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As For-Profit Colleges' Enrollment Growth Slows, Analysts See Signs of an Industry Reset

By Goldie Blumenstyk

After several years of record enrollment growth, the increases have slowed at many for-profit institutions, according to earnings reports of the last few weeks. Many companies say they're expecting that trend to continue as they change course on their marketing and recruiting strategies to comply with new federal regulations.

"The unrestrained growth is coming to an end," says Kevin Kinser, senior researcher at the Institute for Global Education Policy Studies at the University at Albany who studies the for-profit education industry.

ITT Educational Services reported that the number of new students at its campuses declined by 3.9 percent over the previous year. Corinthian Colleges Inc. said it expected declines of 5 percent to 7 percent this year. Strayer Education reported a 2-percent decline. DeVry Inc. and Capella Education both said they expected new enrollment would be down slightly from the previous year.

The biggest changes occurred at the biggest for-profit institution. The University of Phoenix said the 92,000 new degree-seeking students it enrolled in the quarter that ended August 31 represented a 10-percent decline from the previous year.

More telling, the university's parent company, the Apollo Group, said it expected its new-student enrollment could drop by more than 40 percent in the quarter ending November 30, as it radically revamps its enrollment machine in response to new federal regulations and what company executives describe as a transition for the company's business model. The new regulations, which go into effect in July, will eliminate the "safe harbors" that have allowed colleges to base a portion of recruiters' compensation on how many students they enroll.

Phoenix is also adopting new strategies—like its free three-week orientation required for students seeking to enroll with fewer than 24 credits, and financial-literacy training to deter undue borrowing by students—to reshape its student-body makeup so it includes

students who are more likely to persist to a degree and repay their student loans.

"We are not focusing on maximizing new-student enrollments," Charles Edelstein, co-chief executive of the Apollo Group, said in a telephone call with investment analysts last month. The comments and that enrollment projection sent the stock price plunging, from about $50 to $37. But Mr. Edelstein said the changes, while likely to hurt profitability in the near term, would position Apollo for "more stable" results in the future.

Adjusting the Enrollment Mix

Apollo has been among the most visible in making changes to alter its enrollment mix, but it's not the only one. A few months ago, Corinthian announced it would no longer enroll "ability to benefit" students —those who lack a high-school diploma or GED but pass a basic test.

"Colleges are paying much more attention to the students they bring into their doors because they're going to be accountable for them," says Mr. Kinser, of the University at Albany.

He was referring to two sets of new federal regulations. One, which is already scheduled to go into effect, will make it harder for colleges to "manage" their rates of student-loan defaults because defaults will be measured over a period of three years after a student graduates or leaves school, instead of two. The other is the proposed "gainful employment" rule that could require colleges to eliminate or restrict enrollment in programs where students graduate with high levels of student-loan debt relative to what they earn. For-profit colleges have lobbied heavily against the rule, and the Education Department has delayed issuing a final version of it until early next year.

Trace Urdan, an analyst with Signal Hill investment bank, says he believes it was a concern of running afoul of the gainful-employment rule that prompted ITT to recently announce it was cutting back on its television advertising, which has been an effective tool for recruiting to its fast-growing and highly profitable criminal-justice programs. Such programs "represent a real problem for gainful-employment compliance," says Mr. Urdan, so if ITT is curtailing those advertisements, cost was probably not the only motivation.

Weeding Out 'the Bad Actors'

Although a number of the companies are still projecting growth, investment analysts say the reported slowdowns and recently announced changes in strategy reflect only the beginning of what may be a major industry reset.

"We're in the third inning for how bad things will get for the sector," says Ariel Sokol, an analyst with UBS Securities.

The confluence of political, regulatory, and financial pressures is prompting what Mr. Sokol calls "an appropriate contraction" for the for-profit higher-education industry. Those pressures include U.S. Senate hearings (the third of which is scheduled for early December), state investigations, the new federal regulations on student recruiting and student debt, and a slowdown in student inquiries in the wake of news accounts about student-recruiting abuses.

In the end, says Mr. Sokol, the pressures could "weed out the bad actors that don't have the appropriate cost structure or the appropriate business model to serve the student population" they set their sights on.

The shift is notable for its velocity. "Rarely does an industry change abruptly," as this one has, says Jerry R. Herman, an analyst with Stifel Nicolaus. But he notes that the previous few years were unusually heady for the industry, with annual enrollment growing by about 17 percent in 2008 and by 28 percent in 2009, versus the historic growth rate of about 10 percent to 11 percent.

Rising unemployment rates, enrollment caps at budget-squeezed public colleges, an "accommodating" regulatory climate, and the ability to pay enrollment counselors partially on how well they landed students all contributed to the "unsustainable growth" of the past couple of years, he says. "It was a friendlier world."

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