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NOTES ON FOR-PROFIT HIGHER EDUCATION IN THE UNITED STATES

Background

The United States has about 16 million students enrolled in post-secondary education. Seventy-five percent of these students are found in public institutions, financed predominantly by state and local governments. These include such illustrious institutions as the University of California and the University of Michigan as well as many other state universities and more than 1,000 community colleges with programs of shorter duration. The U.S. has long had a tradition of private higher education as well with about 2,500 private institutions serving almost four million students. These include such famous universities as Harvard, Stanford, MIT, and Columbia as well as prestigious liberal arts colleges such as Amherst, Williams, Swarthmore, and Wellesley. However, as with the public institutions, most of the private institutions serve many different functions in providing a broad range of educational programs to a wide variety of populations including those of normal undergraduate college age as well as older students who return to complete their education.

A quarter of all students in higher education in the U.S. are enrolled in private institutions, but 86 percent of these are in private institutions that are not-for-profit. Such colleges and universities are not designed to make profits, but to put all of their revenue into their educational functions. All of the most prestigious and best-known colleges and universities in the private sector are not-for-profit. Not only do such institutions not make a profit. They usually charge student fees that are not adequate to meet their expenses. To overcome the gap between student fees and actual costs and to expand and improve academic programs and facilities, they must engage in considerable fund raising from alumni, philanthropists,

industry, and others who wish to identify with their institutional aspirations. Many have substantial endowments of investments that have accumulated from the fundraising and which are used to generate annual income for the institution. Among the largest and richest private institutions, it is common to establish campaigns for raising hundreds of millions of dollars or even billions over periods of a few years. It is important to note that the strict laws governing not-for-profit institutions mean that an entrepreneur cannot find a way of making profits from such institutions, as can be done in other countries. Any financial gains belong to the institution and cannot be removed by founders or investors. An entrepreneur seeking profits for investors in higher education would have to establish a “for-profit” institution to seek profits.

For-Profit Institutions of Higher Education

For-profit institutions in higher education in the U.S. are not new phenomena. In the past, a substantial number of vocational and professional institutes and colleges at the post-secondary level have been present, generally providing short courses of one or two years or less. Many of these institutions have been suspected of building their institutions to make profits from students with poor educational backgrounds by promising them high-paying jobs and helping them to acquire government loans. Sadly, a high portion of these students do not repay those loans because they do not benefit from the training. Such students do not complete the training courses because of their poor previous education and low quality instruction and their inability to obtain jobs. Thus, the U.S. taxpayer has ended up paying for such students through their loan defaults while the owners of these institutions make large profits. The government has passed regulations to restrict eligibility for loans to institutions with high default rates on student loans.

More recently a new kind of for-profit institution has arisen or expanded, offering more conventional degrees at the Bachelor's, Master's, and Doctoral levels. These institutions provide a range of degrees, but what makes them unique is that they do not attempt to duplicate precisely what the more conventional public and not-for-profit institutions do. What makes them significant is their impressive growth rates

although they occupy only a small portion of the higher educational market. At present the for-profit institutions of higher education account for only about a half-million students, or about three percent of all students in U.S. higher education. However, they are growing at very rapid rates, so rapid that one of them, the University of Phoenix, has recently become the largest private university in the country with about 200,000 students. These institutions try to compete with other higher educational institutions by differentiating themselves in several respects. The first is that they offer only a limited number of educational programs, those for which there is employer demand. The second is that they tailor their program to the needs of a particular type of student whom they would like to attract. The third is that they invest in very heavy marketing to their potential student clientele. Finally, they have chosen instructional approaches that save considerable costs over more conventional institutions so that they are able to charge the student lower fees and still make substantial profits.

University of Phoenix

The University of Phoenix (UOP) is a good example of the present growth of for-profit higher education in the U.S. in terms of its size, dynamic growth, and model of success. UOP offers only a limited number of programs, bachelors, master's and doctoral degrees in business, education, technology, and nursing. In all of these fields there are strong market demands in the 120 local sites at which the University of Phoenix has centers. In addition to the many facilities in which classes are held around the country, the University of Phoenix also offers online degrees and has more students enrolled in such programs than any university in the country.

UOP does not view its clientele as the 18-22 year olds who typically enroll as college or university students. Instead, it seeks working adults who have typically taken some college courses, but have not completed a degree. It appeals to them by telling them that previous college courses that they have taken can be applied to a UOP degree locally or through online courses where UOP will give them credit for any

previous college work. Further, there are no restrictive admission standards with respect to college entrance examinations or previous educational performance. UOP has analyzed the needs of such adult students and found that the classes need to be held at convenient times in places that are easily accessible by automobile and highway with abundant parking and other services such as childcare and job placement. Accordingly, classes are held in convenient locations, typically after the working day. Each class is about four hours on one evening a week for five or six weeks. Students take just one class at a time, so they are able to concentrate on that subject. When students enroll, they are expected to take each course as it is offered in sequence to complete their degree in a prescribed period of time. UOP does not allow students to choose elective courses or to withdraw from courses during the period in which the student is enrolled for a degree. Instead they are expected to follow the prescribed sequence of courses that are necessary to complete a specific degree.

The University of Phoenix invests heavily in marketing campaigns using television, radio, and newspaper advertisements that tell potential clientele that if they want to have greater pay and prestige they can complete their education with a UOP degree. They have a large sales and marketing force that seeks out students and is rewarded financially for their success in expanding enrollments. The substantial pressure that they put on their sales force to recruit students is reflected in a recent penalty imposed by the U.S. Department of Education where the UOP had to pay a fine of \$ 9.8 million for pressuring recruiters to enroll unqualified students. The U.S. Department of Education was particularly concerned since about 60 percent of the UOP's revenue is derived from student financial aid, mostly from government.

Finally, what makes UOP particularly lucrative is their instructional model. They hire very few full-time faculty members, that is, faculty who require salaries and benefits such as health insurance and contributions to pensions. They also do not offer instruction in the broader liberal arts and sciences which are typically the foundation on which U.S. universities build the more career-oriented courses. Instead, they

hire persons from the community to teach each practical or professional course with compensation at about \$ 1,500 a course. The regular faculty at typical U.S. universities receive a salary and benefits at a rate that is ten times this amount per course. Of course regular faculty members at other institutions are also expected to advise students, formulate curricula and departmental policies, and pursue scholarly activities. UOP faculty are already employed in their professions (e.g. accounting, banking, nursing, education), so their teaching a course represents an opportunity to undertake a different challenge and to be awarded with the prestige of teaching in a university. Courses and materials are standardized, so instructors need only follow the subjects, sequence of materials, and administer the examinations that are used at all UOP campuses. All courses are subject to student evaluations to ensure (student) client satisfaction.

The UOP has viewed the higher education market as a business in which it seeks an underserved adult client and makes it easy for the client to use the service. Student costs are lower than in comparable private institutions, and instructional costs to the UOP are considerably lower than those of competitors. Student tuition is about 50-70 percent of that of other private universities, and labor costs per course are 10-20 percent of the costs of hiring permanent and full-time faculty. The advantages of UOP to students are: no academic entry requirements, accessibility and convenience of classes, a simple and straightforward sequence of classes for each degree with credit give for previous academic work, competitive prices for study, and assistance in job placement. The students are also eligible for government grants and loans, and many of them finance their education by this mechanism.

The UOP formula is highly profitable and attractive to a certain group of potential students as evidenced by the growth of the university. From 1998-2003 enrollments grew from about 75,000 students to about 200,000 students of which on-line student enrollments grew from 0 to 80,000. The revenues of its parent company (Apollo Group) grew from \$ 500 million in 1998 to more than \$ 1.3 billion in 2003 with income (profits) rising from \$ 60 million to \$ 250 million over the same period. The price of each share of

stock rose from about \$ 8 to about \$ 60 over this five year period. An investment of \$ 10,000 in 1998 would be worth about \$ 75,000 in 2003.¹

Not all of the for-profit companies entering higher education have done as well as UOP, but the leading companies (Apollo Group Inc., Career Education Corp., Corinthian Colleges Inc., DeVry Inc., Education Management Corp., ITT Educational Services Inc., Laureate Education Inc., Strayer Education Inc., and University of Phoenix Online) had a stock price that was six times as high in 2004 as it was in 1999.² In 2003 the revenues of these top nine companies totaled \$ 6.64 billion dollars. And, there were many smaller companies too, although for-profit institutions accounted for just three percent of all students in U.S. higher education. The general view is that such institutions have established solid positions in the market and will continue to grow. However, most analysts believe that they are unlikely to exceed 10 percent of total enrollments because profitability depends upon finding niches between public institutions of higher education and the traditional non-profit private institutions. Even with low costs and moderate student tuition, such opportunities seem limited.

Concerns

There are a number of concerns about the recent success of for-profit institutions in higher education. The most significant is that they are forcing the more traditional institutions to be more business-like by cutting important programs and services to concentrate on those that are most profitable and are easiest to attract students. For example, very few students take courses in Classical Studies (e.g. Ancient Greek, Latin, Chinese languages and civilizations), and such programs would be abandoned if they depended on student demand alone. Yet, our societies believe that preserving knowledge and understanding of the past is worthwhile, even if it does not generate profits, and resources in higher education are put aside for such purposes. Further, the success of the for-profit institutions has convinced many traditional

¹ <http://www.apollogrp.edu/annual-reports/2003.pdf>

² “The Chronicle Index of For-Profit Higher Education,” The Chronicle of Higher Education (November 5, 2004), p. A 28.

universities to adopt intensely, competitive strategies by establishing marketing campaigns that are expensive and, sometimes, misleading. There is a concern that the “marketization” of higher education will overwhelm all other purposes, even in the more traditional institutions. At the present time there is ongoing research on these phenomena such as that of the group headed by Professor David Breneman at the University of Virginia and the recent book on this subject authored by a noted scholar, Professor David Kirp.³ But, it is too early to know what the precise consequences will be for all of higher education in the U.S.

³ David Kirp, Shakespeare, Einstein, and the Bottom Line: The Marketing of Higher Education (Cambridge, MA: Harvard University Press, 2003).