

Public Policy Barriers to Post-secondary Cost Control

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“And so tonight, I ask every American to commit to at least one year or more of higher education or career training. This can be community college or a four-year school; vocational training or an apprenticeship. But whatever the training may be, every American will need to get more than a high school diploma.”

■ President Barack Obama, February 24th, 2009

The cost of a private four-year college runs about \$25,143 (up 5.9 percent from last year). The cost for a public four-year \$6,585 (up 6.4 percent from last year). When adding in living costs, and books several recent studies present an overall price tag of \$30,000.

■ College Board, 2009

Introduction

What if we took President Obama’s challenge seriously? Could we afford it as a nation? Is it a good value? In today’s higher education system, I think the answers are “no” and “not as much as we think.” In 2008, 2.2 million or 68% of students who had graduated in the previous year were enrolled in college.¹ To achieve Obama’s goal for high school graduates only, 1 million more students would need to be absorbed into the system in the first year. The average tuition, not including room and board, of a year of college to individuals is about \$10,000.² Further, in 2007 states spent an additional \$5,353 per student enrolled in public higher education.³ In today’s higher education system, it might cost about \$15 billion to provide one year of college to these remaining students. Since many of these students would stay in the system, the annual cost would likely approach \$20 billion or more. Even if everyone did have a year of college, studies show that true return on a college degree at less selective institutions is about \$250,000 over the course of a lifetime.⁴ Presumably, the return on a single year of college would be less than a quarter of this. Further, this was calculated before the nation’s economic slump and without the glut of newly degreed individuals that an obligatory year in college would create.

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At the same time, there is little doubt that the economic prospects of our nation hang on our ability to build a better skilled workforce. The only way to reconcile our national needs with the current higher education system is to create a higher education system that is more accountable. In education, accountability usually means holding colleges accountable for the learning outcomes produced. While this is a critical component, colleges also must have market accountability. Are students, states and the nation getting the most for their dollar? Are colleges sufficiently subject to the discipline of competition to ensure efficient and effective operations? To have market accountability, the market must work. There must be opportunities for innovation, for market winners and for market losers. Today, the market does not work. There are significant barriers to innovation, and existing institutions have insufficient incentives to be innovative, cost-conscious, and customer-focused. To meet our nation's educational goals, we need to foster innovation in higher education on a scale never before seen. The good news is that the tools and technology are available to do this. The bad news is the systems and policies of our existing higher education system are not.

Barriers to Innovation

All industries have barriers to innovation. Sometimes the barriers are created by the product itself. For instance, cell-phone service delivery requires an extraordinary fixed investment to build a network of cell-phone towers. Sometimes the barriers are erected to protect consumers. For instance, pharmaceutical and financial services are regulated to prevent consumer injury and fraud. Other barriers are created by market participants. For instance, software companies can generate proprietary code to integrate with their software or a digital camera maker may require a specific chip or charger only produced by that company. The

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government may decide that it is in the nation's interest to distort competition by giving grants and selectively subsidizing providers or levying taxes on other companies. Natural barriers to innovation – like industries characterized by high fixed costs and proprietary specifications – usually give way to technological change and the demands of the marketplace. Artificial barriers to change – like regulation and price subsidies – require governmental action. Today, higher education, particularly public higher education, is protected by a range of mostly artificial barriers to innovation. These barriers prevent consumers from realizing the cost-savings and product evolution possible from technology.

The task for policymakers is to determine whether artificial regulations have outlived their usefulness—and then to summon the political will to change them. Frequently, regulatory obsolescence, like in the telecommunications industry, is caused by the creation or adoption of new technologies that dramatically disrupt the marketplace. Today, in higher education, technology has transformed the cost structure of content creation and distribution and individual and group communication. The tools exist for a variety of new education formats and price points. Technology has created the necessary tools for innovation, yet the policy structures are not sufficient to allow innovation to emerge.

Higher Education Barriers to Innovation

Because higher education is believed to create a variety of public benefits such as economic development, technological breakthroughs and an informed citizenry, federal and state governments subsidize higher education through direct grants to schools, direct grants to students, and subsidized loans. Prospective students prefer to rely on some combination of these subsidies when enrolling in post-secondary education. Accordingly, access to these funding

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streams is critical to the success of new post-secondary providers. The only way students can get access to these grants and loans is to enroll in a nationally or regionally accredited institution.

However, attaining and keeping accreditation has created a regulatory structure that inhibits innovation. Barriers to innovation in higher education include:

1. Start-Up Costs – The basic elements of a course or college are easy to compile – faculty, content, facilities and a few others. This is even easier in an online environment when most course elements are available for license and geography is not a constraint.

However, it typically takes 2 or more years to receive accreditation from the point of an initial application, and an initial application can only be filed after the school has been in operation for several years. Further, only full degree programs, not individual courses, can be accredited. This creates a Catch-22 for would-be school operators. It is difficult to attract students without access to financial aid, but access to financial aid cannot be provided until you have attracted students. Further, by only accrediting degree programs, academic innovations at the course level are discouraged. Further, by extending the start-up period to 3-5 years – the years of initial operation plus the time necessary to receive accreditation -- the return on an investment takes longer to realize thereby further suppressing innovation.

2. Regulatory Burdens – Government imposed regulations are necessary to insure product safety, protect public finances from fraud, and to diminish the opportunity for consumer exploitation. Indeed the accreditation process is often justified as a way to protect consumers from “diploma mills” – entities that will confer a degree without academic rigor – and to insure quality. However, the price for safety and quality assurance are

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higher costs for the regulated industry that are passed on to consumers. Such a price may be worth it if the regulatory infrastructure is effective. Unfortunately, today's accrediting system – the system responsible for most college regulation -- does not seem to provide the promised quality assurance. In higher education the presence or absence of accreditation has very little correlation with college quality. A recent report found wide variations in 6 year college graduation rates among schools with similar admission standards, track records and test scores. Indeed, finding accredited colleges with six year graduation rates below 20% that have stayed that way for years is distressingly easy.⁵

3. Ambiguous Quality Standards – Despite the fact that accreditation provides little information about the quality of an education provided by a college, consumers still must choose a college to attend. Without meaningful data on education quality, students use proxies to make these decisions. So, price, selectivity, rankings, location and other factors not related to the educational process dramatically affect selection. This provides incentives to innovate in non-academic areas, like the provision of climbing walls, better dormitories, sports teams, student centers, recreation facilities and more. However, there is little incentive to improve the teaching and learning process to improve outcomes, cut costs, or both.
4. Proprietary Specifications – Any product composed of inter-operable parts must have specifications that allow them to fit together. The producer of that product can use open specifications such that other providers can build or attach parts to his product or closed specifications such that the provider controls all the pieces. Closed specifications

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typically inhibit innovation, but may improve an overall product. For instance, Apple Computer uses closed specifications for products wishing to run on its system. This has resulted in far fewer programs available for Apple computers. However, many will argue that Apple's system is more reliable and better designed because it keeps tight control of its specifications. While it may seem strange to talk about inter-operability with regard to higher education, the earning and transfer of credit is a specification that allows "parts" earned at one college to be fit into another. Despite having an accreditation process that is supposed to assure a minimum level of quality, articulation – the process by which one college agrees to accept another college's credits – is famously incomplete and confusing. Not only will a college only accept a patchwork of credits from a patchwork of colleges, but information about what will and won't be accepted is difficult to obtain. Further, the process of transferring credit can be cumbersome and time consuming for the student. The lack of easy inter-operability stifles the demand for course-level innovation and keeps students at individual colleges.

5. Distorted Industry Economics – One of the most obvious ways to undermine innovation is for government to "pick" the provider of a product by offering the service itself or by offering price subsidies in the form of tax breaks or grants. This creates a situation in which the new entrant to the market simply is not on a level playing field with the existing entrants. State governments fund most of public higher education. Further, non-profit universities benefit from preferred tax status. This has resulted in a post-secondary system where public universities, not-for-profit universities and for-profit universities are

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offering roughly the same product at wildly different prices. Further, it has created dramatic state-by-state differences.

Given the magnitude of the regulatory barriers, the time needed to start new colleges, the difficulty of transferring credits among schools, the un-level playing field, and the lack of performance information, it is not surprising that the price of higher education continues to rise. Further, despite the growth in price, the amount spent on academics has actually declined. From 2002 to 2006, total spending on education and related services declined for all types of institutions except research universities. Additionally, the share of educational spending dedicated to classroom instruction declined at all types of institutions from 2002 to 2006.⁶ It would seem that, despite all our new technology and new educational capabilities, educational quality has gone down and prices have gone up.

It is Easier to Change the Course of History than a History Course

Unnatural barriers to competition have two pernicious impacts on consumers. First, prices are higher than they should be. Second, product quality is usually lower than it should be. While it is hard to show examples of stifled innovation (because they have been stifled), it is possible to point to market excesses caused by the lack of innovation. In general, the areas of higher education that have a high degree of standardization across colleges and that have few, if any, hands-on or geographic requirements are the ones ripe for dramatic cost reductions and competition. In the table below, the upper right quadrant are the areas that are most ripe for disruption. The bottom left quadrant is the area that is least ripe for disruption.

Geographic Requirements	Low	Social Science Masters and PhD Programs	General Education Courses Continuing Education Units for Teachers Legal Education
	High	Selective Residential Liberal Arts Programs	Hands-On Vocational Programs (Cosmetology, Culinary, Massage Therapy, etc...)
		Low	High

Standardization of Content Across Colleges

Figure 1. Matrix of geographic requirements to college standardization

Not only are courses in the upper right quadrant easily taught online and applicable across the entire industry, but the online versions are usually dramatically overpriced in today's higher education system. For instance, General Education courses, like College Algebra, Microeconomics, History 101, and other pre-requisite courses, typically have a large number of students and are taught by adjuncts or graduate assistants making only slightly more than minimum wage. Though few in number, these courses account for nearly 1/3 of all enrollments in higher education⁷ making them a significant driver of cost and quality. The National Center for Academic Transformation (NCAT) ran a grant program that asked colleges to redesign high enrollment introductory courses in ways that would reduce cost and improve quality. A requirement for participation was to estimate the cost per student before and after redesign. Using data from the 30 initial colleges (all of whom were public), it cost on average \$170 per student before redesign and \$111 per student after redesign.⁸ These colleges charge about \$1,000 per course and they receive state subsidies to boot. While it is impressive that colleges were able to reduce their cost per student and, in almost all cases, improve performance, the difference between the cost to deliver a course and the price charged for that course is extreme.

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At most colleges, this “profit” on high enrollment courses is used to subsidize other parts of the university, like low-enrollment courses, less popular degree programs, new buildings, sports teams and other features. However, many students – particularly commuters, adult students and distance education students – neither want nor benefit from these amenities. These “non-traditional” students are the fastest growing segment of higher education. At many colleges, these formerly “non-traditional” students have become the majority of enrollments. In a better functioning market, new entrants would dramatically reduce this extreme and widening profit margin.

Another example of market imperfection is how online courses are priced. Despite some arguments to the contrary, online courses are dramatically cheaper to offer than face-to-face courses. Online courses need far less infrastructure, rely more on individuals moving at their own pace, and allow greater scale. However, these cost savings are not reflected in prices to students. Online courses typically have the same tuition as face to face courses. Adding insult to injury, additional fees are often charged to take these courses. Universities frequently treat these programs as revenue centers, rather than applying the same subsidies to them as are applied to face to face courses.

Even the exceptions to the rule – those innovations that have succeeded – serve to prove how difficult it is to innovate in higher education. The for-profit education sector serves about 10% of all college students but is the fastest growing sector of higher education. These colleges typically target adult students returning to college with flexible offerings, convenient locations, practitioner led courses and strong ties to post-graduation employment. These colleges were able to charge tuition dramatically higher than local community colleges while fulfilling ostensibly the same function. Starting with the University of Phoenix in the 1970’s, it has taken 30 years for

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for-profit education providers to become accepted by the regulatory establishment. That these providers are able to thrive despite the severe pricing advantage enjoyed by community colleges shows how difficult it is for traditional higher education to adapt to market needs. Even now, for-profit colleges are regarded with disdain by the traditional educational establishment, despite no evidence of differing outcomes.

Pro-Innovation Policies

Everyone wants to make higher education more affordable. Recent policy proposals suggested increasing loans and grants to students, penalizing tuition increases, “shaming” colleges that raise tuition by publishing their names and tuition raises, or a combination of the above. None of these proposals are likely to work. Increasing loans and grants simply pours more money into an inefficient system. Artificially capping tuition increases creates scarcity in some markets which will lead to further market distortions. Lastly, a “shame” list will have little bearing as students more often pay net tuition rather than full tuition. To truly make education more affordable, “education” (or at least some elements of it) must be objectively defined by the regulatory apparatus and the market for higher education must more accurately reflect the costs of providing it at the course level.

The first priority is to create an objective and comparable measurement of minimum college outcomes. Dozens of more specialized fields like nursing, accounting, medical assisting, law, teaching, and others require basic tests to enter a profession. It shouldn’t be too much to ask of general education to create a similar basic test. Even liberal arts colleges that will resist subject-matter assessments could be held to standards of critical thinking improvement among their students that can be measured by tests such as the College Learning Assessment (CLA)⁹

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and others. Such testing requires agreement on what constitutes the elements of minimum success. Efforts are underway in Europe through the Bologna Process and via a Lumina Foundation funded project in Indiana, Utah and Minnesota to identify core standards across institutions in selected disciplines.

The second priority is to require that colleges take each other's credits. Once there is some agreement on minimum standards, as there already is among several state systems, then all colleges should at least accept credits in these courses from other colleges. International travelers know the hassle of preparing for different electrical standards in different countries. What if that were magnified a hundredfold? What if it were magnified a hundredfold and a traveler might not be able to determine the standards before traveling? With its byzantine credit transfer system, post-secondary students are like these twilight-zone travelers. According to a 2005 General Accounting Office study, "institutions vary in how they evaluate credits, who makes the decisions to accept credits, and when credit transfer decisions are made. For example, some institutions evaluate transfer credits prior to student transfer, while others make final credit transfer decisions after student enrollment.... A student's inability to transfer credit may result in longer enrollment, more tuition payments, and additional federal financial aid."¹⁰ While it would seem that colleges regulated by a common entity with supposedly objective standards would be able to easily compare similar courses, this is not the case. Once basic quality measurements are established and accepted, it should be a requirement that any accredited college must accept any other accredited college's credits without additional fees or hassles. Many courses, particularly general education courses, such as college algebra, economics, chemistry and others, are commodities. They should be treated as such.

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The third priority is that colleges and educational entities should be regulated based on their student's performance on common assessments. Today, receiving accreditation is more like joining a country club than achieving a certain standard of success. If you are funded by the state, you are certain to get in. If you are a non-profit institution, you have a very good shot. If you are a for-profit institution, your actions will be scrutinized much more closely than other members. Once in, it's very difficult to be kicked out. With a subjective regulation system, innovation must come in a structure that is acceptable to those already approved. However, innovation is much more likely to take completely different forms. For instance, educational specialists might emerge that focus on specific courses or subsets of courses. New educational practices might emerge that can only be achieved at scale. So long as the student meets a common outcome, it shouldn't matter who provides the education.

The fourth priority is to create a level economic playing field. Imagine going to several car dealerships to purchase a car. The first dealership gives you the lowest price, and it is based on where you live. The second gives you a price that is much more expensive, but professes to fit your needs better. The third one gives you a price, but only has a limited supply and can't guarantee that you will get one. The second and third dealers also insinuate that, if you buy a car from them, they will cut you a special deal. Lastly, you know that all the cars must be pretty similar, but you aren't allowed to look prior to buying. While this is perplexing to the consumer, it wreaks havoc on new car sellers. If I want to be a new car seller, I wouldn't improve the car because the customer is not making the purchasing decision based on the product. The customer is making the purchasing decision based on ambiguous pricing, location and marketing. To allow innovation to flourish, policymakers not only need to create common objectives and evaluative practices, they must tie these to the true cost of delivery. This brings market discipline to the

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delivery of education. Specifically, states should stop funding colleges directly. Assuming that states believe that higher education is a public good worth subsidizing, it would be much more efficient to create a voucher system such that the market determined pricing and the state subsidized a portion of it. A variety of conditions could be attached to these vouchers to achieve policy goals. For instance, like the existing financial aid system, students could be means-tested to insure that the neediest received vouchers. Further, to keep state dollars and college graduate in-state, states could require college attendance in-state, post-graduation residency requirements or both. Given the dramatic organizational change that a voucher system would entail, most states are not likely to implement it in the short term. Short of a voucher system, states should let each public college set its own tuition. For private colleges, states should consider giving all institutions tax exemptions or giving tax exemptions to none.

Objective Evaluation

In 2007 the Spellings Commission – a commission appointed by the Department of Education by the Bush Administration – examined issues of access, affordability, accountability and quality in higher education. Their findings were highly critical of the higher education system. In an article written after his time at the commission, Charles Miller, the commission’s Chair said, “If the academy does not find ways to measure and assess its productivity and outcomes, that will be done for it. The evidence is clear, particularly because of financial pressures, that outside intervention is going to occur if higher education does not respond to the need to change.”¹¹ This was met with severe resistance from the higher education community. Existing accrediting bodies argued that the extraordinary diversity of missions within post-

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secondary education makes it impossible to prescribe a single model of evaluation. Instead, accreditors and colleges argued for the status quo and voluntary quality assurance efforts.

It is true that one of American higher education's strengths is its diversity of institutions. Would it be fair to measure a college that deliberately serves struggling students on student success? Some liberal arts colleges argue that their academic offerings cannot be separated from the academic culture created by a resource intensive residential college. Should this college be penalized because it is necessarily expensive? What might a common assessment system look like?

Though finding a common assessment system to compare all aspects of all colleges will be impossible, there are at least four principles that can guide the creation of a sufficient assessment system. Because no single measure will accurately evaluate colleges, multiple methods of evaluation need to be combined. Some are:

- 1) Assess Minimum Commonalities Only – Despite the arguments to the contrary, much of the general education core is be more or less the same across colleges. If what a student learns in calculus at one college is truly different than what a student learns at another college, then our bridges would not meet in the middle and our buildings would fall down. Admittedly, some subjects – particularly the liberal arts – are more subjective across colleges. However, where there are common standards – math, science, economics, accounting, statistics, basic composition -- they should be assessed.
- 2) Results Must Be Tied To Price – Knowing that more students pass a calculus course at College A than at College B doesn't tell me much about that course. If I am buying a car, I'd love to have the Mercedes, but I may only be able to afford the Ford. Assuming

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objective standards, schools could publish “price per pass” information which would be the price per course divided by the percentage of students that passed it. For instance, a course that cost \$1000 that had a 90% pass rate would have a cost per pass of \$1,111. A course that cost \$150 and had a 50% pass rate would have a cost per pass of \$300. Which is the better course? In conjunction with other measures, this can give some sense of the value of the course.

- 3) Student Opinions Matter – While studies have shown that lenient graders get better student survey results, student opinions about their overall education, particularly within a decade of graduation, do matter. It is an indicator of the student perception of value of the educational experience and whether it provided what he or she expected it to provide in the workforce.
- 4) Transparency Is Critical – Assuming objective standards, inter-operability and a level economic playing field, pass rates, price figures and student opinions should be sufficient to allow students to pick the college experience that best meets their needs. However, this information needs to be publicly accessible and current.

Innovations That Aren't

Many of the points made in this article are not new to higher education. Policymakers and higher education administrators wring their hands about price escalation. They are aware that their ability to demonstrate and compare effectiveness is insufficient. Institutions spend a large and increasing amount of money on new technologies with which they intent to save money and

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increase access to education. There are many, many efforts underway within higher education to address these problems. Unfortunately, most of these efforts serve to perpetuate existing structures or to respond to critics. Like in less restricted markets, market disruption that dramatically changes product make-up and cost structures almost never originates from those who would be disrupted. Existing players tend to make incremental changes that will appeal to their individual customers. For instance, the addition of non-academic amenities at a four year college appeals to a particular subset of incoming students, yet pushes the overall cost structure up. Here are some of the innovations that are not likely to change the cost and accountability problems of higher education.

- 1) Statewide Collaborations – In international trade, countries are happy to exchange the things that neither has. The U.S. is happy to import sushi and the Japanese are happy to import hamburgers. However, when both Japan and the U.S. want to send the other one its cars, negotiations get tense. Suddenly, tariffs, regulations, and motivated constituencies restrict trade. Similarly, colleges in collaborations are happy to accept courses and programs not provided at their own college, but are much less likely to allow students to take courses already offered by the home institution. It is telling that many states have distance learning collaboratives, but most are structured as distance learning catalogs for the member institutions. Such an arrangement preserves college autonomy, without creating competition among individual departments or courses. A more cost-effective structure would be the aggregation of an entire state's demand for online courses and letting a single public entity fulfill that demand. Such a structure would take advantage of economies of scale to derive pricing advantages and amortization

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efficiencies. It would also avoid the duplicative online efforts offered by a state's many public colleges.

- 2) Voluntary Quality Assurance Programs – In response to increased pressure on higher education to demonstrate accountability, several voluntary accountability programs that allow cross-institutional comparisons have emerged.¹² While these programs represent an improvement over the current lack of comparable data, they still suffer from several critical problems. First, these programs are voluntary. The participants are few in number and, presumably, are the ones with little to hide. Second, the information is usually self-provided, creating an incentive to provide biased information.

- 3) Content Collaboratives – Classic economics states that the price of a good should equal its marginal cost of production. In other words, in a perfect market, the price of an item should equal the amount that it costs to produce one more unit of that item. Rightly, states have taken note of the fact that the marginal cost of electronic content is effectively zero. Therefore, electronic content produced by their institutions can be shared at almost no cost. In theory, this should reduce course development costs, textbook costs, and speed the development of new courses. Several collaboratives have been created to take advantage of this. For instance, Merlot is a collaboration of 15 state college systems that contribute to a database of educational content objects – combinations of content and software that provide a lesson or explanation. Unfortunately, while there are many states and individuals who are willing to contribute to Merlot (www.merlot.org), college governance structures, course development procedures, textbook adoption processes and

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tuition policies conspire to limit the demand for free content. For instance, a professor has limited incentive to develop a course more cheaply. Further, even if the professor does develop a course more cheaply, that savings will not be passed on to the student. Lastly, there is no way to gauge the impact of a course that uses cheaper inputs. Is it the same quality at a lower cost, or not?

- 4) Open Course Ware – In 2002, the Massachusetts Institute of Technology (MIT) made headlines by announcing that it intended to put all of its course materials online and make them available to anyone for free. In the last fifteen years, this evolved into the Open CourseWare Consortium with well over 100 members across the globe. With such materials available, everyone would be able to benefit from MIT's world class educational content. By providing free materials, the cost of education should decline. However, while content may be available, the credentialing component and selectivity components of MIT are not. Further, other institutions wishing to take advantage of this material would still need to navigate the accreditation and regulatory barriers necessary to award bonafide credits. Accordingly, despite having free materials and very low start-up costs for new course initiatives, prices to students haven't budged. This initiative clearly demonstrates that educational pricing is disconnected from its cost of delivery. To truly take advantage of free educational content, the price of a course must reflect its cost of delivery.

- 5) Technology Adoption – Colleges are eager to adopt new technologies. Most colleges offer some form of learning management system for both distance education and face-to-

face classes. Most make extensive use of administrative tools to manage student data, grades, payments, and other necessary services. Overhead projectors, smartboards, “clickers” and other in-classroom technologies are extremely common. Most colleges offer some form of distance education. However, despite the presence of all of these technologies, costs continue to rise. Without changes in the business processes in which these technologies are embedded, the potential for cost and quality improvements will not be realized.

Signs of Change

Despite the significant policy barriers to innovation, the post-secondary market is poised for dramatic transformation. The cost savings of electronic content and communication are so significant that they can allow new entrants to overcome the pricing advantages enjoyed by public and non-profit colleges. Further, and more importantly, by making post-secondary education time and place independent, online education removes the biggest barriers to competition. Instead of having a few post-secondary options, the prospective student now has dozens. Online enrollments continue to grow at rates far in excess of the total higher education student population. Over 3.9 million students were taking at least one online course during the fall 2007 term; a 12 percent increase over the number reported the previous year. The 12 percent growth rate for online enrollments far exceeds the 1.2 percent growth of the overall higher education student population. Over twenty percent of all U.S. higher education students were taking at least one online course in the fall of 2007.¹³ Eduventures, an education market research firm, estimates that the market for online education was \$6.2 billion in 2005, \$11.7 billion in 2008 and will grow to \$26 billion by 2013.¹⁴

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With increased competition between distance education providers *and* between distance education providers and face to face providers, colleges seeking to enroll new students must compete on the features of their offering, price, their marketing efforts, or some combination. Not willing to compete on price, so far, online colleges have differentiated themselves primarily on educational features -- such as course flexibility, access to potential employers, and degree specialization -- while increasing marketing expenses. The marketing cost to enroll a new student continues to rise, though the recent global recession has decreased the cost of advertising which has temporarily slowed the overall marketing cost increase. In 2005, private not-for-profit colleges spent \$2073 to enroll a student.¹⁵ For-profit colleges spend between 15% and 20% of their annual revenue on marketing. Public colleges spend substantially less, as their pricing advantage allows them to enroll students without as much marketing effort. However, as the online education market gets even more crowded, many colleges will no longer be able to afford to spend more on marketing and will be forced to look to other ways to attract students such as lower prices and differently packaged courses and degrees.

So far, price competition has been constrained because the low cost provider is almost always the public university or community college. However, as public college tuition and fees continue to rise, the difference between their pricing and private and for-profit college pricing will decrease, despite the government subsidies enjoyed by public colleges. Further, private and for-profit colleges will likely engage in fierce price competition bringing their costs even closer to public college tuitions. Also, less selective colleges are increasingly willing to allow students to “import” credits from elsewhere to attract students – creating de facto inter-operability among less selective colleges.

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Concurrent with colleges showing signs of being subject to newly competitive market dynamics, students are displaying characteristics of retail consumers. Enabled by technology, they are submitting significantly more college applications than ever before. In 1991 about 59% of high school seniors applied to three or more colleges. In 2006 that number had skyrocketed to 71%, and about 18% of seniors applied to seven or more institutions.¹⁶ The economic crisis is increasing their interest in low-cost college options like public four year universities and community colleges.¹⁷ They are increasingly emboldened to switch colleges mid-stream for one that has better value. The number of “swirlers” – students who attend two or more institutions prior to graduation – is growing rapidly. As of 2001, 40% of students who first enrolled in college in had attended more than one post-secondary institution. As of 2004, 20% of all four year college enrollments were comprised of transfer students.¹⁸ Because selective institutions are far less likely to have a large transfer population, this likely dramatically understates transfers for less selective institutions. Additional information on transfer students is difficult to find as it is not routinely collected by the U.S. Department of Education. However, anecdotal information suggests rapid growth. Other methods of alternative credit generation are accelerating as well. For instance, Dual Enrollment, the fulfillment of college credits while taking high school courses, has become a fixture of public secondary and post-secondary education in dozens of states. Also, the number of students taking AP courses continues to rise. In 2008, 1.6 million high school teens sat for 2.7 million AP exams, a 45 percent increase in students from 2004.¹⁹ Interestingly, this may be causing more selective schools to limit the number of courses for which it will grant exemptions. For instance, Tufts, following the lead of Williams College, restricted the number of courses that a student could exempt out of with AP scores.²⁰ This, of course, requires the student to spend more for a selective education.

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Also, a variety of controversial business models have emerged that combine private sector marketing and efficiency with the public college accreditation to offer students lower cost courses. These models take aim at the high profit margins inherent in the market niches that are easily delivered online, have common standards across schools, and tuition does not reflect the cost of delivery. For instance, Higher Ed Holdings, a for-profit company run by an established education entrepreneur, has partnered with Lamar University in Texas to offer graduate degrees in education through Lamar at half the price of Lamar's existing programs. Higher Ed Holdings provided the marketing expertise, student services, content, and other resources in exchange for a significant percentage of the tuition revenue. The partnership yielded record enrollment. However, a similar program at the University of Toledo generated enough opposition from University of Toledo's faculty to prevent the program's implementation. StraighterLine, a company that I founded, offers general education courses that can be taken by students for \$99 per month and can be transferred into regionally accredited colleges. Multiple regionally accredited colleges agreed to award credit upon enrollment to students who had completed these courses. Further, the Distance Education and Training Council (DETC), a nationally recognized accreditor, said that these courses met all of their standards of quality. Despite these assertions of quality, the model has generated strident opposition from faculty members and the media. In addition to Higher Ed Holdings and StraighterLine, a variety of other for-profit and not-for-profit entities provide turn-key online courses that include content, infrastructure and instruction using an accredited university's brand name and accreditation. For instance, Bisk Education provides finance, nursing and education programs that are "private labeled" by partner colleges. Ed2Go provides non-credit courses through community colleges. Regis Colleges' New Ventures program provides adult education curricula and expertise to other Catholic colleges. The Institute

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for Professional Development owned by the University of Phoenix provides similar adult focused programming for colleges. The potential impact of online learning on the cost structure of course delivery combined with the ever increasing prices charged by public colleges and the dramatic decrease in the ability of the population to afford post-secondary education is poised to overcome the legacy structural barriers to innovation in higher education.

What Higher Education Will Look Like

Imagine if you will that many of these barriers to innovation are removed. What might higher education look like? What kinds of business models might emerge? What assumptions might become irrelevant? In no particular order, here are some prognostications:

- 1) **Selective, High-Priced Colleges Will Continue to Be Selective, High Priced Colleges –**
Much of the value inherent in a selective college is derived from the fact that it is selective. By creating a community of high-achievers, students create expectations, networks and social groups that last a lifetime. It is hard to argue that Harvard teaches calculus significantly better than a community college. However, its students may grasp the concepts more quickly, may be willing to work harder to do so, and may make valuable friendships and associations that will last a lifetime.

- 2) **Non-Selective Colleges Will Loosen Their Credit Transfer Policies While Selective Colleges Will Tighten Them –** Colleges that do not struggle to attract students have no incentive to allow students to reduce their college expenditure. These colleges will argue, often rightly, that their distinctive experience cannot be replicated by importing credits from other schools. On the other hand, colleges that do struggle to attract and retain

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students or who seek to grow their student populations rapidly will loosen their articulation policies. While these colleges do not have an incentive to reduce a student's expenditures, they have a stronger incentive to attract a student who would otherwise attend a competitor with less restrictive articulation policies.

- 3) **Course Pricing Will More Accurately Reflect The Cost To Deliver The Course –** In a competitive and inter-operable environment, less selective schools will not be able to continue generating 1000 percent profit margins on general education courses. If they do, the student will move to another provider that provides the same product which costs less. Since some courses cost more than others to provide, course costs are more likely to be variable. Colleges may also offer different priced versions of the same course. For instance, a creative writing course requires extensive instructor feedback and a biology course may have an expensive lab requirement. On the other hand, a college algebra course may simply require on-demand assistance and be able to be graded automatically. Course costs include facilities use (physical or virtual), instructor use, content, and overhead. Students that take longer to complete a course will likely pay more. Students that need more support will likely pay more. Colleges may also create subscription pricing instead of flat-fee pricing.

- 4) **A Residential College Experience Will Cost More Than An Online College Experience –** It is a fact that a residential college environment costs more than an online college environment. The opportunity cost of the land and facilities, the upkeep of the facilities, security, the non-academic opportunities such as extra-curriculars and others simply cost

more than an online environment. With true competition, the price competition between online and offline will become dramatic. Many colleges may abandon per-credit pricing for their residential experience in favor of charging a fixed price per term, per year, or per degree.

- 5) **Highly Efficient and Effective Providers of Single Courses and Subsets of Courses Will Emerge** – In health care, hospitals that specialize in single, high-volume procedures are held up as examples of cost saving and quality improvement. At colleges, certain courses will lend themselves to certain ways of teaching, presenting content, or both. For instance, math instruction is different than writing instruction which is different than philosophy instruction. Best practices will emerge and, unlike today, the cost and effectiveness of these practices will be quantifiable and these practices will spread.

- 6) **Non-Selective College Marketing Strategies Will Borrow Heavily From Retail Marketing Strategies** – In a provider-neutral and inter-operable market, many of the courses delivered by non-selective colleges are commodities. So long as students meet minimum course standards, there would be little functional difference among them. The marketing strategies in such commodity markets are dramatically different than those in the current higher education market. For instance, Nike built its athletic shoe dominance on celebrity endorsements. In a recent headline, Jack Welch, the celebrity former CEO of General Electric, has lent his name to the Jack Welch MBA program being built by Chancellor University in exchange for an equity stake. Chancellor University is a for-profit entity that purchased the bankrupt non-profit Meyers University in 2008.²¹ Similarly, the

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University of Phoenix joined Staples, Gillette, Miller Brewing, 3Com, Minute Maid, and dozens of brand-aware companies for whom professional sports stadiums are named.

Other strategies that one is likely to see are course-level discounting, loss leader strategies where an initial offer is underpriced in order to develop brand loyalty and “buy-one-get-one-free” offers. For instance, to increase retention, why wouldn’t a college offer its senior year for free if the student completed his or her previous three years at that college? Why wouldn’t a college offer a discount or free freshman classes to students that successfully complete remedial programs? Why wouldn’t a college offer “frequent learner” points for classes taken? Given that colleges already engage in dramatic discounting with prospective students, are these types of strategies so far-fetched?

- 7) The 2-Year and 4-Year Distinction Will Become Obsolete – Already colleges offer condensed term lengths and more frequent start dates to appeal to working adults. Also, more and more colleges are talking about offering three year degrees to enable students to save money. "It will not be easy to produce a low-cost, high-quality three-year curriculum for a college degree, but now is the time to try," said Sen. Lamar Alexander (R-Tenn.), a former education secretary and a past president of the University of Tennessee said in 2009.²² When education is composed of a critical mass of students assembling in a certain place for a certain time, then a fixed time period for a degree makes sense. When these students can be aggregated from anywhere around the globe, education can be time and place independent.

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- 8) The “Superstar” Teacher Model Will Emerge and the Reliance on Adjuncts and TA’s Will Grow – A persistent hope placed in technology has been that it would enable those teachers who were most effective to broaden their audience by either video delivery, expanded classrooms or some other teaching technique. In turn, these teachers would demonstrate their effectiveness and would be paid more. So far, this hasn’t happened. However, in a higher education world where course-level brand matters, this model will emerge. Much as the “Jack Welch MBA Program” relies on business star power to attract students, some courses will rely on noted mathematicians or, more likely, media stars talking about math. The hope had been that educational effectiveness or popularity would yield bigger paychecks for teachers. However, to drive economic returns for teachers, educational effectiveness needs to be combined with an ability to generate revenue. Conversely, a more efficient market will likely reveal that some courses are less dependent on an instructor than previously thought. In these courses, the full-time faculty member will give way to adjuncts, TA’s, and outsourcing.
- 9) The Research University Will Survive and Maybe Thrive – Universities do a lot more than just teach. Many, particularly the flagship universities, have a powerful research mission. A strong performance in research is likely to improve a university’s brand and to attract students in the disciplines where a research university excels and where the research is relevant to a student’s career track. Conversely, where research is not viewed as being critical to a program’s brand or an attraction to students, it will wither. Like selective liberal arts colleges, research universities that generate respected and relevant research will likely be strengthened in a more competitive market for higher education.

10) The Rising Cost of College Will Become a Non-Issue – Why is it that we hear the same lamentations about the rising cost of college every year? It's because the student or family consumer doesn't really know what he or she is getting for this price. A provider-neutral, inter-operable system of higher education would stop the annual cost complaint because students would have a much better sense of the value of the education that they chose. For example, you never hear complaints about the rising cost of all cars. A consumer can buy an expensive car or a more affordable car. The complaint is about whether a particular car met the consumer's purchasing expectations.

A Note On The Cost of Textbooks

Within public and not-for-profit higher education, the textbook market is another example of an imperfect market that drives students' costs upward. Currently, a full-time college student can expect to spend more than \$1,000 on textbooks over the course of an academic year. According to a 2005 report by the General Accounting Office (GAO), college textbook prices increased almost twice as quickly as the overall rate of inflation from 1986 to 2004.²³ Students blame publishers for exorbitant prices and unwanted add-ons. Publishers blame the retailers who mark-up the price of books and who give a portion of textbook revenue back to the university. Publishers also claim, rightly, that the supplemental materials that come with the textbook are desired by professors. Retailers say they are only selling what the faculty ordered.

To combat the problem, colleges have established textbook rental programs, states have enacted or proposed legislation to limit the bundling of supplemental materials, and the federal government included a clause in the 2008 Higher Ed Reauthorization Bill requiring publishers to

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provide pricing, release and revision information to professors when professors are making adoptions. While these actions are admirable, they are unlikely to significantly affect college textbook prices.

Like so much in the higher education industry, the college textbook market suffers from a fundamental misalignment of incentives. Professors choose the textbook, but the student buys it. As experts in their field and devoted educators, professors want as much educationally helpful material as possible to come with a textbook. The student, on the other hand, may use only a small portion of the materials that he or she has been forced to purchase. To further muddle the incentives, the college frequently receives a portion of a bookstore's revenue, providing no incentive to the college to reduce expenses to the student.

The only way to rectify this problem is to align the incentives more closely. First, colleges should not have revenue sharing relationships with textbook retailers. Second, and more importantly, the price of all course related materials should be included as part of the course price or listed with the price of a course. Presumably, both within a college and between colleges, students could then make informed decisions about the total cost of a course.

Conclusion

U.S. higher education, whether for-profit, non-profit or public, is big business. To maintain national competitiveness and meet the new Administration's policy goals, the number of students served must increase. However, given the state of the economy and the national debt, we cannot afford to spend more to do this. The only way to educate more students without breaking the bank will be to improve the effectiveness, efficiency and accountability of higher education. This requires us to re-think the regulatory structure of higher education to create

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conditions more favorable for academic and price innovation. Allowing a more efficient education market – one that allows price competition, new entrants, winners, and losers – could impose far greater market accountability. In turn, market accountability can create a stronger relationship between product quality and price paid.

Fortunately, technological change and the resulting competition plus the emergence of new business models are pulling a reluctant higher education edifice into conversations about reform. However, without supportive policy makers, new business models will continue to be forced to perform unnatural acts to succeed. For instance, why must Higher Ed Holdings partner with an accredited college if it is providing the lion’s share of the educational experience? Why must StraighterLine’s credits be limited to only those regionally accredited colleges where the faculty is willing to accept its credits? What value does a university provide in a “private labeled” relationship with a 3rd party that is providing all of the educational resources? What other business models might emerge if the pricing advantage enjoyed by public universities didn’t prevent competitors from entering the market?

From the residential liberal arts experience to vocational training to online baccalaureate degrees to cutting edge research, post-secondary education provides an extraordinary diverse set of experiences to an extraordinarily diverse set of students. This has served the United States well. However, with even more students needing to be served in even more ways through new mediums, the assumptions of the past need to be revisited. It’s time to build a provider-neutral, objectively assessed higher education system.

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