

View From the Financial Community

Richard Close and Rob Humphreys

The following article was adapted from *Proprietary Higher Education*, published in January of this year by Sun Trust Equitable Securities. Its authors, Richard Close and Rob Humphreys, study the business of education for the financial community. The lens through which these analysts see higher education serves to sharpen the self-reflective acuity of an institutional structure that has for too long relied upon itself for gratuitous affirmation. Close and Humphreys see winners and losers. Many will not like the face they put on the losers. Worse yet is the unspoken implication of the reasoned optimism they display toward the for-profit educators (winners). Think of this: there is now a substantial, and growing, portion of the public for whom the term “not-for-profit education” is viewed with suspicion. —Ed.

The Evolution of the Post-Secondary Education System

Since World War II, a college education has been increasingly accepted as the ticket to a successful career. In *Discontent in the Field of Dreams: American Higher Education 1945-1990*, Marvin Lazerson discusses several theories for the dramatic expansion in post-secondary enrollments following WWII. One theory for the rapid expansion relates to the shift to an information or knowledge-based economy. In what is often referred to as the “human capital model,” technical and literacy skills increase an individual’s productivity, making that person a greater contributor to the national economy and a greater asset in the marketplace. We believe that this is one reason inflation has remained at these low levels despite upward wage pressures caused by the tight labor market. The technologically skilled workforce has dramatically improved productivity, thus offsetting any inflationary pressures caused by wage increases.

Another theory for the expansion of higher education relates to status. This status theory contends that higher education is a form of “cultural currency,” whereby employers are primarily concerned with an individual’s organizational and behavioral skills rather than the technical skills for a specific career. Where once the status theory proved successful, we believe that the shift to a skilled

workforce or a knowledge-based economy forces individuals to acquire added skills through the post-secondary system. Thus, the demand for human capital should drive strong future enrollment growth.

In its current state, we believe that the higher education system in the United States often fails to provide the desired outcomes sought by the customers of higher education — students and employers. As a result, the acceptance of proprietary providers has begun to revolutionize the post-secondary education process. In years past, for-profit providers were often looked down upon as schools that provided little value to the marketplace or its students. The barber school or truck-driving institute around the corner were repeatedly joked about. Although we believe that the aforementioned schools serve a definite purpose, we have seen the evolution of the for-profit sector expand to include high-tech schools as well. These schools actively work with local businesses to produce a highly qualified and properly trained employee base that can contribute immediately upon hiring.

Why the Proprietary Schools are Succeeding versus Non-Profit Competitors

As the higher education industry continues to evolve, we believe that there are several

key reasons for the increasing acceptance of the proprietary higher education sector. These include convenience and flexibility as well as affordability and placement. First, the location of a school is often a factor in a potential student's decision making process. Local proprietary schools offer students a convenient, focused, career-oriented education whereas many private and public non-profits that require relocation fail to do so. Further, flexibility is an integral part of the for-profit expansion. Typically students can complete degree programs in a shorter period of time at proprietary schools versus the non-profit competition. These schools offer working students the opportunity of higher education through flexible schedules and convenient locations. The proprietary segment has been receptive to the various scheduling demands of a diverse student base, while non-profits remained relatively rigid to students' needs. The price of any product is a major factor in the purchaser's decision-making process. Interestingly, with respect to education, the higher the price, the higher the perceived value. This contributed to the skyrocketing cost of college education during the 1980s, which outpaced the rate of inflation. While more expensive than community colleges or many state universities, proprietary schools cost considerably less than their non-profit private school counterparts. Given that a student can gain the technical skills more directly associated with a specified career in a shorter period of time at a proprietary school, we maintain such an institution is often a more affordable choice. We believe the for-profit school student receives a more focused education in a shorter period of time, thus enabling the student to begin earning a return

on his or her investment more quickly than non-profit (public or private) school students.

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Proprietary schools define their customers as students and employers. If they are successful, they serve both customers well. Many, perhaps most, non-profit institutions focus on neither students nor employers. For example, as college education expanded in the post-WWII era, the view that the post-secondary system was failing gained momentum. A study by the National Center for Post-Secondary Improvement found that from 1952 to 1982, students who failed to complete school declined from roughly 50% to 30%. Despite these good results, students began to bear an increasing amount of the ever-rising cost of college. Following 1982, student completion rates began to deteriorate. Students who withdrew from school before obtaining a bachelor's degree reached more than 40% in the 1990s. We believe that this occurred due to a lack of acknowledgment of who the true customers are — students and employers. Proprietary providers must give their full attention to developing successful students while operating as efficiently as possible. Student completion and high placement are crucial for a for-profit school's survival. As a result, an individual's tuition is primarily allocated to making a student into an employable asset. Large universities and private schools are more likely to allocate a substantial portion of tuition to areas such as athletics and research rather than teaching students current technical skills. In the for-profit sector, high placement rates lead to strong referral leads,

potential future enrollments and continued operations. In the non-profit segment, state funding and endowments downplay the importance of student referrals. As a result, reliance on these funding streams ultimately leads to a disregard for the skill base that the student needs to enter the workforce, specifically for the placement of a graduate in a career directly related to his or her educational training.

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The Bottom Line

Through its ability to be innovative, the proprietary sector has caught the eye of community colleges, state universities and non-profit private schools. Much of the competition has attempted to adopt many of the practices that appeal to an ever-evolving student base; however, change in such a bureaucratic structure (public and private non-profits) is often a challenging task. In contrast, the proprietary sector has exhibited its ability to deal with external challenges, as exemplified by the successful compliance to the 1992 Higher Education Amendments. In dealing with a heightened regulatory environment, the customers (students and employers) have remained the focus of the for-profit segment. Both students and employers have benefited from the hands-on skills obtained through the for-profit higher education system. With the rapid rate at which technology advances, we believe that for-profit providers, rather than their non-profit counterparts, are more apt to evolve with technology and the customers of higher education.

Basis for Continued Growth

The for-profit sector is in a position to benefit from the positive growth trends that exist in the post-secondary marketplace for the following reasons:

- For-profits can maneuver quickly to meet the changing demands of students and employers, as exemplified by the opening of IT programs by many of the public players. The non-profit sector is often much more bureaucratic, thus limiting the ability to change quickly to meet evolving demands. An analysis by American College Testing stated that there appeared to be a “tension between college curricula and demands in the job market.”
- For-profits are more adequately prepared to expand the number of programs and campuses in order to meet the expected surge in enrollments. Although many states have recently enjoyed times of budget surpluses, in many cases a lower percentage of tax revenue) is being allocated to post-secondary education now than in previous years, thereby limiting expansion of public higher education systems.
- For-profits focus on the needs of students by providing flexible schedules and year-round classes, enabling students to complete their degree in a shorter period of time, often for a lower cost. Therefore, students can begin to earn a return on their investment more quickly than students who attended traditional schools.

Shift to a knowledge-based economy. The number of jobs requiring higher education degrees is expected to grow faster than those requiring fewer skills. Over the last 30-plus years, the economy has changed from one driven primarily by manual labor to one spurred by human capital.

Long Term Prospects

We remain confident that the long-term growth opportunities for the post-secondary sector remain strong due to the following statistics:

- Substantial growth in the number of individuals in the prime age group for post-secondary education is projected over the next decade. The number of individuals in higher education is anticipated to grow from 14.3 million in 1996 to 16.1 million by 2008. Sixty-seven percent of high school graduates enroll in college, up from 62% in 1992 and 1995.
- Widening wage gap between high school graduates and college graduates. The wage gap between high school graduates and individuals with a bachelor's degree expanded from 58% in 1977 to 77% in 1997.
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