

THE BUSINESS  
OF HIGHER  
EDUCATION

The  
Guardians  
Initiative™

Reclaiming the Public Trust

**ABOUT AGB**

Since 1921, the Association of Governing Boards of Universities and Colleges (AGB) has had one mission: to strengthen and protect this country's unique form of institutional governance through its research, services, and advocacy. Serving more than 1,300 member boards, 1,900 institutions, and 40,000 individuals, AGB is the only national organization providing university and college presidents, board chairs, trustees, and board professionals of both public and private institutions and institutionally related foundations with resources that enhance their effectiveness.

Copyright © 2017  
by Association of Governing Boards  
of Universities and Colleges  
1133 20th St. N.W., Suite 300,  
Washington, D.C. 20036  
[www.agb.org](http://www.agb.org)

**ACKNOWLEDGEMENTS**

The Association of Governing Boards extends its gratitude to the following for their contributions to this publication:

SANDY BAUM  
Senior Fellow, the Urban Institute;  
Professor *emerita* of Economics, Skidmore College;  
Trustee, Bryn Mawr College

RICK BEYER  
Managing Principal, AGB Institutional Strategies

ANDREW DELBANCO  
Alexander Hamilton Professor of American Studies,  
Columbia University

MORTON O. SCHAPIRO  
President, Northwestern University

LAWRENCE WHITE  
AGB Consulting Specialist; Senior Counsel,  
University of New Hampshire System

# The Guardians Initiative™

Reclaiming the Public Trust

**The Association of Governing Boards of Universities and Colleges (AGB) is pleased to share this first in a series of informational briefings developed as part of *The Guardians Initiative: Reclaiming the Public Trust*, an effort to educate and engage trustees as advocates on key issues in higher education. In months to come, governing board members, institutional leaders, and those who work with them will periodically receive additional briefings from AGB addressing issues of substantial moment for America's colleges and universities.**

**Our objectives are twofold:**

- 1. to encourage board members to engage in informed discussion with stakeholders who are less knowledgeable about our institutions, and**
- 2. to equip board members with the tools they need to stimulate national discussion about the missions that our colleges and universities serve, as well as how those institutions operate, what they cost, and what they contribute to society.**

# THE BUSINESS OF HIGHER EDUCATION

**While the tone of public criticism of higher education has sharpened, public understanding about the sector’s legitimate challenges and contributions is often lacking. Board members have an important role to play in improving the level of public discourse. In this first briefing, we examine the prevailing business model in higher education, with emphasis on undergraduate education in four-year colleges and universities.**

**M**uch of the higher education sector uses an unconventional business model that sets it apart from the rest of the national economy. The price it charges for its core product—higher education instruction—only partially covers the costs of providing that product. Many of the significant issues that animate policy discussion in higher education today—assertions that college costs more than it should, doesn’t reach students beyond those in the elite upper strata of society, saddles graduates with unsustainable levels of debt, fails to prepare students for future employment opportunities, and devotes too many resources to research and scholarship at the expense of teaching—reflect a lack of transparency in the way colleges and universities price their product and cover their costs.

This opacity is aggravated by higher education’s adherence to a largely 20th-century business model that causes it to miss cues from the public, policymakers, and other audiences about their current dissatisfactions with colleges and universities. Board members can enrich public conversations about higher education by contributing to a broader understanding of today’s business model and envisioning how it might evolve.

## **Today’s Higher Education Business Model**

For several generations, American colleges and universities have charged less—substantially less, in some sectors of higher education—than what it costs those institutions to educate students. Higher education institutions depend on government support and revenues from other sources to make up the difference between what students *pay* for their education and what it costs these institutions to provide that educa-

tion. In this paper, we will examine that business model in some detail. We will consider some of the drawbacks of the model—its opaqueness, the cross-subsidies it obscures, its dependence on revenue streams that are unpredictable in the best of times, and especially the extent to which it allows critics to undermine public discussion of higher education’s extraordinary value proposition—and whether those drawbacks can be addressed or at least explained.

All businesses in this country organize their finances around revenues and expenses. Opportunity for growth results from manipulation of three variables: increasing demand, adjusting prices in response to competitive market forces, and containing costs. The late Gordon Winston, professor of political economy and director of the Project on the Economics of Higher Education at Williams College, posited that, “No economic aspect of higher education is of greater interest to the public, policymakers, and parents than the setting and changing of tuition, yet economics has not been very successful in explaining it.” He observed that confusion over the cost to consumers of higher education arose from a simple fact: “Colleges and universities, as firms, are highly unconventional in their sources of revenue, their production processes, and their institutional values.” In the next several pages, we will deconstruct this important insight as it pertains to demand, pricing, and costs.

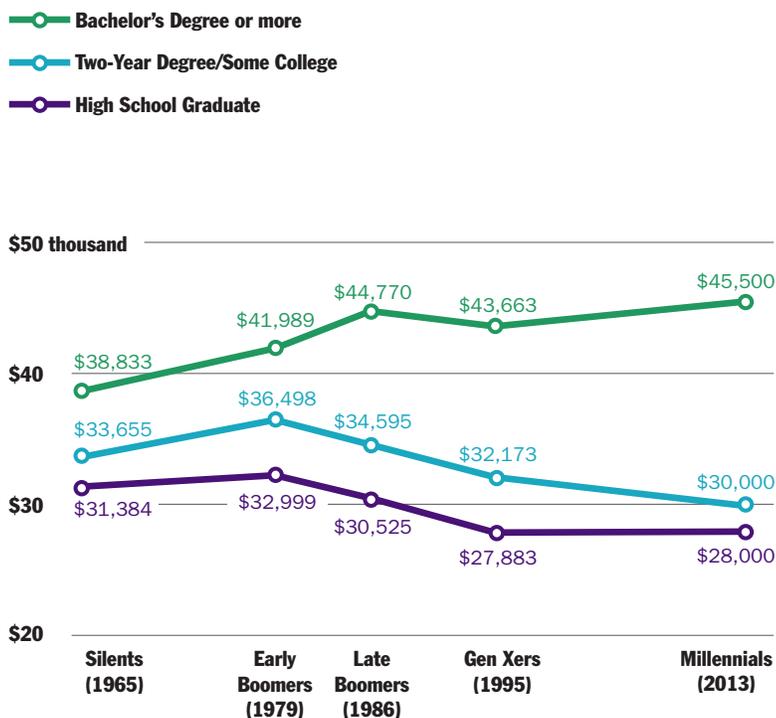
### **Demand**

Colleges and universities sell a product that, at least since the middle of the 20th century, has been in high demand. Underlying higher education is an astonishing value proposition, one that is easy to support yet that the sector’s critics largely overlook. While the cost of attending college is indisputably high, so are

# THE BUSINESS OF HIGHER EDUCATION

## Rising Earnings Disparity Between Young Adults With and Without a College Degree

Median annual earnings among full-time workers ages 25 to 32, in 2012 dollars.



NOTES: Median annual earnings are based on earnings and work status during the calendar year prior to interview and limited to 25- to 32-year-olds who worked full time during the previous calendar year and reported positive earnings. "Full time" refers to those who usually worked at least 35 hours last year.

SOURCE: Pew Research Center tabulations of the 2013, 1995, 1986, 1979, 1965 March Current Population Survey (CPS) integrated Public Use Micro Samples. *Trends in College Pricing 2016*. ©2016 The College Board. [www.collegeboard.org](http://www.collegeboard.org)

the benefits to be reaped by making the investment in higher education. This translates into persistently high demand for higher education—a phenomenon that helps to explain heightened concern about college costs as well as why tuition prices have not been very responsive to that concern.

“On virtually every measure of economic well-being and career attainment—from personal earnings to job satisfaction to the share employed full time—young college graduates are outperforming their peers with less education,” a 2014 study from the Pew Research Center concluded. “And when one compares today’s young adults with previous generations, the disparity in economic outcomes between college graduates and those with a high school diploma or less formal schooling has never been greater in the modern era.”

The researchers explain that, a generation ago, when people in the first wave of Baby Boomers were the same age that Millennials are today, the average high school graduate earned about three-quarters (77 percent) of what a college graduate was paid. Today, Millennials with only a high school diploma earn 62 percent of what the typical college graduate earns.

Leading economists like Walter McMahon, a professor *emeritus* at the University of Illinois, assert that the United States *underinvests* in higher education because we underestimate

its benefits both to individuals and society as a whole. Higher education, he argues, efficiently creates human capital that improves communities and contributes to the economic well-being of the nation over the course of graduates' entire lives. College graduates enjoy better health, longer lives, and greater degrees of individual and professional satisfaction that are directly attributable to higher levels of education and increased earning capacity. They also use the skills learned in college to foster democracy and human rights, as well as to accelerate technological advancement. Greater numbers of college graduates also reduce economic inequality and lower the social costs of welfare, medical services, and prison incarceration.

feed public perceptions of colleges as elite bastions not accessible to most Americans. "American universities represent declining value for money to their students," concluded a 2012 article in *The Economist* titled "Not What It Used To Be." It went on to add, "Rising fees and increasing student debt, combined with shrinking financial and educational returns, are undermining at least the perception that university is a good investment." The fact is, even if higher education has a story to tell about the continued value of a college degree, many people are not hearing it.

The argument that college is worth a high cost has become less persuasive over time. This is at least in part due to public perceptions that students who

---

**When public mistrust grows and combines with anxiety, the combination can easily lead to a kind of resentment the French call *ressentiment*, a technical term in political science. This kind of political resentment is probably the second most dangerous political emotion, the first being the fear of instability. That's what creates revolutions and riots.**

**The buildup of public *ressentiment* is very bad for institutions. And there are sound reasons to believe that higher education could become a target in the future. —Daniel Yankelovich (2009)**

---

Yet a disturbing undercurrent runs through recent reports on the public's perception of higher education's value. Opinion research by Public Agenda shows that Americans were substantially less likely to agree that college is necessary in 2016 than they were a decade prior. Also, between the late 1990s and 2016, the percentage of poll respondents who agreed that "there are many people who are qualified to go to college but don't have the opportunity" increased from 45 percent to 69 percent.

Other commentators observe that national news stories on higher education issues are predominantly negative in tone and focus on controversial issues that

start but do not complete college come away with debt, foregone earnings, and little material benefit. In other words, going to college represents something of a gamble, with a risk of loss. Yet at any level—associate, baccalaureate, and graduate—acquiring a degree is a prudent investment. As Jason Abel and Richard Dietz, economists with the Federal Reserve Bank of New York, found, "The return [on a college degree] has remained high in spite of rising tuition and falling earnings because the wages of those without a college degree have also been falling, keeping the college wage premium near an all-time high while reducing the opportunity cost of going to school."

# THE BUSINESS OF HIGHER EDUCATION

Anecdotes of unemployed college graduates with six-figure student debt loads may make for juicy headlines, but they do not reflect the norm. The U.S. Bureau of Labor Statistics reports that, at peak unemployment during the recession of 2009-10, about 5 percent of bachelor's degree recipients were unemployed. To put this in perspective, in the decade leading up to the recession, the lowest unemployment rate for those with just a high school education was only about 4 percent. And in 2015, the national unemployment rate for bachelor's degree recipients was only 2.8 percent.

At the same time, the Organisation for Economic Co-operation and Development (OECD) has found that the net private financial return on investment in a college degree in the U.S. is among the very highest in the world. It is little wonder that more Americans are college-bound today than at any moment in our nation's history and that competition for open seats in the nation's colleges and universities has remained high even as tuition has risen rapidly.

## Pricing

Most Americans are aware that the average published price of attending college has jumped sharply over the last several decades. Focusing on the average obscures the vast range of published prices across some 4,000 diverse colleges and universities, and yet it is common knowledge that the average has increased. Since 1974, tuition and fees have gone up, in inflation-corrected dollars, by 300 percent at private colleges and even more—400 percent—at public institutions. “If over the past three decades car prices had gone up as fast as tuition,” *The New York Times* reported in 2015, “the average new car would cost more than \$80,000.”

In the minds of policymakers, journalists, and other opinion-shapers, no higher education issue has more of an impact on public discourse than the rising

cost of college tuition and fees. It is important for board members, as community leaders, to appreciate that perception—and also to understand and articulate some of the complexities underlying these numbers.

## GENERAL SUBSIDIES

The first complexity—and perhaps the most widely misunderstood aspect of college and university pricing—is that tuition payments from students make up only a fraction of operating revenues at most of the nation's nonprofit colleges and universities. The amount any student pays in tuition, even one who pays the full sticker price, is less than what the institution expends to educate that student. Other sources of revenue—among them state subsidies, donations and gifts, and income from endowment—make up the difference. As Professor Winston summarized: “Unlike a normal firm, a college can be in a sustainable equilibrium even when the price it charges for its product—net tuition—is much less than unit production costs. It is necessary only that the gap between cost and price be no greater than the school's donative revenues per student can support. From a student's perspective, that gap between cost and price is an in-kind subsidy as *[the student] is sold an expensive product at a price less than its production cost.*” [Emphasis supplied.]

Describing these general subsidies as widely misunderstood understates the issue. For instance, congressional leaders in recent years have assailed the endowment spending policies of the nation's wealthiest—and most expensive—institutions, suggesting various reforms designed either to compel minimum levels of annual endowment spending or to focus that spending more single-mindedly on undergraduate student aid. Largely missing from the debate over these measures is that endowments are typically composed of gifts that carry legal restrictions limiting the

spending of proceeds to specific uses: scholarships, capital spending, research, and faculty salaries, to name just a few.

Moreover, for those institutions with the capacity to use endowment proceeds, virtually all endowment spending subsidizes tuition, paying the costs of running the institution that tuition or other revenue would otherwise have to cover. Research by the Association of American Universities shows that institutions with large endowments actually tend to increase tuition at a slower rate than others. As for the related question of whether institutions with large endowments are enrolling enough students with financial need, that is an important policy question for the board of any such institution to consider with the president.

Regardless of whether endowment revenue is available, the provision of general subsidies from various streams means that students across the sector tend to be charged considerably less in tuition than the college's actual expenses for educating them. For example, the College Board estimated that, in 2011, it cost the typical community college \$7,750 to educate one student, compared with an average published tuition of \$3,260. In doctoral, master's, and baccalaureate public institutions, respectively, general subsidies covered about 42, 43, and 48 percent of the cost of education on a per-student basis. Some of the largest subsidies to students and families are already reflected in the published tuition and cost of attendance.

#### PUBLISHED PRICE VERSUS NET PRICE

A second complexity arises from the distinction between the published price—the tuition the institution's governing board approves and that appears in compliance reporting to the government—and the much more significant net price that a student actually pays,

which is calculated by subtracting institutional grants awarded to individual matriculants from the published price. Tuition discounts are far steeper and advantage a far greater proportion of students than many people realize. As economist Sandy Baum has explained:

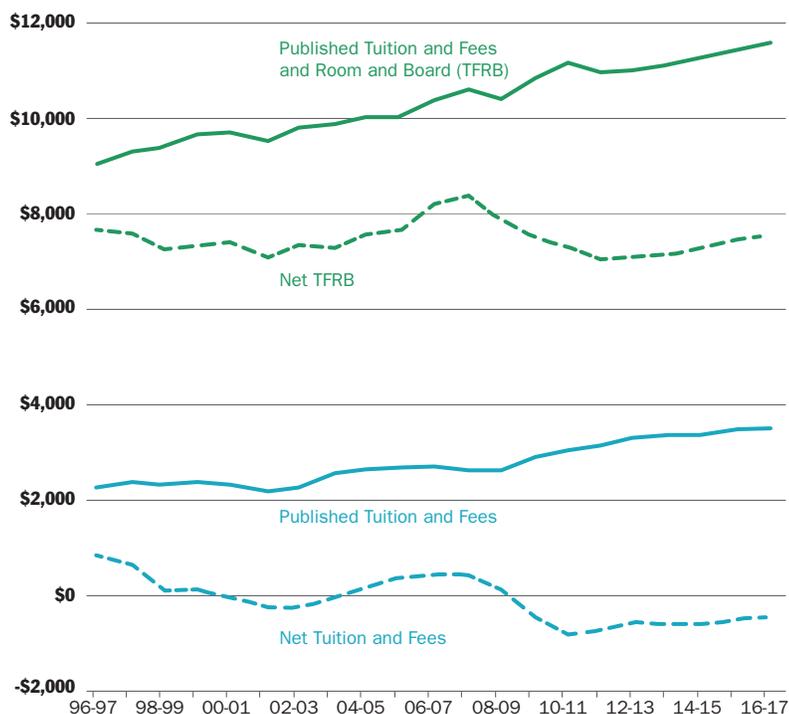
Families and students consistently overestimate the price of college.... [The] major confusion is between the published price, sometimes called the "sticker price," and the net price that students actually pay after taking grant aid into consideration....The average grant aid for full-time public two-year college students is more than enough to pay the \$2,544 published tuition price. So the average net tuition price at these schools is actually zero. At public four-year colleges, the average net price is about \$1,600 (compared with a list price of \$7,020). At private four-year colleges, it's about \$11,900, compared with a list tuition price of \$26,273....The differences between list tuition and net tuition are so large because about two-thirds of full-time college students receive some grant aid. At private four-year colleges, almost 80 percent do.

While the published price of a year of college has increased substantially over the last two decades overall, average net price has increased at a far slower rate. Data compiled by The College Board show that, between 1990 and 2016, the published price of tuition and fees at public two-year institutions more than doubled (from \$1,670 to \$3,520) while the net price actually decreased by nearly 200 percent (from \$450 to -\$500). This means the average community college student receiving financial aid in 2016-17 receives about \$500 over and above tuition and fees to offset the cost of books, transportation, and other living expenses. For public four-year institutions, the published price for *Continued, p. 11*

# THE BUSINESS OF HIGHER EDUCATION

## Average Net Price: Public Two-Year

In 2016-17, the average net tuition and fee price paid by full-time public two-year college students is \$920 (in 2016 dollars) less than in 2006-07—but \$270 more than in 2011-12.



NOTES: Estimates of net price exclude military/veterans aid, which awards relatively large amounts to a small number of students. Because information on grant aid and education tax benefits for 2016-17 is not yet available, the net price for 2016-17 is estimated based on 2015-16 financial aid data. Room and board in this sector refer to housing and food costs for commuter students, as few community colleges provide on-campus housing.

SOURCE: *Trends in College Pricing 2016*. ©2016, The College Board. [www.collegeboard.org](http://www.collegeboard.org). Reproduced with permission.

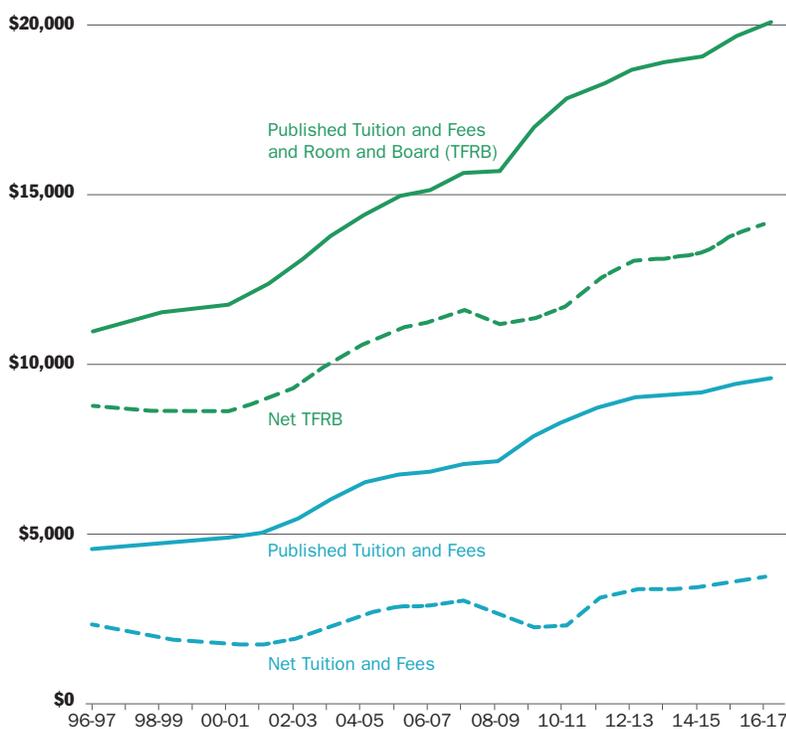
- In 2016-17, full-time students at public two-year colleges receive an average of about \$4,020 in grant aid and federal education tax credits and deductions—\$500 more than required to cover tuition and fees. They can use these funds for books and supplies or living expenses.

- Between 2006-07 and 2016-17, the average published tuition and fees at public two-year colleges increased by \$840 (31%) after adjusting for inflation. Average combined grant aid and tax benefits increased by \$1,560 in books and supplies and living expenses.

- In 2016-17, on average after grant aid, full-time students at public two-year colleges must cover about \$7,560 in books and supplies and living expenses.

## Average Net Price: Public Four-Year

In 2016-17, the estimated average net tuition and fee price paid by full-time in-state students at public four-year institutions is \$3,770, \$860 (in 2016 dollars) higher than the net price a decade earlier and \$1,150 higher than the 2009-10 low of \$2,220.



NOTES: Estimates of net price exclude military/veterans aid, which awards relatively large amounts to a small number of students. Because information on grant aid and education tax benefits for 2016-17 is not yet available, the net price for 2016-17 is estimated based on 2015-16 financial aid data.

SOURCE: *Trends in College Pricing 2016*. ©2016, The College Board. [www.collegeboard.org](http://www.collegeboard.org). Reproduced with permission.

- In 2016-17, the average full-time in-state public four-year college student receives an estimated \$5,880 in grant aid and federal tax benefits, covering 61% of the \$9,650 published tuition and fee price.

- Average published tuition and fees for in-state students at public four-year colleges and universities increased by \$2,790 (in 2016 dollars) between 2006-07 and 2016-17. The \$1,930 increase in average grant aid from all sources and federal education tax credits and deductions covered 69% of the price increase.

- Average published tuition and fees grew by only 9% in inflation-adjusted dollars between 2011-12 and 2016-17, after rising by 29% over the preceding five years. However, because of the dramatic increase in federal student aid between 2007-08 and 2010-11 and the subsequent leveling off, average net tuition and fees increased by about 22% from 2011-12 to 2016-17, compared to 7% over the preceding five years.

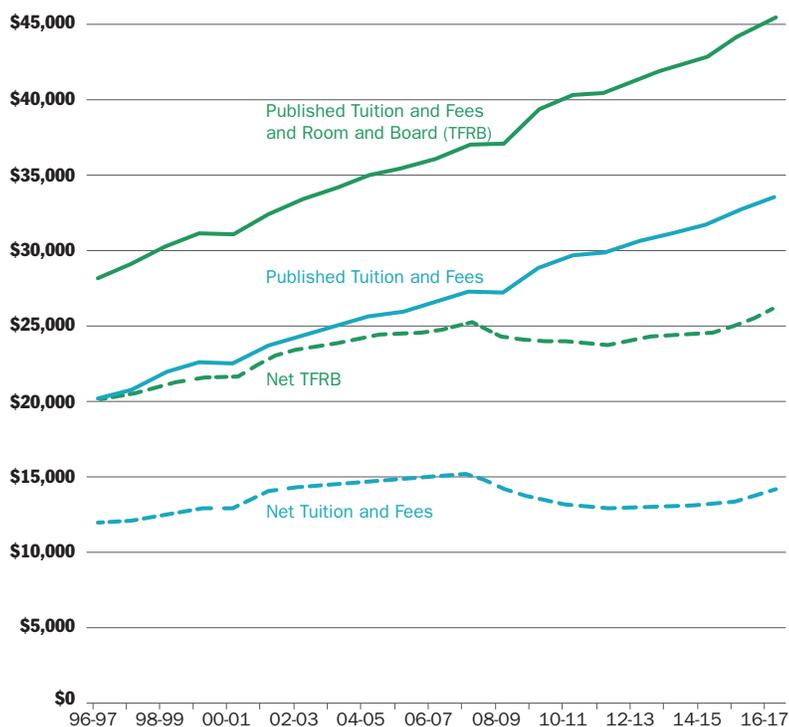
- In 2016-17, the average full-time in-state student at a public four-year institution faces an average of \$14,210 in charges for tuition and fees and room and board combined, net of grant aid and tax benefits.

### ALSO IMPORTANT

Average net prices conceal considerable differences among students, both within institutions and across institutions within the sector.

### Average Net Price: Private Nonprofit Four-Year

After declining from \$14,900 (in 2016 dollars) in 2006-07 to \$12,770 in 2011-12, the average net tuition and fee price paid by full-time students at private nonprofit four-year institutions rose to an estimated \$14,190 in 2016-17.



NOTES: Estimates of net price exclude military/veterans aid, which awards relatively large amounts to a small number of students. Because information on grant aid and education tax benefits for 2016-17 is not yet available, the net price for 2016-17 is estimated based on 2015-16 financial aid data.

SOURCE: *Trends in College Pricing 2016*. ©2016, The College Board. [www.collegeboard.org](http://www.collegeboard.org). Reproduced with permission.

- The average net tuition and fee price at private nonprofit four-year institutions is lower in 2016-17 than it was in 2006-07 because the increase in average grant aid and tax benefits was larger than the increase in published prices.

- Between 2011-12 and 2016-17, average published tuition and fees at private nonprofit institutions rose by \$3,780. The \$2,360 increase in grant and tax benefits per student covered 62% of that increase.

- Financial aid explains the gap between published and net tuition and fees. Average grant aid from all sources and federal education tax benefits covered 41% to 44% of published tuition and fees at private four-year institutions from 1996-97 through 2006-07. That percentage was between 57% and 59% from 2011-12 to 2016-17.

- The average net tuition and fees and room and board price is \$26,080 in 2016-17, an increase of 6% (\$1,500 in 2016 dollars) over the last decade.

#### ALSO IMPORTANT

Over 70% of the \$19,290 in aid per student that lowers net prices for full-time students in the private nonprofit sector comes from colleges and universities in the form of discounts from their published prices.

In 2011-12, 67% of full-time students at private nonprofit four-year institutions received grant aid from their institutions. Thirty-six percent received federal grant aid and 24% received state grant aid. (NPSAS 2012)

in-state tuition and fees rose by 174 percent, while the net price increased only half as much (88.5 percent). And for private four-year institutions, the jump in published tuition and fees was 94 percent (an annual compounded rate of just 2.6 percent), while the growth in net tuition and fees was 21 percent, or less than 1 percent per year, compounded. In short, going to college is more affordable than one might surmise solely by looking at an institution's published sticker price.

#### PRICING STRATEGIES

What accounts for higher education's unusual approach to pricing? Why do college catalogues display one price while matriculating students are charged varying and, in many cases, deeply discounted prices?

In its simplest form, discounted tuition is a mechanism for charging a scaled price that varies depending on such factors as a student's ability to pay, academic abilities, athletic prowess, and geographic home. While it is true that not every student pays the institution's published tuition, some do. That said, students who pay full freight typically do not subsidize the educational costs of classmates whose tuition is discounted—the amount of subsidy varies, but virtually every student receives one. Differential pricing is a tool that allows institutions to strategically target tuition discounts to select students across a broad range of qualities and to shape the institutional culture and academic experience.

In addition to differential pricing, American higher education is also known for its commitment to *progressive* pricing. Few service sectors in the American economy price their products progressively—by which we mean that the price charged for the same service varies in accordance with the ability to pay. (Healthcare has been noted by some people as being a close cousin to higher education on this point.)

At the same time, however, non-need-based student aid is also ubiquitous—for instance, colleges offer so-called merit aid to recruit academically gifted students, or they award scholarships to accomplished athletes—and higher education leaders are often challenged to balance a commitment to progressive pricing against broader enrollment goals. In 2012, 82 percent of high school graduates from the top family income quartile attended college, compared with just 45 percent of those in the bottom income quartile. That reality suggests the sector's commitment to progressive pricing will continue to be tested in the coming years.

#### CROSS-SUBSIDIES

In another mode of subsidy, colleges often charge an unvarying tuition for the courses of every undergraduate department. An engineering student is charged the same tuition as a philosophy or English student, notwithstanding that it costs more to educate a student in the physical sciences than in the humanities or social sciences. The philosophy student in effect subsidizes the cost of instruction for classmates in engineering and physics courses by paying the same amount in tuition and receiving an education that costs the institution less. Cross-subsidies among academic programs may appear to be more fair to some students than to others, but they preserve an important American tradition of academic self-direction. Students can choose what to study and which skills to develop with remarkable disregard for differential costs.

College pricing is typically unclear to students and families, but the deeper challenge is not simply one of increasing transparency but also of reducing underlying complexity. Most colleges and universities commingle revenues from many sources—tuition and fees, state appropriations, auxiliary services, inter-

# THE BUSINESS OF HIGHER EDUCATION

est income on endowment, federal research grants and contracts, and government-funded financial aid programs—in an institutional general fund, making the relationship of price-to-product difficult to determine, let alone explain to those outside higher education.

## Containing Costs

Classical economic theory posits that costs are controlled through *competition* and *increased productivity*. Yet those moderating factors do not conventionally fit the business model of higher education.

In most sectors of the national economy (think WalMart, McDonald's, or Microsoft), businesses compete with one another primarily on the basis of price and quality. We have addressed the nuances of higher education's predominant approaches to pricing above. With regard to quality, competition tends to focus on indirect indicators, in part because of a lack of consensus about how quality can and should be measured.

"There are reasons for the limited progress in developing college quality measures," wrote Jordan Matsudaira, an assistant professor of policy analysis and management at Cornell University, in a 2016 paper prepared for the National Academy of Sciences. "Colleges and the students they serve have myriad and diverse goals, and many of these are intangible and not readily subject to measurement or quantification."

In the absence of universally accepted measures, colleges tend to compete against each other by seeking to raise the quality of the students they attract, to enhance their reputation among college presidents, to increase the size of their annual expenditures, and to pursue other strategies having little to do with the quality of education that students receive. As Jonathan Robe, a research associate at the Center for College Affordability and Productivity, writes:

In a sense, the incentive to compete on prestige makes sense for colleges and universities. After all, it is notoriously difficult—if not ultimately impossible—to adequately capture and measure the learning students at these institutions gain during the course of their studies. A degree from a prestigious institution of higher learning often does confer certain career advantages, whether the graduate pursues a career on Wall Street or as a scholar or academic.

## TECHNOLOGY AND COSTS

People in some circles have touted technology as the most promising remedy to higher education's cost challenges. Classical economics posits that, in most sectors, technological innovation in the means of production—tools and equipment—will lead to cost savings by increasing worker productivity. By contrast, however, labor-intensive sectors that rely heavily on specialized human activities experience little or no growth in productivity over time. To explain why higher education does not conform to classical economic theories of productivity improvement over time, Princeton University economists William Baumol and William Bowen have used the example of a performance of a Mozart string quintet. When composed in the 18th century, the quintet required five musicians to perform. "Today," Baumol and Bowen write, "it still takes five people and, unless they play really fast, it takes as long to perform the piece as it did centuries ago." The musicians' *productivity* has not increased, but their real wages have risen—and because those wages constitute virtually the entire cost of production, the associated costs of a chamber music performance are substantially higher now than when the quintet was composed.

When it comes to many of its core functions, higher education stubbornly resists productivity improve-

ment. Notwithstanding efficiencies made possible by desktop computers and Internet access, it takes college professors just about as much time to prepare and teach a course in 2017 as it did in 1967—maybe more. Technology has, acknowledging certain pedagogical limitations, made possible new instructional economies of scale. But research has not resolved the question of whether online instruction tends to be more affordable to produce than traditional classroom instruction, let alone whether it is frequently cost effective.

#### GROWING DEMANDS

Another reason why academic personnel costs keep rising is that higher education's mission keeps expanding. William Massy, professor *emeritus* of education and business administration at Stanford University, refers to the phenomenon as “growth force,” by which he means that new fields of endeavor do not generally displace existing fields so much as they accrete on top of those fields. To take one contemporary example, as colleges expand departments of computer science in their engineering schools, they do not simultaneously shrink or disassemble their older departments of civil, electrical, and chemical engineering. Additionally, due to growing compliance requirements, market demand for student services, and specialization in the field—entire professions have emerged and flourished in the span of a few decades in areas like academic advising, financial aid, and student services—college and university staffs often rival the faculty in size.

Often, more than 75 percent of a college's total operating budget consists of personnel expenses, including the rapidly rising cost of benefits. According to the Delta Cost Project, the higher education workforce grew 28 percent between 2000 and 2012, more than 50 percent faster than the rate of growth in the preceding

decade. Taken together, increases in both personnel costs and the number of employees on the payroll create remarkable pressure for cost reduction elsewhere in the budget.

### Contributing to Discussion of the Higher Education Business Model

Imagine you were asked to fashion the business *pro forma* for the institution you serve as a board member. On one side of a ledger sheet, you would list the revenues at your institution's disposal. They would include fees (tuition, room, and board) paid directly by your “customers.” Your first realization would be that, while that revenue stream is large—the largest single source of revenue at most colleges and universities—it constitutes on average less than half the institution's total revenues. The balance would come from a variety of other sources: state and local subsidies, federal financial assistance programs, gifts and donations, patent and trademark royalties, auxiliary services, and interest on endowment.

Your second realization would follow close on the heels of the first. Revenues are volatile and generally subject to unpredictable swings from year to year. That is particularly true of revenues from state governments. Federal revenues come principally from established financial assistance programs (Pell Grants, veterans' benefits, and other categorical grant programs), which have generally increased in real terms over the last decade. Whether that trend will continue in the future remains unknown. However, no single factor has had a greater impact on the business of higher education over the last 20 years than the shriveling of state appropriations on a per-student basis in support of

# THE BUSINESS OF HIGHER EDUCATION

public two-year and four-year institutions. According to the American Academy of Arts and Sciences, state and local appropriations, which accounted for 33 percent of the cost of educating a full-time-equivalent student at public research universities in 2000, now account for less than 20 percent of that cost—a startling drop in barely more than a decade. Although higher education is typically the third-largest area of expenditure in state budgets (after elementary and secondary education and Medicaid), state support has become increasingly untethered from the size of institutional enrollments, even as the number of students entering public universities has grown substantially.

On the opposing side of the ledger sheet, you would list institutional expenses. Think for a moment about the extraordinary range of operations and services your institution provides. The institution is, of course, principally a provider of education. It operates libraries and classroom buildings. It employs faculty members. Education is, in business speak, its primary business line.

But consider how many subsidiary lines are also part of the business. Your institution is a landlord. It operates residential facilities, often on a substantial scale. It manages retail operations such as restaurants, bookstores, and garages. It provides healthcare and psychological counseling to students and sometimes faculty and staff members. It has the functional equivalent of a police department with a fleet of motor vehicles. It manages a sophisticated computer and data management infrastructure. And many of the nation's largest institutions are in the business of basic research and development at least as robustly as they are in the business of undergraduate education.

In sum, colleges and universities embrace many services that are at some remove from the traditional business of educating students in classrooms, making it harder to speak of the “business” of higher education as though it were a single “product line,” as an economist would say. Members of the public and their elected representatives often have strong opinions about what priorities colleges and universities should have—whether undergraduate teaching, partnering with employers, providing specific services for the community, or others. But they often don't have a clear understanding of how higher education institutions operate, especially given the complexity of the enterprises.

Colleges and universities are now typically suspected of core operational inefficiency and are criticized because they cost too much and deliver too little. Trustees are uniquely positioned to not only respond but also contribute to public understanding of the demand, price, and cost distinctions that shape the business of American higher education. There is a story to tell, and whether in the company of friends, community leaders, or others, board members should be prepared to discuss a few key propositions in an informed way:

**1. The cost of attending college is not as high as many people believe.** First, a vast range exists in the published prices of American colleges and universities, notwithstanding the relatively high prices of the most prestigious and selective among them. Further, the press and partisan politics have done little to help explain substantial differences between the cost of educating a student, published tuition, and the net tuition students pay. The public is generally not aware that students receive all the subsidies and tuition discounts that they do.

**2. The value of a postsecondary credential has never been higher, as reflected by the record number of young adults enrolling in the nation's colleges and universities.**

While earnings for bachelor's degree recipients have fallen in real terms, they have fallen far less than for those without a college education. Even as the cost of attending college has increased, the earnings premium for American college graduates has remained among the very highest in the world. And the advantages go far beyond earnings: college degrees are associated with an array of quality-of-life benefits for individuals, communities, and the larger American society.

**3. Colleges and universities are highly complex from a business perspective, for understandable reasons.**

Today's college experience is not your mother's or father's college experience. Students can now attend institutions offering more academic choices, a greater range of co-curricular enrichment, more counseling and support services, broader residential and dining choices, and more career relevance than ever before. The net result is that, while students and families largely do not understand how, colleges continue to find ways to maintain and enhance their value and respond to growing market demands.

**4. Colleges and universities—far from being oblivious to the problem of rising tuition—are implementing reforms designed to improve cost transparency and keep college affordable.**

Colleges and universities where tuition is rising at a higher-than-expected rate must complete a "College Affordability and Transparency Form," mandated by the U.S. Department of Education, to explain why and provide a cost-containment plan. In some states, tuition increases have been legislatively limited and even eliminated altogether. Some community colleges have already implemented programs to reduce tuition costs all the way to zero. Meanwhile,

tuition increases at many independent institutions, once a foregone conclusion, have slowed or stopped.

While government regulation has played a role, much of the improvement in affordability stems from the fact that today's higher education's leaders are aggressively responding to the public's concern about the cost of attending college. They are rethinking their business practices and identifying efficiencies. They are cutting administrative expenditures, renegotiating contracts, reducing energy consumption, and refinancing debt. They are using data analytics to obtain intelligence to help enhance productivity and make good budgetary decisions. They are pursuing partnerships and cooperative agreements and, where appropriate, outsourcing programs and services. More work is needed, but today's cost of attending college is actually the result of serious efforts by college and university leaders to contain it.

**Due in part to its sheer vastness, American higher education has proven extraordinarily susceptible to anecdotal critique. Colleges and universities are now typically suspected of core operational inefficiency and criticized because they cost too much. Yet while those views are partially legitimate, an honest assessment of American higher education requires taking stock of factors that distinguish its business model from those of other industries in our immense national economy. Few laypeople are able to do this well, and policymakers have little tolerance for complexity amid growing populist skepticism. More than anyone else, board members are distinctly positioned to clearly and accurately tell the story of the business of higher education—and, in doing so, contribute to public understanding of this sector that is so vital to the future advancement of individual Americans and our nation.**

## Resources

- Jaison R. Abel and Richard Dietz, "Do the Benefits of College Still Outweigh the Costs?" *Current Issues in Economics and Finance*, 20(3). New York, NY: Federal Reserve Bank of New York, 2014.
- David H. Autor, "Skills, Education, and the Rise of Earnings Inequality Among the 'Other 99 Percent.'" *Science*, 344(6186), 843-851. Washington, D.C.: American Association for the Advancement of Science, 2014.
- Sandy Baum, *Financial Aid and Enrollment: Questions for Boards to Consider*. Washington, D.C.: Association of Governing Boards of Universities and Colleges, 2015.
- Margaret Cahalan and Laura Perna, *Indicators of Higher Education Equity in the United States*. Washington, D.C.: The Pell Institute, 2015.
- The College Board, "Trends in College Pricing 2016." *Trends in Higher Education Series*. New York, NY: The College Board, 2016.
- Donna M. Desrochers and Rita Kirshstein, "Labor Intensive or Labor Expensive? Changing Staffing and Compensation Patterns in Higher Education." *Delta Cost Project Issue Brief*. Washington, D.C.: American Institutes for Research, 2014.
- Jim Hundrieser, *What Boards Need to Know About Enrollment Management*. Washington, D.C.: AGB Press, 2015.
- Jennifer Ma, Matea Pender, and Meredith Welch, "Education Pays 2016: The Benefits of Higher Education for Individuals and Society." *Trends in Higher Education Series*. New York, NY: The College Board, 2016.
- OECD, "Education at a Glance 2016." *OECD Indicators*. Paris, France: OECD Publishing, 2016.
- Pew Research Center, *The Rising Cost of Not Going to College*. Washington, D.C.: The Pew Research Center, 2014.
- Public Agenda, *Public Opinion on Higher Education*. Brooklyn, NY: Public Agenda, 2016.



THE BUSINESS  
OF HIGHER  
EDUCATION

The  
Guardians  
Initiative™

Reclaiming the Public Trust

**AGB** ASSOCIATION OF  
GOVERNING BOARDS  
OF UNIVERSITIES AND COLLEGES

1133 20TH STREET, N.W., SUITE 300, WASHINGTON, D.C. 20036

[WWW.AGB.ORG/GUARDIANS](http://WWW.AGB.ORG/GUARDIANS)