, which reveals the wider set of opportunities which are available to a public service provider to improve its own output quality than that revealed by the estimation of the PPF associated with standard models of DEA. In doing so, the paper enables DEA to be still applied, but in modified form, to the estimation of the scope for improved output of any given public service provider in the presence of such resource endogeneity.

Keywords Data envelopment analysis, resource endogeneity, public services, output quality, frontier analysis.

JEL Classifications: C30, C61, D24, I23, I26, L30

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1 Introduction

In emphasising the need for “applications-driven theory” (see Banker and Kaplan 2014), William W. Cooper was well aware of the value of exploring directions in which public policy and other applied problems present additional features of reality which are not adequately addressed by existing analytical techniques as a way of stimulating productive theoretical and methodological developments in these available analytical techniques. One main area of application of Data Envelopment Analysis (DEA) has been with analysing the efficiency of public services, such as education and health care (see, for instance, Smith and Mayston 1987; Jesson et al. 1987; Johnes and Johnes 1995; Mayston 2003; Emrouznejad et al. 2008; Hollingsworth 2008). In many other contexts, DEA’s main focus to date has been with identifying a Production Possibility Frontier (PPF) of the quantities of output that can be produced from a given set of inputs and the minimum level of resources that are required to produce a given vector of output quantities. However, evaluating the management of public services raises also important issues regarding the quality of service delivered. These quality issues are of concern both to the recipients of public services and to their funders. In an effort to stimulate greater efficiency and effectiveness in the delivery of public services, greater competition between public service providers, such as hospitals, schools and universities, has been introduced in recent years. The quality of the service delivered by a provider can therefore have important implications for their funding and available resources, which in turn introduces an additional inter-relationship beyond the simple uni-directional relationship between inputs and outputs considered by the PPF in the standard models of DEA. As a result, the provider’s quality scores, in areas such as university research and teaching, have also become a major focus for managerial attention in recent years.

In the case of universities, Johnes and Johnes (1995) have used DEA to identify those DMUs which are on or below a PPF that involves different categories of research publications as outputs, with research grants classified as one of the key inputs. In contrast, Izadi et al. (2002) have used the value of research grants and contracts received as a key output in their efficiency analysis. The difficulty in categorising research grant income as either an input or an output is arguably better resolved by explicitly recognising it as an endogenous resource input which contributes towards the production of research publications, but with the ability to attract such research grant income also dependent upon the quality of research being produced by the DMU.

The extent of the bias in the parameter estimates of a conventional production function, and its associated PPF, which the presence of endogeneity for public service providers in sectors such as
education can produce when single-equation regression-based econometric techniques, such as Ordinary Least Squares (OLS), are deployed is discussed in detail, for instance, in Mayston (1996, 2007, 2009). However, “because additional demand-side relationships can systematically change the set of observed points, in ways which a production frontier alone cannot adequately model, DEA is itself not immune from endogeneity bias, even in the case of multiple outputs” (Mayston 2003). Yet, as stressed by Cordera et al. (2013), “the potential distortions that endogeneity may cause in the measurement of technical efficiency using nonparametric techniques have received much less attention in the literature” than is the case for econometric models. Following earlier contributions by Orme and Smith (1996), Bifulco and Bretschneider (2001, 2003), Ruggiero (2003a, 2003b) and Johnson and Ruggiero (2011), Cordera et al. (2013) have recently concluded from their detailed simulation study that “a high positive endogeneity level, i.e., a high positive correlation between one input and the true efficiency level, severely biases DEA performance”. As we discuss below, such positive correlations may well exist in sectors such as education. There is therefore a need to respond in a positive way to Cordera et al. (2013)’s plea that “a technique should be developed to deal with endogeneity in order to improve DEA estimations”.

In doing so, our primary objective in this paper is to enable DEA in the presence of such additional inter-relationships to still adequately address questions such as (i) where is the feasible frontier that includes the quality of the output of any individual public service producer, given the constraints and opportunities which it faces? (ii) how much scope is there for an individual public service producer to improve its output quality, given the constraints and opportunities which it faces? and (iii) which individual public service producers are currently on the resultant quality achievement frontier? In Sections 2 and 3 below, we therefore examine several relevant additional inter-relationships beyond the uni-directional relationship between inputs and outputs which is considered in the PPF and beyond the associated production function relationship of standard micro-economic theory. At the same time, we examine the methodological developments which these additional considerations can give rise to in the application of DEA, which will enable DEA still to address the above questions in the presence of these complicating factors. Section 4 contains an application of our resultant modified DEA methodology to the interesting context of the achievable frontier of university teaching and research quality. Section 5 contains our conclusions.
2 Endogenous Resource Inputs

That additional inter-relationships between output quality and the availability of inputs can have important implications for the answers to questions (i) – (iii) above can be seen from the following example. We will consider the relatively simple case of local not-for-profit public service broadcasting where the quality of public service delivered by an individual local public service broadcaster matters to both its audience and its funders. We will denote by $Q_i$ the quality of the service delivered by the local public service broadcaster $i$, where $Q_i$ is measured by a survey of consumer satisfaction of the local residents on a continuous point-score basis. We will assume for simplicity that the local public service broadcaster $i$ makes use of a single resource input $x_i$ in its production process that involves a positive linear relationship between the maximum level $Q_i^*$ of its quality rating it could achieve and its resource input $x_i$ of the form:

$$Q_i^*(x_i) = \alpha_{i0} + \alpha_{i1}x_i \quad \text{where} \quad \alpha_{i1} > 0$$

(1)

This linear relationship is mapped out by the line KL in Fig. 1 over a relevant range of variation of $x_i$. It corresponds to a relevant section of a production function for $Q_i$ as the resource input $x_i$ is varied. If DEA identifies broadcasters K and L, with input and output quality combinations $(x_K, Q_K)$ and $(x_L, Q_L)$ respectively in Fig. 1, as being the efficient DMUs with which to compare broadcaster J’s result of $(x_J, Q_J)$, the line KL would also be mapped out by considering all the interior convex combinations of K and L’s achievements that DEA might consider.

We may note here that Eq. (1) indicates the maximum quality of output which producer $i$ could produce with an input of $x_i$ if it were production efficient. However, an individual broadcaster, such as $i = J$, may prove to be less than fully efficient in its production of output quality. Thus in Figure 1, the actual point $J$ corresponding to $(x_J, Q_J)$ for the public service producer $i = J$ is below the production frontier given by the line KL, with a shortfall of $\varepsilon_{iJ} = (Q_i^* - Q_i) = JF$ in the quality score of $Q_J$ which it did actually achieve, compared to the quality score $Q_i^* = Q_i^*(x_J)$ it could have achieved from its existing input level of $x_J$ if it were fully productive efficient. We then have more generally from equation (1) that the actual quality score of broadcaster $i$ equals:

$$Q_i = \alpha_{i0} + \alpha_{i1}x_i - \varepsilon_{iJ} \quad \text{where} \quad \alpha_{i1} > 0 \quad \text{and} \quad \varepsilon_{iJ} \geq 0$$

(2)
where $\varepsilon_{iQ}$ is the extent of any shortfall for producer $i$ in the output quality that it produces from its existing level of input $x_i$ compared to the maximum that it could have achieved if it were fully production efficient.

The value of $\varepsilon_{iQ}$ for the broadcaster $i = J$ would indeed be correctly identified in this example by the application of the output-orientated Banker-Charnes-Cooper (BCC) form of DEA (Cooper et al. 2007, p.93), which would seek to find:

$$\theta'_j = \max_{\theta_j, \lambda} \ s.t. \ \theta_j Q_j \leq Q_k \lambda_k + Q_r \lambda_r, x_j \geq x_k \lambda_k + x_r \lambda_r, \lambda_k + \lambda_r = 1, \lambda_k \geq 0, \lambda_r \geq 0, \lambda = (\lambda_k, \lambda_r)$$

and hence find the maximum feasible increase $\varepsilon_{iQ} = (\theta'_j - 1)Q_j$ in the output quality $Q_j$ that places it on the line KL of convex combinations of the efficient input-output vectors $(x_i, Q_i)$ of producers $i = K, L$ at a point, given by $F = (x_j, Q'_j)$ in Fig.1, corresponding to broadcaster $J$’s level of resource input $x_j$, with $Q'_j = Q'_j(x_j)$. 

![Fig. 1 The multiplier effect of output quality efficiency improvements](image.png)
However, in addition to the linear production function relationship (1), we will assume that the not-for-profit broadcaster operates under a budget constraint in which the maximum resources \( x_i^* \) it could have available to it depend in a positive linear way on the population size \( z_i \) of its local area and on how satisfied local residents are with its output, as reflected in its \( Q_i \) rating, so that:

\[
x_i^*(Q_i, z_i) = \alpha_{20} + \alpha_{21}Q_i + \alpha_{22}z_i \text{ where } \alpha_{21} > 0, \alpha_{22} > 0
\]

(4)

This additional revenue generating function relationship may arise because the not-for-profit broadcaster depends upon subscriptions from its audience whose size depends upon \( z_i \), and whose willingness to pay depends in part upon how satisfied they are with its output. It may also arise because the size of any grant the public service broadcaster receives from local or central government is based upon its local population size and on its published satisfaction scores. In addition it may arise because any advertising revenue which the broadcaster receives depends upon advertisers’ assessment of how popular the broadcaster is with its potential audience and the size of its potential audience. Such an additional inter-relationship between the broadcaster’s output quality and their available inputs beyond the simple one-way relationship of the standard production function has important consequences for the value of the maximum achievable output quality that an initially inefficient producer could achieve.

Thus, for an individual broadcaster, such as \( i = J \), Eq. (4) will map out another line, such as RS in Fig. 1, in \((x, Q)\) space, holding constant the size of the local population \( z_i = z_J \). Eq. (4) indicates the maximum level of resources producer \( i \) could secure when its output quality is \( Q_i \) and its population size is \( z_i \) if it were fully effective at revenue raising. We will assume in this example that the broadcasters K and L are themselves both production efficient and fully effective in their revenue raising for the size of their respective local populations, with \( z_K < z_J < z_L \). The points \( K \) and \( L \) in Fig. 1 will therefore lie at the intersection points of the production frontier \( KL \) with the respective revenue generating lines parallel to \( RS \) corresponding to their respective values of \( z_K \) and \( z_L \) in Eq. (4).

However, broadcaster \( J \) in this example is less than fully effective at revenue raising. Thus in Fig. 1, the actual point \( J \) corresponding to \((x_J, Q_J)\) is to the left of the revenue raising line \( RS \) for the given value of its local population size \( z_J \), with a shortfall of \( \varepsilon_{Jx} = (x'_J - x_J) = GJ \) in the resourcing level \( x'_J \equiv x'_J(Q_J, z_J) \) it could have achieved with its existing quality score of \( Q_J \) and its population size of \( z_J \).

We then have more generally from Eq. (4) that the actual resourcing level of broadcaster \( i \) equals:
\[ x_i = \alpha_{20} + \alpha_{21} Q_i + \alpha_{22} z_i - \varepsilon_{ix} \quad \text{where } \alpha_{21} > 0, \alpha_{22} > 0 \text{ and } \varepsilon_{ix} \geq 0 \]  

(5)

where \( \varepsilon_{ix} \) is the extent of any shortfall for producer \( i \) in the resources that it succeeds in raising with its existing output quality score and population size. However, it is important to note that even if we had simply \( \varepsilon_{ix} = 0 \) in Fig. 1, the answer to question (ii) raised in Sect. 1 above, of how much scope would there be for the public service producer \( J \) to increase its output quality, would here be not simply the amount of its existing quality shortfall \( \varepsilon_{iJ} \). Instead if producer \( J \) did eliminate the existing shortfall in its output quality by the amount \( \varepsilon_{iJ} \), so that is did achieve an output quality of \( Q^*_j \equiv Q^*_j(x_j) \) from Eq. 1, the existence of the additional revenue raising relationship (4) means that it could increase its input level to \( x^*_j \equiv x^*_j(Q^*_j, z_j) \) in Fig. 1 if it were fully effective in its revenue raising. Moreover, this in turn would enable it to further increase its output quality beyond \( Q^*_j \), with a resultant multiplier process that has an equilibrium in Fig. 1 at the point H at which:

\[ Q^*_i(x_i) = \alpha_{10} + \alpha_{11} x_i \quad \text{and} \quad x_i = \alpha_{20} + \alpha_{21} Q^*_i + \alpha_{22} z_i \]  

with both the efficient production function equation (1) and the effective revenue raising inter-relationship (4) holding simultaneously at the fully efficient and effective point \( H = (x^*_i, Q^*_i) \) for \( i = J \) in Fig. 1. Eq. (6) in turn has a solution for the maximum achievable output quality for producer \( i \), given by:

\[ Q^*_i = \beta_0 + \beta_1 z_i \quad \text{where} \quad \beta_0 \equiv \gamma(\alpha_{10} + \alpha_{11} \alpha_{20}), \quad \beta_1 \equiv \gamma \alpha_{11} \alpha_{22} > 0, \quad \gamma \equiv 1 / (1 - \alpha_{11} \alpha_{21}) > 1, \quad \text{for } 0 < \alpha_{11} \alpha_{21} < 1 \]  

(7)

As we note in Sect. 5 below, our approach parallels here that of deriving a reduced form equation in econometrics, in which the attainable equilibrium values of the endogenous variables are specified as functions of the exogenous (or pre-determined) variables.

The condition \( \alpha_{11} \alpha_{21} < 1 \) in Eq. (7) is here a stability condition that ensures that the feedback effect \( \alpha_{21} = (\partial x_i / \partial Q_i) \) of a unit improvement in a producer’s output quality on its resource availability in Eq. (4), when multiplied by the feasible additional output quality \( \alpha_{11} = (\partial Q_i / \partial x_i) \) that the DMU could achieve with an additional unit of the resource input in Eq. (1), does not exceed the initial unit increase in \( Q_i \), so that the successive iterations in the multiplier process in Fig. 1 grow smaller and converge to an equilibrium point.
The overall feasible increase in output quality for producer $J$ under its given population size of $z_J$ is therefore here $Q_J^* - Q_J$, which in Fig. 1 substantially exceeds the increase $Q_J' - Q_J$ that the standard DEA program (3) would indicate as being feasible. Recognising that there is not only a production side to a DMU’s operations, but also a demand side which influences consumers’ willingness to pay for its output and available resources can therefore make a substantial difference to an assessment of the DMU’s feasible scope for output quality increases.

![Quality, Q](image)

**Fig. 2** A linear section of the Achievement Possibility Function

When the efficient production-side relationship (1) holds simultaneously with the effective revenue raising function (4), the result is a set of two simultaneous equations which yield a solution for the maximum achievable output quality for producer $i$ in Eq. (7) which depend upon its local population size $z_i$. Under our above assumption that the comparator DMUs $K$ and $L$ are both production efficient and fully effective in their revenue raising, Eq. (7) defines here a new locally linear relationship between $Q_i$ and the exogenous variable $z_i$ that maps out feasible convex combinations of the end points of $K' = (z_K, Q_K)$ and $L' = (z_L, Q_L)$ in the relevant new $(z_i, Q_i)$ space in Fig. 2. **Thus even though the exogenous variable $z_i$ does not directly enter into the production relation in Eq. (1), it plays an important part in determining the achievable level of output quality which is feasible in Eq. (7) if the DMU is both**
technically efficient and fully effective in increasing its resource income in response to feasible improvements in its output quality. For the case of a single output variable, Eq. (7) therefore defines a linear facet of what we can call an Achievement Possibility Function in the relevant \((z_i, Q_i)\) space, in contrast to the conventional production function in the standard \((x_i, Q_i)\) space.

Equations (2), (5) and (7) imply that the actual output quality of producer \(i\) equals:

\[
Q_i = \beta_0 + \beta_i z_i - \eta_i \quad \text{where} \quad \eta_i = \gamma (\varepsilon_{iQ} + \alpha_1 \varepsilon_{i\alpha}) \geq 0
\]  

(8)

Equation (8) in turn implies performance multiplier effects from reductions in the production efficiency shortfall \(\varepsilon_{iQ}\) and the revenue-raising effectiveness shortfall term \(\varepsilon_{i\alpha}\) that are given by:

\[
\psi_1 = (\Delta Q_i / - \Delta \varepsilon_{iQ}) = \gamma > 1, \psi_2 = (\Delta Q_i / - \Delta \varepsilon_{i\alpha}) = \gamma \alpha_1 > 0, \text{ for } 1 > \alpha_1, \alpha_2 > 0
\]  

(9)

We are now in a position to extend the application of DEA to more fully answer questions (i), (ii) and (iii) of Sect. 1. in the above context. The overall value of the shortfall \(\eta_j\) in Eq. (8) for any DMU that is less than fully efficient and effective can be estimated here using DEA by modifying the output-orientated BCC form of DEA so that the exogenous variable \(z_j\), such as local population size in the above example, replaces the endogenous resource input \(x_j\) in its formulation. We then have:

\[
\rho_j^* = \max \rho_j \quad \text{s.t.} \quad \rho_j Q_j \leq Q_k \sigma_k + Q_L \sigma_L, z_j \geq z_k \sigma_k + z_l \sigma_L, \sigma_k + \sigma_L = 1, \sigma_k \geq 0, \sigma_L \geq 0
\]  

(10)

with \(Q_j^{**} = \rho_j^* Q_j = Q_j + \eta_j\), with \(\eta_j = (\rho_j^* - 1)Q_j\), \(\kappa_j = (Q_j / Q_j^{**}) = 1 / \rho_j^*\), \(\sigma = (\sigma_k, \sigma_L)\)

(11)

In the absence of slacks, the modified output-orientated DEA program (10) finds the convex combination of \(z_k\) and \(z_l\) that replicates \(z_j\), together with the corresponding convex combination of the output qualities \(Q_k\) and \(Q_L\) that identifies the point \(H'\) on the line \(K'L'\) in the \((z_j, Q_i)\) space in Fig.2, and hence the maximum feasible increase \(J'H' = \eta_j = (\rho_j^* - 1)Q_j\) in \(Q_j\) in (8) and (10).

The term \(\kappa_j\) in (11) defines what we can call a cumulative coefficient of effectiveness, being inversely related to the overall performance shortfall \(\eta_j\), which from Eq. (8) is a weighted sum of the DMU’s efficiency and effectiveness shortfalls \(\varepsilon_{iQ}\) and \(\varepsilon_{i\alpha}\), where the weights are the corresponding multiplier effects in Eq. (9), with \(\gamma > 1\). It therefore more fully answers question (ii) of Sect. 1 of how much scope there is for a producer, such as \(J\), to increase its output quality, once there are additional revenue raising
relationships involved. It also addresses questions (i) and (iii) by identifying the fully efficient and effective DMUs K and L and the feasible frontier between them that is formed by the convex combinations of their exogenous variable and output-quality vectors in (10), with such convexity implied by the underlying linear relationships (1), (4) and (7) in the above example.

3 Additional Inter-relationships

We can extend the above analysis by considering the general form of the BCC output-orientated DEA program (see Cooper et al. 2007, p.93):

\[
\begin{align*}
    \max \ & \varphi_j \quad \text{s.t.} \quad \varphi_j Y_j \leq Y \mu, X_j \geq X \mu, e \mu = 1, \mu \geq 0 \quad \text{for} \ e = (1,1,...,1) \\
    \varphi_j, \mu
\end{align*}
\]

(12)

where \(X_j = (x_{j1},...,x_{mj})^\prime\) and \(Y_j = (Q_{j1},...,Q_{jn})^\prime\) in our present context are the input and output quality vectors of providers \(i = 1,...,n\), with \(X = (X_1,...,X_n)\) and \(Y = (Y_1,...,Y_n)\). In the presence of endogenous resource inputs, the problem with the standard DEA formulation (12) is that it takes provider J’s input vector \(X_j\) as being fixed independently of any feasible expansion of provider J’s achieved output quality vector by a factor such as \(\varphi_j\).

3.1 Feedback effects

In contrast, recognition of endogeneity amongst the resource inputs would involve permitting producer J’s input vector \(X_j\) to expand in response to positive feedback from relevant improvements in its output quality vector. Any such expansion in \(X_j\) in (12) would in turn permit those input vectors \(X_i\) in \(X\) that are given positive weights \(\mu_i\) in (12) in defining a relevant comparison group \(C_J\) for the DMU J to be greater than previously in some relevant directions. Such increases in the comparison input vectors \(X_i\) would have associated with them greater output quality vectors \(Y_i\) that efficient DMUs can produce with these increased input vectors. An increase in the \(Y_i\) that receive positive weights \(\mu_i\) in (12) in turn facilitates a feasible increase in the expansion factor \(\varphi_j\) in DMU J’s achievable output quality vector. This situation is illustrated in Fig. 3 below where the frontier \(Y_1 Y_2 Y_3 Y_4\) represents the feasible Production Possibility Frontier (PPF) based upon the original input vector \(X_j\). It implies a corresponding feasible proportional expansion factor for DMU J of \(OE_{j1}/OT_j\) in its original output quality vector.
here at point $T_j$. However, under positive resource endogeneity, an improvement in DMU $J$’s output quality vector would increase its available input vector, making a new reference set of DMUs with greater output quality vectors, such as $N_2$ and $N_3$ in Fig. 3, admissible as comparators, with a correspondingly higher Achievement Possibility Frontier $N_1, N_2, N_3, N_4$ for different output mixes and a greater feasible expansion factor for DMU $J$ at point $P_j$ of $OE_j^* / OT_j$ in Fig. 3.

![Diagram](image)

**Fig 3:** Attaining a higher possibility frontier under positive resource endogeneity

The highest possible frontier that is achievable by DMU $J$ when resources are endogenous can be identified by considering the achievements of those public service providers which are fully production efficient and fully effective at raising revenue, in attracting able staff and at other activities which can increase their available resources. As a multi-dimensional generalisation of the endogenous resourcing Eq. (4), we will assume that for DMUs which are within any given comparison group $C$ of fully efficient and effective DMUs, we have the resources of type $k$ which are available to DMU $i$ are given by:

$$x_{ki} = \sum_{h=1}^{m} a_{hk} x_{hi} + \sum_{t=1}^{r} b_{h,t} Q_{it} + \sum_{t=1}^{o} d_{h,t} z_{it} \quad \text{for } k = 1, ..., m \text{ and } i \in C$$

(13)
with each \( a_{kh} \geq 0 \), \( b_{kr} \geq 0 \) and \( d_{k'} \geq 0 \), and \( b_{kr} > 0 \) for some \( k \) and \( r \) and \( d_{k'} > 0 \) for some \( k' \) for each \( \ell \). The logic of the endogenous resourcing equations given by (13) can be illustrated by their application to the case where the public service provider is a university operating under a budget constraint:

\[
x_{1i} = x_{2i} + x_{3i} + z_i
\]

(14)

where \( x_{1i} \) is the university’s total expenditure budget, \( z_i \) is here its base level of exogenous government funding, \( x_{2i} \) is any additional tuition fee income that it raises from students outside those specified in its base level of government funding, and \( x_{3i} \) is the level of additional research grants which it attracts. Both \( x_{2i} \) and \( x_{3i} \) assume to be in turn dependent upon the attractiveness of the university to students and to research grant-awarding bodies. Such attractiveness is determined by the quality of the university’s teaching and research (which we denote by \( Q_{1i} \) and \( Q_{2i} \) respectively), by the ability of its staff in teaching and research (which we denote by the variables \( x_{d1} \) and \( x_{s1} \) respectively), and by its total expenditure level, \( x_{11} \), on staff, equipment and other facilities, as in the relationships:

\[
x_{ki} = a_{k1}x_{1i} + a_{k4}x_{d1} + a_{k5}x_{s1} + b_{k1}Q_{1i} + b_{k2}Q_{2i} \quad \text{for } k = 2, 3 \text{ where each } a_{kh} \geq 0, b_{kr} \geq 0
\]

(15)

Similarly, we will assume that the ability of the university to attract able staff depends upon its academic reputation, as reflected in the quality of the university’s teaching and research, and upon its total expenditure budget, as in the relationships:

\[
x_{ki} = a_{k1}x_{1i} + b_{k1}Q_{1i} + b_{k2}Q_{2i} \quad \text{for } k = 4, 5 \text{ where each } a_{kh} \geq 0, b_{kr} \geq 0
\]

(16)

The resultant input vector \( X_i = (x_{1i}, \ldots, x_{5i})^\prime \) is here endogenous because it depends upon the output quality levels \( Q_{1i} \) and \( Q_{2i} \) via the relationships (14) – (16). These inter-relationships exist in addition to the one-way production correspondence that maps \( X_i \) into \( Y_i = (Q_{1i}, Q_{2i}) \) which the standard DEA program (12) seeks to reflect as a representation of the production supply-side of output quality. However, the additional relationships (14) – (16) reflect important additional considerations that affect its resource availability and output quality, such as the demand by students for places at the university, the willingness of grant-awarding bodies to pay research grants to the university, and the labour market willingness of able staff to work for the university.
The general form of (13), which takes into account such additional inter-relationships in a linear way, can be written in the matrix form:

\[ X^C = AX^C + BY^C + DZ^C \]  \hspace{1cm} (17)

For \( I - A \) non-singular, the input vectors for a fully efficient and effective DMU in the comparison group \( C \) then become linear functions of its output quality vector and its exogenous variables (such as the base level of its government funding) of the form:

\[ X^C = (I - A)^{-1}BY^C + (I - A)^{-1}DZ^C \]  \hspace{1cm} (18)

For any given output initial quality vector \( Y^o_j \), DMU \( J \) is assumed to face similar inter-relationships less any shortfall, given by a vector \( \varepsilon_{JX} \), in the resources it actually secures compared to what it could have achieved if it were fully effective in securing inputs, given its initial output, so that we have:

\[ X_J = AX_J + BY^o_J + DZ_J - \varepsilon_{JX} \text{ where } \varepsilon_{JX} \geq 0 \]  \hspace{1cm} (19)

The extent of the initial production inefficiency of DMU \( J \) is reflected in the output shortfall:

\[ \varepsilon_{JY} = Y\mu_o - Y^o_J \geq 0 \]  \hspace{1cm} (20)

where \( \mu_o \) is the value of \( \mu \) generated by the output-orientated DEA program (12) when \( Y_J = Y^o_J \), with the vector of output shortfall in (20) reflecting both DMU \( J \)'s overall technical efficiency and any additional remaining slacks in each output direction.

### 3.2 Multiplier effects

From (19) and (20), we have:

\[ X_J = (I - A)^{-1}BY\mu_o + (I - A)^{-1}DZ_J - (I - A)^{-1}\varepsilon_{J0} \text{ where } \varepsilon_{J0} = B\varepsilon_{JY} + \varepsilon_{JX} \]  \hspace{1cm} (21)

In a similar way to the parameter \( \gamma \) in Eq. (9) for the case of one input and one output, the matrix \( (I - A)^{-1} \) provides a set of multiplier effects, here for the impact on producer \( J \)'s available input vector \( X_J \) of reductions in its vector of overall effectiveness shortfalls \( \varepsilon_{J0} \), which is made up of both the output production inefficiencies, \( \varepsilon_{JY} \), and DMU \( J \)'s effectiveness shortfalls in generating as much input
as it feasible could in Eq. (19). We can illustrate the strength of these multiplier effects by considering the case given by Eqs. (14) – (16) in which \( m = 5 \), using the following numerical values:

\[
(I - A) = \begin{bmatrix}
1 & -1 & -1 & 0 & 0 \\
-0.2 & 1 & 0 & -0.3 & -0.4 \\
-0.3 & 0 & 1 & 0 & -0.5 \\
-0.4 & 0 & 0 & 1 & 0 \\
-0.1 & 0 & 0 & 0 & 1
\end{bmatrix}
\]

and hence \((I - A)^{-1}\) =

\[
\begin{bmatrix}
3.45 & 3.45 & 3.45 & 1.03 & 3.10 \\
1.24 & 2.24 & 1.24 & 0.67 & 1.52 \\
1.21 & 1.21 & 2.21 & 0.36 & 1.59 \\
1.38 & 1.38 & 1.38 & 1.41 & 1.24 \\
0.34 & 0.34 & 0.34 & 0.10 & 1.31
\end{bmatrix}
\]

Once the above interactions in Eqs. (19) – (21) are taken into account, a unit reduction in simply the first element of \( \epsilon_{j0} \) would increase the availability of the first input by 3.45 times the initial reduction in its shortfall. Similarly, a unit reduction in its shortfall each element of the shortfall vector \( \epsilon_{j0} \) would here increase producer \( J \)'s availability of the first resource input by \((3.45+3.45+3.45+1.03+3.10) = 14.48\) units. At the same time, it would similarly increase the availability of the other four inputs by 6.91, 6.38, 6.79 and 2.43 units respectively. Included within the shortfall vector \( \epsilon_{j0} \) in (21) and (22) is the vector of output production inefficiencies in (20), which also therefore generates multiplier effects on resource availability from any reductions in its magnitude as one seeks to move to an efficiency frontier.

However, as in Fig. 3, greater resource availability for the input vector \( X_J \) shifts out the relevant Production Possibility Frontier and attainable set of output vectors, with corresponding changes to the vector \( \mu \) in the DEA program (12). When resources are endogenous, the original constraint \( X_J \geq X_J \mu \) in the DEA program (12), that in the conventional analysis involves a fixed input vector \( X_J \), can be replaced by one that requires that producer \( J \) could have at least as much of each input if it were fully efficient and effective as a relevant convex combination of the input vectors of other DMUs, i.e. by

\[
X_J^* \geq X_J \mu
\]

where:

\[
X_J^* = (I - A)^{-1}BY\mu + (I - A)^{-1}DZ_J
\]

results from setting the shortfall vector \( \epsilon_{j0} \) in (21) equal to zero and relaxing the constraint that \( \mu = \mu_n \). In identifying the outer feasible frontier, the relevant vector \( \mu \) will include positive weights on the input vectors of DMUs that are in the comparison group \( C \) of fully efficient and effective DMUs and zero weights on all others. We will therefore have \( X_J = X_C \mu^C \), where \( X_C \) includes only the input vectors of
DMUs that are in $C$, and $\mu^C$ is the vector of the corresponding positive elements of $\mu$. Using Eqs. (18) and (23), the constraint $X_j^* \geq X \mu = X^C \mu^C$ now becomes:

$$(I - A)^{-1} BY^C \mu^C + (I - A)^{-1} DZ_j \geq (I - A)^{-1} BY^C \mu^C + (I - A)^{-1} DZ^C \mu^C$$

(24)

and hence

$$(I - A)^{-1} D(Z_j - Z^C \mu^C) \geq 0$$

(25)

When all the elements of $(I - A)^{-1}$ are positive, as in (22), and all the elements of the matrix $D$ in Eq. (13) are non-negative with at least one positive in each column, all the elements of the matrix $(I - A)^{-1} D$ will also be positive. These conditions guarantee that the maximum attainable value of each input for DMU $J$ within $X_j^*$ is an increasing function of each element of its vector $Z_j$ of exogenous variables. From (24) and (25), the constraint $X_j^* \geq X \mu = X^C \mu^C$ will then be satisfied for all such positive values of the elements of $(I - A)^{-1} D$ and for any given comparison group $C$ by requiring that:

$$Z_j \geq Z^C \mu^C \text{ where } Z^C \mu^C = Z \mu$$

(26)

i.e. the exogenous variables which DMU $J$ faces are no worse than the convex combination of those faced by DMUs in the comparison group $C$. Under such circumstances, DMU $J$ could have attained at least as much of each input if it were fully efficient and effective as the relevant convex combination of the input vectors of other DMUs.

### 3.3 Stability conditions

As in Eq. (7), also relevant are the stability conditions which ensure a stable solution to the multiplier process in (21), and which can be shown to require that the principal minors of the matrix $I - A$ are all positive (see Quirk and Saposnik, 1968). Under such stability conditions, it follows from Morishima (1963, p. 15) that whenever $a_{kk} = 0$ and $a_{k\ell} > 0$ for all $k \neq \ell = 1, \ldots, m$, all the elements of the inverse matrix $(I - A)^{-1}$ will indeed be positive. Moreover even if we relax this condition to simply $a_{k\ell} \geq 0$ for all $k, \ell = 1, \ldots, m$, it follows from Morishima (1963, p. 15) that it will be sufficient for the elements of the matrix $(I - A)^{-1}$ to all still be positive under such stability that the $A$ matrix is indecomposable, i.e. cannot be transformed, by permutations of the same rows and columns, to a matrix of the form

$$\begin{bmatrix} A_1 & A_2 \\ 0 & A_3 \end{bmatrix}$$

where $A_1$ and $A_3$ are square sub-matrices on the main diagonal.
When we replace the constraint $X_j \geq X \mu$ under a fixed input vector $X_j$ within the conventional DEA program (12) with the less restrictive constraint $Z_j \geq Z \mu$ that permits input vectors to vary endogenously subject to the exogenous parameters which the DMUs face, the associated DEA program becomes:

$$
\begin{align*}
\max \phi_j & \quad \text{s.t.} \quad \phi_j Y_j \leq Y \mu_0, Z_j \geq Z \mu_0, e_0 = 1, \mu_0 \geq 0 \text{ for } e = (1, \ldots, 1) \\
\phi_j, \mu_0
\end{align*}
$$

(27)

with the positive elements in the optimal value of the vector $\mu_0$ defining the relevant comparison group $C$ of DMUs for producer $J$ under this less restrictive formulation. In a parallel way to our 2-dimensional case of Sect. 2 above, our multi-dimensional exploration of the implications of resource endogeneity here yields a well-defined modified DEA program (27) in the space of the $(Z_i, Y_i)$ vectors, rather than in the $(X_i, Y_i)$ space of the conventional DEA program (12). The new DEA program (27) therefore defines a multi-dimensional Achievement Possibility Frontier (APF), which maps out the frontier of output qualities in each relevant direction which producer $J$ could achieve if it became fully production efficient and fully effective at boosting its available resources, given the external exogenous factors which it faces.

We will denote by $\mu_0^*(Z_j, Y_j)$ the optimal value of the vector $\mu_0$ for the given values of $Z_j$ and $Y_j$ in (27). If producer $J$ does become fully efficient and effective, so that $\varepsilon_{j0} = 0$ in (21), we have the associated optimal resource vector which producer $J$ could achieve given by

$$
X_j^*(Z_j, Y_j) = (I - A)^{-1} BY_0^*(Z_j, Y_j) + (I - A)^{-1} DZ_j
$$

(28)

where the vector $\mu_0^*(Z_j, Y_j)$ places positive weights on the output vectors in the sub-matrix $Y^C$ of $Y$ for DMUs in the corresponding comparison group $C_j$ and zero weights on DMUs outside this reference set. The optimal resource vector $X_j^*(Z_j, Y_j)$ in (28) can be regarded as the multi-dimensional generalisation of the point $x_j^*$ in Fig. 1, being the equilibrium outcome of a multiplier process from efficiency improvements that result in improved output quality and hence also greater resource availability when resourcing levels are endogenous. The point $E_j^*$ in Fig. 3 on the APF facing producer $J$ therefore corresponds to the point along the ray $0E_j^*$ through $Y_j$ at $T_j$ that lies on the PPF which producer $J$ could attain if it did secure the optimal resource vector $X_j^*(Z_j, Y_j)$.
3.4 Returns to Scale

We have formulated our analysis in terms of the more general case of variable returns to scale (VRS) that is assumed by the BCC model, in which the constraint \( e\mu_0 = 1 \) is imposed, as in (27). However, this constraint can be relaxed in the above analysis, so that an assumption of constant returns to scale (CRS), as in the Charnes, Cooper and Rhodes (CCR) (1978) model, is also compatible with our above approach to tackling the problem of endogeneity within a DEA framework.

3.5 Convexity

A basic assumption of DEA models, such as the BCC output-orientated model (12), is that of convexity of the associated production possibility set facing any given DMU \( i \) given by:

\[
\Phi_i = \{X_i, Y_i : X_i \geq 0 \text{ and } Y_i \in P(X_i) \subset R_i^+\}
\]

where \( P(X_i) \) is the set of outputs which it is feasible to produce from an input vector of \( X_i \) under existing technology, and \( R_i^+ \) is the non-negative domain of \( r \)-dimensional Euclidian space. A feasible combination \( (Z_i, Y_i) \) in our above model is one such that:

\[
X_i = AX_i + BY_i + DZ_i - e_{ix} \quad \text{where} \quad e_{ix} \geq 0 \quad \text{and} \quad (X_i, Y_i) \in \Phi_i
\]

If follows from (30) that if \( (Z_i', Y_i') \) and \( (Z_i'', Y_i'') \) are both feasible combinations, then so too is \( (Z_i'''', Y_i'''') \), where:

\[
Z_i''' = \omega Z_i' + (1 - \omega)Z_i'', \quad Y_i''' = \omega Y_i' + (1 - \omega)Y_i'' \quad \text{and} \quad X_i''' = \omega X_i' + (1 - \omega)X_i'' \quad \text{where} \quad 1 \geq \omega \geq 0
\]

when \( \Phi_i \) is a convex set. Convexity of \( \Phi_i \) in the \( (X_i, Y_i) \) space, as the BCC model (12) assumes, therefore implies here convexity of the feasible set in the \( (Z_i, Y_i) \) space for the DEA program (27).

It should be noted that \( Z_i \) in our above model does not directly enter the production process, but instead is a vector of exogenous variables that influences the input vector \( X_i \) via the inter-relationships given by (30), and therefore affects the maximum feasible output quality which any given DMU can attain given the exogenous environment that it faces. Our above model therefore differs here from those of Banker and Morey (1986) and of Ruggiero (1996) in which environmental variables enter directly into the production process, with Ruggiero (1996) relaxing the convexity condition which Banker
and Morey (1986) retained for their direct influence in the production process. Here convexity of the feasible set in the \((Z_i, Y_i)\) space follows directly from the basic DEA assumption of convexity of the feasible set in the \((X_i, Y_i)\) space, under the linear endogeneity relationships in (30).

4 Application

For empirical analyses, differences in the production processes and associated cost functions across science, arts, medical and engineering Departments within universities make university Departments covering more specific subject areas a more suitable focus for efficiency analysis than an analysis at university level, particularly when different universities involve different subject mixes. We will therefore illustrate how DEA can be used empirically to explore the quality frontier between teaching and research for a single subject category, namely that of Economics and Econometrics, based upon our above analysis. In order to keep our illustration relatively straightforward, we will focus upon a recent period of time in which there was a major exogenous component to government funding for individual universities in the UK. This was the period before 2012-13 when individual UK universities were subject to strict externally determined controls on the total number of funded home and EU undergraduate and taught Masters students which they could admit, with standardised national fee remuneration based upon these controlled student numbers determining the associated block government grant to the university. The partial relaxation of these student number controls from 2012-13 onwards (see DBIS, 2011), and the accompanying freedom of individual universities in England to compete with each other, in large part on the basis of their teaching and research quality scores, for additional well-qualified home and EU students, and freedom to determine their own tuition fees, add further complexities to the scope for endogeneity, including of home and EU student numbers from 2012-13 onwards, that we will examine in a later paper.

Before 2012-13, the latest available comprehensive quality assessment of the research output in individual university subject areas in the UK was that of the Research Assessment Exercise (RAE) that was carried out in 2008, based upon publications in the previous five years submitted to the assessment panels by the census date of 31st October 2007. The relative quality weights of 0, 1, 3 and 9 were placed by the Higher Education Funding Council for England (HEFCE, 2010a) on its assessment of the relative importance of the different quality grades 1*, 2*, 3* and 4* on individual publications. The average quality-weighted score, which ranges from 0 to 9, for each university’s submitted publications in a given
subject area for this period provides the quantitative research quality measure $Q_{ir}$ used in our empirical application of the modified DEA program (27).

The quality of teaching and associated facilities in UK universities has been assessed in this period by an annual National Student Survey (NSS) of final-year undergraduates, with the proportion of student who agree, or strongly agree, in response to Q22, taken to provide an overall summary of the degree of satisfaction of students with the quality of their course (see HEFCE, 2010b) in a given subject area. We will therefore use this proportion as our quantitative measure $Q_{ir}$, for the Economics subject area for the academic year 2006-7 as the latest available for such final-year students for the period in question.

In our DEA study of the quality frontier between teaching and research quality, we combine this proportion of satisfied students with the available RAE research quality measure for the Economics and Econometrics Unit of Assessment 34 for research in this subject area during the period up to 31st October 2007 as our two output quality variables. There were a total of 50 universities which took part in the NSS for Economics for the academic year 2006-7. There were also a few universities, such as the University of Cambridge, which declined to take part in the NSS for that year, even though they took part in the RAE. Rather than substitute a score of zero for their teaching quality assessment, these universities were excluded from the sample. However, within the 50 universities which took part in the NSS for Economics for the academic year 2006-7, there were 21 which made no submission to the RAE 2008 for Economics and Econometrics. Since a positive outcome from a RAE 2008 submission would have been to their financial advantage and enhanced their academic reputation, a non-submission is taken to imply a lack of confidence in a positive assessment, with these universities given a zero score for their associated $Q_{ir}$ measure in the analysis.

**TABLE 1:** The distribution of effectiveness scores across DMUs

<table>
<thead>
<tr>
<th>Effectiveness Score</th>
<th>DMUs</th>
<th>No of DMUs</th>
</tr>
</thead>
<tbody>
<tr>
<td>= 1.0</td>
<td>2(9), 6(0),22(1),27(6),28(2),36(1),42(15),45(36),47(4)</td>
<td>9</td>
</tr>
<tr>
<td>≥ 0.9 &amp; &lt; 1.0</td>
<td>4, 7, 12, 13, 14, 15, 18, 19, 23, 24, 26, 29, 33, 35, 39,41,43, 44, 46, 48</td>
<td>20</td>
</tr>
<tr>
<td>≥ 0.8 &amp; &lt; 0.9</td>
<td>1, 9, 10, 11, 17, 32, 37, 38, 40, 49, 50</td>
<td>11</td>
</tr>
<tr>
<td>≥ 0.7 &amp; &lt; 0.8</td>
<td>3, 5, 8, 16, 21, 25, 30, 31, 34</td>
<td>9</td>
</tr>
<tr>
<td>≥ 0.6 &amp; &lt; 0.7</td>
<td>20</td>
<td>1</td>
</tr>
</tbody>
</table>
The exogenous variable which is used in the empirical application of our modified DEA program (27) as our single input variable \(z_i\) for each Department \(i\) is that of the total home and EU student numbers for undergraduates and taught postgraduate students in Economics for the academic year 2006-7, which determines the associated level of the base government funding to the university for students in this subject area. The two output variables used were the research and teaching quality scores \(Q_{ir}\) and \(Q_{ir}\) specified above. The results of this analysis are shown in Tables 1 and 2. Table 1 shows that there are 9 of the 50 relevant DMUs which have overall effectiveness scores of 1.0. However, since the 21 universities which did not make an RAE submission for Economics and Econometrics in 2008 are labelled 1 – 21, it can be seen that only two of these, namely DMUs 2 and 6, have such a score. The figures in the brackets in the second line of Table 1 indicate how many comparison groups for other DMUs the respective DMU enters into. Thus, whilst DMU 2 entered into 9 such comparison groups, DMU 6 failed to enter into any, so that those DMUs which concentrated their efforts on teaching rather than research are in general not shown as being outstandingly effective at achieving output quality. Eight of the 20 DMUs which had an overall effectiveness score of between 0.9 and 1.0 were, however, amongst those that concentrated on teaching. At the same time the DMU with the lowest overall effectiveness score, and 5 of the 9 DMUs with an efficiency score between 0.7 and 0.8, were amongst those that concentrated on teaching. Of the 7 DMUs which did have positive RAE submissions and are assessed as being fully effective, DMU 45 enters into by far the largest number, namely 36, of comparison groups of other DMUs.

<table>
<thead>
<tr>
<th></th>
<th>DMUs 1 – 50</th>
<th>DMUs 1 – 21</th>
<th>DMUs 22- 50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Effectiveness Score</td>
<td>0.8926</td>
<td>0.8648</td>
<td>0.9126</td>
</tr>
<tr>
<td>Average (z) slack</td>
<td>76.681</td>
<td>57.537</td>
<td>90.543</td>
</tr>
<tr>
<td>Average (Q_{ir}) slack</td>
<td>0.976</td>
<td>2.170</td>
<td>0.111</td>
</tr>
<tr>
<td>Average (Q_{cr}) slack</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>Average (Q_{ir}) score</td>
<td>2.139</td>
<td>0.000</td>
<td>3.688</td>
</tr>
<tr>
<td>Average (Q_{cr}) score</td>
<td>0.826</td>
<td>0.808</td>
<td>0.839</td>
</tr>
<tr>
<td>Average (z) value</td>
<td>314.33</td>
<td>224.32</td>
<td>379.51</td>
</tr>
</tbody>
</table>

**TABLE 2: Average scores and slacks for the two groups of DMUs**
As in Table 2, the average value of the overall effectiveness score for those DMUs that concentrated on teaching was below the corresponding average for those that had positive scores in the RAE. This is despite the fact that the output-orientated DEA analysis allows each DMU to choose its own output mix, and then estimates the proportion rate feasible increases in its outputs for this given output mix. Table 2 also shows a lower average NSS score for the DMUs that concentrated on teaching, and larger average slacks for potential research quality, when compared with those DMUs that also made positive RAE submissions. Even though the DMUs that concentrated on teaching had on average smaller intakes of home and EU students, the analysis also revealed decreasing returns to scale at all points along the quality frontier, except for the points corresponding to DMUs 6 and 36, which exhibited constant returns to scale.

We can thus obtain useful empirical insights from the modified DEA program (27). Moreover, this is true even though comprehensive detailed data are not available at an individual subject area or Departmental level for universities across the UK for the period in question for the important expenditure and staffing input variables which would need to enter into the estimation of a standard DEA program of the form (12). Even aside from risking endogeneity bias in its estimates of production efficiency, a conventional DEA analysis would therefore not be feasible here.

The choice of the relevant total number of home and EU undergraduates and taught postgraduate students for the academic year 2006-7 as an exogenous variable is consistent with the university funding formula which was imposed externally on universities during this period by the central government funding agency (see HEFCE, 2006, 2010), in which there were externally imposed quotas on such home and EU student numbers, and central government funding in proportion to these externally determined numbers across different subject areas. As in Eq. (14) above, such exogenously determined base government funding, however, only formed part of the total income and available budget of universities, totalling some 37.7 per cent of the overall budget for UK universities during this period (see HESA, 2015). Other major source of income, such as additional international student fee income and research contract income, were determined endogenously, as in Eq. (15) above, in a way which depends upon the performance and effectiveness of the individual university in raising such additional income. Recognising the implications of such endogeneity, and the associated multiplier effects discussed in Sect. 3 above, in order to answer questions (i) – (iii) of Sect. 1 involves here generating the outer Achievement Possibility Frontier using the methodology of (27), in place of the simpler notion of a standard Production Possibility Frontier which ignores such multiplier effects.
In cases where it is less clear which variables are exogenously determined and outside of the control of the relevant DMU, use may be made of the procedure suggested by Banker (1996) (see also Ericsson and Irons, 1994; Gujarati and Porter, 2010; Banker and Natarajan, 2011; Kneip et al., 2015) to test the model specification of which variables should be included in the vector of exogenous variables in (27), although in small samples, these tests may well fail to reject many of the associated null hypotheses.

5 Conclusions

Rather than attempting to use DEA to produce biased estimates of the position of a standard PPF in the conventional \((X',Y')\) input-output space, our above approach uses DEA to estimate an Achievement Possibility Frontier in the space of the \((Z',Y')\) vectors, where the variables in \(Z\) are chosen to be exogenous, and thus uncorrelated with the true efficiency levels of the individual DMUs. By looking at the maximum feasible output quality that a DMU can achieve given the exogenous environmental variables which it faces, our approach parallels the specification of a reduced form equation in econometrics (see e.g. Gujarati and Porter 2010, p. 352) which can be used to produce unbiased estimates of the impact of changes in the stochastic disturbance terms within a system of simultaneous equations on the equilibrium values of the endogenous variables. For an application of this approach to the address the endogeneity problem in Stochastic Frontier Analysis, see Mayston (2015). It should be noted that the separate identification and estimation of the parameters of the underlying structural inter-relationships are not necessary for the unbiased estimation of the reduced form parameters. Such identification would indeed impose additional conditions on the structure of the underlying inter-relationships, which we do not need to impose under our above approach.

As stressed above, our primary focus in this paper is with addressing questions (i) – (iii) of Sect. 1, when additional demand-side and other inter-relationships exist between inputs and output quality beyond those of the uni-directional supply-side production correspondence that is assumed by standard DEA models. We have shown that answers to these questions can be obtained by adopting a modified form of DEA in which the exogenous variables facing individual DMUs determine the underlying constraints within which their inputs may be endogenously varied. How well individual DMUs do in achieving output quality subject to the exogenous variables which they face is then the key to answering questions (i) – (iii). This approach is both powerful and efficient in its data demands. It does not require detailed data on the input expenditure patterns of individual DMUs, which, as our above application illustrates, may not be readily available. It does not require detailed quantitative knowledge of the parameters of the
additional underlying structure inter-relationships beyond the general linearity assumptions involved in (30) and associated stability assumptions. Whilst these structural parameters influence the overall outcome, the data one needs to estimate the Achievement Possibility Frontier under the modified DEA program (27) are simply the resultant observable output quality outcomes for the individual DMUs and the exogenous variables they face in achieving them. This frontier is not the same as the PPF for the current input vector of any inefficient DMU, since the APF recognises that improvements in the efficiency of such a DMU in boosting its output quality can in turn attract a higher level of resources and shift out the relevant PPF, as in Fig. 3 above.

The extent to which an individual DMU could improve its output quality subject to the exogenous variables which it faces is revealed in the modified DEA program (27) by a comparison of the DMU’s current output quality with a convex combination of the output qualities currently attained by efficient and effective DMUs in its comparison group who have had the opportunity to maximise their output quality subject to the exogenous variables which they face. While the extent of the feasible improvement is shown diagrammatically in Fig. 1 as occurring sequentially as a series of steps, the DEA program (27) identifies the final outcome of this multiplier process of feasible improvement, whether it is made in one step or many. It is indeed this final outcome which is relevant to answering questions (i)- (ii) of Sect. 1.

Rather than viewing the current output qualities of efficient DMUs as a result of their equilibrium achievements under the exogenous variables which they face, an alternative approach would be to model the world as being in a state of flux, involving the dynamic analysis over time of the inter-dependencies between output quality and resource availability. Some progress can be made in this direction by using past levels of output quality as pre-determined variables within the relevant $Z_i$ vectors in the efficiency analysis. However, if they are to be truly exogenous, possible inter-temporal correlations in the efficiency levels of individual DMUs may need to be excluded. An alternative approach would be that of network DEA (see e.g. Cook et al. 2010; Cook and Zhu 2014) in which a two-stage DEA model is used in which the outputs from the first stage can form part of the inputs for the second stage. In comparison, our above approach is essentially a multi-stage multiplier approach in which efficient DMUs have converged on a stable equilibrium outcome for their given exogenous variables. If these equilibrium outcomes form the available database for efficient DMUs, then our modified DEA program (27) provides a direct way of assessing the overall performance of individual
DMUs. However, if individual efficient DMUs are yet to converge on such an equilibrium outcome and sufficient additional data on detailed resource inputs are available, a multi-stage version of network DEA, rather than simply a two-stage version, may provide an interesting comparison with the results of our above modified DEA program.

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