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For-Profit Status Is Not the Problem

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By
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The debate on the Department of Education's proposed "Gainful Employment" rule has fixed attention on the failure by both sides to resolve one of the nation's most important problems: How to effectively serve the education needs of America's new traditional students.

On one side are those who support the department's new regulations that end student aid to career-oriented programs whose graduates fail to meet certain arbitrary debt-to-earnings ratios and loan default rates. Driven chiefly by opposition to the role of profit-seeking in higher education, this camp appears little concerned with the fate of hundreds of thousands of mostly underprivileged students who may be left without a postsecondary education as a result of the proposed rules.

The opposing camp, dominated primarily by the proprietary sector's executives, trade groups, and free-enterprise partisans, has taken up a defensive position that too easily dismisses the fundamental need for new regulations to help align the sector's business interests with higher education's social goals.
While the former group is working to undermine the institutions best suited to address the needs of students poorly served by public institutions, the latter includes too many players that are far from reforming themselves so as to solve the problems that landed them in the crosshairs of their hostile detractors.

Among the most strident defenders of the proposed regulations is Robert Shireman, a former Education Department executive. In "Perils in the Provision of Trust Goods," released this week at the Center for American Progress (see related article), Shireman argues that the essential problem with for-profit higher education institutions is that they are for-profit. Shireman contends that because for-profit education companies are unencumbered by the "nondistribution constraint," which limits the rent-seeking incentives of administrators at nonprofit institutions, executives at proprietary schools are tempted to cut corners on quality or mislead students to increase the returns to shareholders.

Though there is much to take issue with in Shireman's essay, I focus here on a contradiction in his argument that undermines his thesis that for-profit status is the problem in order to highlight what the private and publicly traded proprietary sector must do to silence its critics and better serve its students.

Shireman shows that being for-profit is not in itself a bar to being a socially responsible and successful education institution by pointing to the example of the for-profit University of Phoenix. He writes that in its first two decades Phoenix “built a strong reputation, and by all accounts it was well deserved.”

The reason, he adds, is that it primarily served middle managers required to be at least 23 years old with significant prior college experience (60 credits) and a minimum of two years of work experience. Consequently, he correctly notes, many had their tuition reimbursed by their employer. Shireman then goes on to claim that beginning in 2001, Phoenix started eliminating these requirements “to pursue more students using federal aid -- which led to enormous profits but declines in quality and reputation.” Undeniably, as Phoenix lowered the number of credits required for admission, students entered less prepared, resulting in a decline in retention and graduation rates. However, until recently the university had great difficulties recalibrating its once-successful vision and business plan, resulting in a substantial blow to its reputation and a dramatic decline in its parent company’s market value -- from nearly $12 billion in 2009 to the present $3 billion. But Phoenix was not alone.

Challenged by rising competition, negative publicity, and a transformed economy -- driving many would-be students into the work force -- in the last five years eight of the next largest publicly traded higher education companies lost a collective market value of almost $14 billion. Without diminishing the negative effects of increased competition and a changing economy, the $22 billion loss in market value among companies worth over $32 billion a mere five years ago suggests something more than external challenges as the cause, especially when an additional education company managed to increase its value by almost $90 million during the same period. What, then, is this other cause?

To answer this, I turn to the experience of Paul Polman, who since his appointment as CEO five years ago has increased Unilever’s market value from $73 to $139 billion, partly as a result of the termination of the Great Recession, but more importantly as a consequence of his doing the unthinkable. After 10 years of no growth, he led the company to a new vision based on the idea that to succeed Unilever must evolve around leaders who have the skills “to focus on the long term, to be purpose-driven, to think systematically, and to work much more transparently and effectively in partnerships.”

This means that businesses, especially those with a social purpose, such as higher education, must be organized to serve society by taking responsibility for their decisions through a process requiring thinking long-term about their business model and goals.

Taking a page from the strategy Polman successfully executed, I suggest higher education companies do three things to escape the ongoing wrath of politicians and regulators.

- First, end offering quarterly guidance and reduce what is reported to analysts and shareholders to metrics that monitor the creation of long-term values.
- Second, make sure performance-based incentive plans are largely based on periodic success measures of long-term goals that reflect a positive social impact.
- Third, because merely cutting expenses will not lead to success, apply accumulated cash mainly to the improvement of student performance -- the only currency of lasting value in education.
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As some education companies already working to apply the above suggestions know, share price will be affected in the near term. However, these initiatives will diminish negative media and regulatory zeal permitting stocks to ultimately reflect the true value of those companies on a path to sustainable growth. This strategy requires educating and working on changing the stockholder base. But given the large participation of pension funds and other long-term investors in the stock market, it should permit education companies to stop yielding the future to short-term investor interests.

As some private and publicly traded proprietary institutions have already learned, long-term thinking will make better, uncompromised decisions possible by removing the pressure to make poor choices based on short-term concerns.

Only by thinking for the long term will education companies fully attend to their real social goal: the successful education of their students. That's what reputable traditional education institutions have done, and what many comprehensive public institutions, subject to volatile annual budgets and lacking in long-term incentives cannot.

In short, it is not that they are for-profit that makes proprietary institutions so vulnerable to questionable practices, it is that many have still not grasped that education is a social goal requiring a commitment to a long-term ramp up.

BIO
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