The Disruption of the Higher Education Business Model: The Search for Financial Sustainability Strategies

Similar to other sectors, higher education is going through a business model disruption – albeit a slow, multi-decade evolutionary shift. Simultaneous changes to educational customer demographics, revenue streams, and consumer expectations are creating challenges to the preexisting paradigms of what higher education institutions provide and represent. Change is a certainty; the question is what will change and which institutions will effectively implement such changes.

Depending on the source, there are somewhere around 4,700 institutions of higher learning in the U.S.[1] It is a very diverse sector. Some are 2-year, some are 4-year, and some have graduate programs. Some are public institutions, and most are private. The diversity is significant, as some focus on local commuters, others look for traditional dorm boarders, many focus on the traditional spectrum of programs, and others choose to specialize.

For the sake of this discussion, let us focus on the roughly 1,800 private colleges and universities. Within this population, eliminate the minority of elite institutions with considerable endowments and alumni giving programs that rely much less on tuition to survive. What remains is a significant portion of the US higher educational infrastructure: private institutions in the mid- to lower-ranks who are educating a bulk of the nation's recent high-school graduates and a large number of working adults (i.e. non-traditional learners).

The headlines are filled with stories of ever increasing tuition costs, rising debt loads, and poor return-on-investment (ROI) based on job prospects.[2] Intermixed with the narrative of the national wealth gap, a bleak picture is emerging.

[1] "Fast Facts," U.S. Department of Education, National Center for Education Statistics.
[2] "The Real Reason College Tuition Costs So Much," New York Times Op-Ed, by Paul Campos, April 4, 2015.

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Politically driven solutions to rising tuitions abound, as 16% of the US budget is spent on defense, 28% spent on health, and 3% goes to education.[3] There is great debate on who should 'pay' for higher education: students and the future earning (via loans), the past generation's retirement savings (via parent 529 accounts), or government grants (funded by current taxpayers).[4] However, this debate only addresses who should bear the cost and debt. It does not address the underlying business model and structural realities that drive the costs.

The real issue is whether institutions can shift and change to the needs of their customers, provide a valuable service, and manage costs and expenses to ensure healthy margins. Let's call this a *strategy for higher education financial sustainability*.

For such a strategy to work, several new 'norms' must be embraced by institutional leaders – which may cause cultural heartburn for many. However, without change, a leading prediction foretells that one-third to one-half of higher education institutions may go bankrupt over the next quarter century.[5]

The New Norms

1. Recognize Students as 'Customers'

For various reasons, the traditional academic side within higher education institutions often do not view students as customers to whom they must align their services to serve their needs and wants. It appears rooted in historical higher education culture, the professor-student dynamic, and the parent or grant-giver being the tuition payer. Institutional leadership wrestles with the tension between their erudite viewpoints on academic programming and the growing consumerism of students.

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[3] "Federal Spending: Where Does the Money Go," National Priorities Project.
[4] Beth Akers and Matthew Chingos, *Game of Loans*, Princeton University Press, 2016.
[5] "Five Trends to Watch in Higher Education," Boston Consulting Group, April 10, 2014.

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Regardless, in the higher education sector, the 'if we build it, they will come' reality is disappearing. Dictating curriculum and launching programs without thorough market demand analysis may no longer work. Prospective students (and their parents, when they are the tuition check writers) are exercising choices as consumers, have greater comparative data than ever before[6], and must be targeted and understood to ensure the right products and services are delivered to meet their needs. Freshman survey data illustrates a trend toward viewing a college or university degree as a practical step to gain or progress employment[7] – and less about the classic life experience and character development of the college years.

In addition, due to the 'baby boomer' demographic bubble in the U.S., the number of high school graduates has decreased slightly and will remain flat until the 2030s.[8] Thus, there are fewer traditional domestic prospective college students and a growing number of institutions[9] – with many institutions expanding traditional student enrollment capacity.[10] The data leads to a reasonable conclusion: there is an overcapacity of enrollment slots for too few traditional, domestic prospective students. (For now, this paper sets aside the issue of international recruitment to fill the enrollment capacity.)

Therefore, institutions need recognize that their traditional pool of 'customers' is shrinking; the competition for this pool is increasing; and the 'customers' are more discerning and pragmatic in their views toward the value of a degree. Leaders must look at their academic programs as products and services, and they must consider students, parents and alumni to be customers. Adopting this attitude, alone, will catalyze change.

[6] "College Scorecard Data," U.S. Department of Education.
[7] "CIRP Freshman Survey [Confidential College Source]," Higher Education Research Institute, 2015.
[8] "The Baby Boom Cohort in the United States: 2012 to 2060," U.S. Census Bureau, Issued May 2014, pg. 15.
[9] "Fast Facts," U.S. Department of Education, National Center for Education Statistics.
[10] "The Enrollment Slowdown," Insider Higher Ed, by Doug Lederman, February 28, 2014.

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2. Redefine the Measures of Quality

When shopping for an institution, prospective students and/or parents look at the available data to determine which are 'good schools.' Yet, few understand how to measure 'good' and, more disturbingly, many institutions are not truly able to measure and report on the actual quality of their academic programs in the same way organizations in other industries would measure and report the quality of their products and services.

On the historically driven and newly emerging published 'scorecards,' most prospective students will find statistics related to graduation rates, retention rates, and diplomas awarded.[11] There are complicated story lines behind each of these statistics; but, none really answer the simple question of how well the institution is able to teach its students what they need to know and whether that learning led to those students taking their desired next life steps (not to mention the long-term longitudinal impact on success and achievement over a lifespan).

What is emerging, but requires more prominence, is the *standardization* and use of learning outcomes assessments in institutions. For the majority of common programs, prospective customers should be able to see how well one institution delivers learning on biology (for example) vs. another institution, as well as how program graduates were able to secure jobs in their field or progress to desired graduate programs. These baselines and comparative indicators are a missing link. Comparing how many graduate within six years doesn't explain all of the potential drivers of success and failure, which may include high-school preparation, financial strain, and life/work stresses.[12]

In addition, prospective customers should be able to easily compare the satisfaction opinions of prior customers. Though some comparative data does

[11] "College Scorecard Data," U.S. Department of Education.

[12] "Graduation Rates by State," The Chronicle of Higher Education.

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exist[13], it is not easily found and an interpreted in the consumer realm. Prospective students and parents should readily understand if current students and recent graduates have high-opinions of the educational quality and experience of an institution under consideration. Granted, these numbers must be controlled for college student bias (e.g. I like my classes because they are easy). Yet, the premise remains true – customers must feel they are getting a great value for their money and time.

3. Understand Competition, Focus on Strengths and Innovate

Higher education often focuses inward and on historical precedent (i.e. "This is who we are and what we've always done.") However, as competition for the same prospective students increases, institutions must do what all organizations do within a competitive environment: know their competition, figure out where they want to focus, and innovate new ways to deliver better products for lower cost.

First, institutions must become acutely aware of where they stack against other institutions against which their target customers compare them. This is difficult, because it partly depends on which students will be targeted (e.g. in-state, local commuters, out-of-state boarders, international). However, the key is to pick a comparative group and work to understand how the institution stacks up and is perceived. Then, track those perceptions from prospective and current students.

Second, focus on strengths. This could take the form of building on existing core competencies and assets. Or, it could be a calculated risk to invest in new strengths. Here, again, it may depend on the chosen target customers and their comparative institutions. But, it must be done to create focus and to bolster strengths, while helping to avoid trying to be good at too much.

Third, embrace innovation. Institutions must recognize that students, today, are increasingly looking at the 'return on their investment' from an education and the

[13] National Survey for Student Engagement, Indiana University.

associated cost. These customers often see education as a direct tool to drive a desired career and employment – and less about the character building experience that many traditional institutions profess.[14] The National Survey of Student Engagement conducted by Indiana University examines 'high impact practices,' as they show correlation to student satisfaction, success and retention. The high-impact practices survey indicates a recognized movement to promote innovations in learning delivery, such as increase learning communities where groups of students take two or more classes together, the inclusion of community-based projects, student-faculty research projects, internships, co-ops, field experience, student teaching, clinical placement, study abroad, and a culminating senior experience.

Yet, innovation, by definition, does not reside in known boundaries. It is about invention, creating new ideas, and breaking paradigms. Through the use of on-line learning tools, many are offering accelerated, lower-cost MBA progams.[15] Many programs are embracing flipped classrooms to drive increased exposure to critical thinking.[16] Online live and off-line learning is rapidly growing.[17] And, innovation is not limited to the classroom. Institutions are working to find new ways to help students stay in school through improved early detection risk systems.[18] Mobile technologies are being developed to help students stay engaged and connected with their professors and peers compelling new ways.

Therefore, understanding an one's competition, recognizing and targeting strengths, and embracing and pursuing innovation in all aspects of the higher education experience are now the part of the requisite path toward survival.

[14] "CIRP Freshman Survey [Confidential College Source]," Higher Education Research Institute, 2015.
[15] "Benedictine offering $10,000 MBA to adult learners." The State Journal-Register, February 11, 2014.
[16] Flipping for success…." US National Library of Medicine, National Institutes of Health, February 28, 2015.
[17] "Use of MOOCs and Online Education is Exploding…." Forbes.com, January 5, 2016.
[18] "Early Warning Systems Pathway," American Institutes for Research.

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4. Align Recruitment, Enrollment and Retention

Herein lies one of the most difficult rubrics of the higher education business model. The end game is to fill an institution with the largest number of students who will be most academically successful while providing the maximum tuition revenue. However, this is far from simple.

Recruitment is about targeting and aligning to the needs of the institution. Are the dorms full? Can the parking lot hold more cars? Are the biology labs filled to capacity? Are there resources to help financially challenged students to stay enrolled? How are scholarships awarded: by merit or by financial need? Much of a recruitment strategy is about working backwards from the institutional needs.

To increase enrollment, an institution can simply lower its academic standards. However, then it will bear the burden of less academically prepared students who will likely drop out after their first year.[19] In addition, the institution will suffer a drop in published average SAT/ACT scores, which is a consumer-facing indicator, thus making it harder to attract future top students. Enrollment is also about the final decisions prospective students make between two or more institutions. The decision triggers include financial aide, academic quality, social life, living experience, extra-curriculars, distance from home and many more. The concept of 'early-decision' applications was designed to prevent or circumvent the competition at enrollment deadlines (though, early decision is now controversial due to claims that it discriminates against lower socio-economic status students.[20])

Retention is increasingly important. For many institutions, the loss of an enrollee is often only known once a semester starts and the student is no longer attending class (or paying the next housing and tuition bill). Dropping out can be driven by

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[19] "What Matters to Student Success: A Review of the Literature," National Post Secondary Education Cooperative, July 2006.

[20] "The Discriminatory (Dis)advantages of the Early Decision Process," The Catalyst, by Max Kronstadt, Nov. 5, 2016.

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financial factors and academic struggles. If an institution decides to increase its enrollment by accepting more academically challenged students and/or those with great financial burdens, they must be prepared to closely monitor and have in place early warning indicators of risk. Once risk indicators appear, services must be provided to help the students receive the resources and support to stay in school. Similar to other businesses, it is far more expensive to lose a customer and find a new one, than to retain an existing customer.[21]

Go after the right prospective students, enroll those that best match the institutional needs, and retain the maximum number to drive their success.

5. Run Efficiently and Effectively

As with any organization with limited financial resources, higher education institutions must look at efficiency across both their operating units and academic units. Many institutions are relatively un-automated and/or with un-integrated systems. As with any business, look for 'Lean' approach improvements, error proofing, and customer experience improvements.

On the academic side, a more cultural change may be needed. Consider costing out the 'profit-and-loss' within each program. Maintaining educational infrastructure is expensive. Ensure that there is a strategic reason for maintaining programs – especially those that do not cover their own costs.

Within recruitment and enrollment, examine the admissions process to speed up student acceptance decisions. Such 'cycle-time' reductions and significantly impact student enrollment numbers and affect the bottom line – especially in the discussed sectors of institutions where a few more of the 'right' students can measurably impact institutional financial margin.

[21] "Looking at the Costs of Student Acquisition and Attrition," Magnapubs.com, by Craig Heldman.

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On the asset and infrastructure side, always understand the financial implications to the institution. Often, the proverbial stadiums and pools are built because it seems like a great idea to have a lacrosse team or a swimming team (and due to directed financial gifts).[22] Yet, will those students typically received scholarships thus making them lower margin customers? Will the facilities pay for their own maintenance once the construction endowment is spent? The key is to ensure extra-curricular infrastructure is chosen or maintained for the right reasons – which include customer satisfaction, recruitment, public relations, alumni relations, and financial aspects.

6. Generate Sufficient Revenue to Plan Long-Term

What may be the most challenging aspect for the bulk of private institutions is that many operate from paycheck-to-paycheck. In fact, 45% of tuition-dependent private institutions spend more than they can afford.[23] Their upcoming fiscal year budgets are often dictated by the last minute details of the current tuition income. This makes long term planning increasingly difficult. To strategically plan and execute on the above outlined new norms, an organization needs financial breathing room and needs to break out of a survival cycle.

The key to the generation of sustainable margin rests in the ability of an institution to harmonize these preceding 'new norms.' Moreover, like other top-tier institutions, they must consistently generate alternative revenue streams. Alumni giving, major donations, estate planning, facility rental, summer programs, and other avenues must be explored. Either generate the revenue or reduce targeted expenses to find room to breathe.

[22] "College athletic departments are paying themselves to lose money," Washington Post, by Sally Jenkins, November 25, 2015.
[23] www.thesustainabilityuniversity.com, Bain & Company, data updated in 2014.

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7. Run Like a Business

In reality, there is no new thinking herein. This is about recognizing that higher education institutions are facing a smaller pool of more discriminating and financially strapped customers. Competitive pressures are increasing. Historical and culturally driven investments have created high debt-to-revenue burdens. Customer needs and desires are changing toward more pragmatic and practical outcomes (i.e. a good job or career advancement). Innovative delivery and learning products are necessities – not experiments. And, only those who embrace change may ultimately survive. The hope is that the financial sense of urgency facing these institutions will drive many to become more innovative, customer-oriented, efficient and effective over time – resulting in better products and services to their customers at a more affordable cost. Said another way, it is about the realization of a higher education financial sustainability strategy.

About the Author
Michael Brazukas is the President and Founder of the Strategy Management Institute, a strategy, performance and change consultancy trusted by the world's most impactful mission-based organizations — from the smallest non-profits, to the largest multilateral treaty organizations, and innovators changing the world. SMI is recognized across multiple continents for its deep expertise in best-practice strategic planning and strategy execution methodologies.

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