

MOVING BEYOND COLLEGE

RETHINKING HIGHER
EDUCATION REGULATION
FOR AN UNBUNDLED WORLD

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Executive Summary

In the face of increasing costs and lackluster outcomes, traditional higher education is under increasing pressure to prove its value proposition. Meanwhile, new providers have “unbundled” the components of a postsecondary degree or certificate, offering stand-alone courses or sequences of courses, targeted job training, and assessments and certifications, often at much lower cost than existing institutions. These models cannot deliver all of what a traditional college or university does, but they can provide affordable, flexible, and customizable opportunities to learn.

As unbundling in higher education has accelerated, reformers have asked whether there is a role for federal aid dollars to play in facilitating access to these new opportunities. This, in turn, has raised questions as to whether the traditional approaches to regulating postsecondary education at the state and federal level are well suited to this new ecosystem. The entire regulatory system that governs postsecondary education—from financial aid policy to quality assurance to data collection and transparency—is premised on the institution as the key unit of analysis. Students who wish to access federal aid must be enrolled in degree- or certificate-granting programs at accredited colleges. Shorter-term training, sequences of courses, and prior learning assessment are typically held at arm’s length.

That the existing quality assurance system is ill-designed for this new world is abundantly clear. Less clear, however, is what should replace it. Simply lowering barriers to entry such that federal money can flow to a much wider array of providers would invite waste, fraud, and abuse. Thus, this policy brief outlines potential regulatory approaches and tools—many of which would work well in combination—that policymakers could use to facilitate access to this unbundled market while protecting consumers and taxpayers.

First, we discuss a series of reforms to the federal approach to quality assurance: increased transparency, a chartering model, and an outcomes-based accountability framework. For instance, policymakers could require innovative providers to opt in to additional data collection and reporting to be allowed access to federal aid. A chartering model would empower new, independent authorizers to govern market entry and hold providers accountable over time. Finally, reformers could also develop an outcomes-based approach focused on value that measures labor market outcomes and student satisfaction relative to an institution’s total expenditures.

The second section presents a couple of ways that policymakers could rely on private financing to bear some of the risk in quality assurance. For instance, new providers could be required to put up private capital to become eligible for federal aid. In addition, the government could employ a “pay for success” model—perhaps through a social impact bond—in which providers could be reimbursed if they reach agreed-upon outcome benchmarks. Lastly, at the individual level, the government could create space for private financing, such as income share agreements, that could help students access worthwhile options.

The third section argues that policymakers might also choose to wait for the market to mature on its own and let consumer demand and competition drive innovation. Market pressure, not government, may better facilitate the emergence of a high-quality unbundled market, though this pathway may limit access for students who lack the necessary resources.

We do not recommend one approach over the others but instead suggest that policymakers should carefully experiment with them. Such experimentation can lay the groundwork for a more comprehensive reform to the entire federal aid system as we learn more about what approaches prove successful.

Moving Beyond College: Rethinking Higher Education Regulation for an Unbundled World

This paper is the fifth in a series examining higher education quality assurance from a number of perspectives.

Amid a chorus of concerns about quality and cost in American higher education, a range of new post-secondary models has emerged as an alternative to the traditional system. In particular, entrepreneurs have asked why the ability to provide college-level courses should be reserved for only colleges. Digital content and smart people are abundant, and advances in technology have made it possible to deliver that content and assess learning at a far lower cost and without respect to geography. In response, organizations have developed modular—or unbundled—offerings powered by technology that target both adult and traditional college-age learners. Although these models cannot deliver all of what a traditional college or university does, they can provide affordable options that are more flexible, targeted, and customizable.

This development is not unusual. In every industry, the early successful products and services often have an interdependent architecture—meaning that they tend to be proprietary and bundled. The reason is simple: when a technology is immature, to make the products good enough so that they will gain traction, an organization has to wrap its hands around the system architecture so that it can wring out every ounce of performance.

As a technology matures, however, it eventually overshoots the raw performance that many customers need. As a result, new disruptive innovations emerge that are more modular, and customers become less

willing to pay for things such as raw functionality and increased reliability. Instead, they start to prioritize the ability to customize a product to their individual needs at an affordable price. Customizing a bundled service is expensive because it forces a full redesign of the underlying system architecture, but customizing a modular offering is affordable because it is merely a matter of mixing and matching discrete parts that fit together in well-understood ways.

The computing industry provides one illustrative example. The Dell desktop computers that disrupted Apple and IBM's personal computers were modular devices, as Dell made none of the parts internally but instead purchased them from manufacturers such as Seagate, Intel, and Microsoft. This modularity enabled Dell's customers to specify the features and functions they wanted, and then Dell could assemble and deliver them an affordable computer within 48 hours.

A similar unbundling has taken place in the newspaper industry. Newspapers are in fact a bundled offering that perform many functions—including allowing people to sell used goods, find a job, become well-informed, and make commuting time more productive—even if readers historically chose which aspects they consumed. As such, it has not been just news websites and blogs that have disrupted newspapers but also services such as Craigslist, Cars.com, Zillow, and Monster.com, along with new, affordable hardware such as smartphones and tablets.

The early days of such unbundling may be underway in higher education. Universities emerged in the 17th and 18th centuries primarily as teaching institutions, but most gradually evolved to become expensive confections of three very different value propositions

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around research, teaching, socialization, and networking. The bundling of research and teaching, in particular, made sense. In a world where knowledge was scarce, it was crucial to have those who did the research also teach students about their field and what they were learning and to bring those researchers and students together in the same place. Universities have relentlessly worked to perfect this bundled paradigm by layering more and more services, academic departments, and research facilities onto existing institutions.

Regulators' continued reliance on the bundled model has constrained new entrants' ability to compete with existing institutions on a level playing field.

But the bundled model is unavoidably expensive; as the wages for highly educated workers grow in the rest of the economy, institutions must pay professors more even though they teach the same number of students every year. Meanwhile, the competition for prestige leads campuses to invest in things that will attract the best students and the best faculty but may have little to do with the core business of teaching and learning. Moreover, the university's different value propositions inevitably rub up against one another, particularly when public funding is tight; maintaining each of them requires significant coordination of overhead costs—in the form of administration—which takes resources away from research and teaching.

The rise of the Internet has arguably changed this equation, making access to knowledge—and even the experts themselves—abundant and not dependent on place. Students can now access inexpensive college-level coursework and exams from anywhere in the world. The Internet has also changed both the kinds of jobs people want and the training they require as it has lowered the cost of founding educational organizations, recruiting students, and delivering content.

The result is a new opportunity for firms to offer stand-alone courses and career-preparation programs that reflect the skills that are currently in demand. Online

course providers such as Udacity and Udemy have worked with employers to create new courses, assessments, and credentials that are tailored to the changing needs of employers. New place-based programs, such as General Assembly and Dev Bootcamp, have also popped up around the world to provide immersive and condensed blended-learning programs as well as individual online courses designed to prepare students for jobs in the tech industry. Offerings such as these enable people to customize their education at a relatively low cost.¹

As increasing numbers of people question the value of the bundle traditional colleges and universities offer, the unbundling of college into its component parts—courses, assessments, credentialing, even campus life and personal growth—will continue to pick up steam.²

The challenge is this: although this unbundling has already begun, the entire regulatory system that governs postsecondary education—from financial aid policy to quality assurance to data collection and transparency—is based on the idea that the institution is the fundamental unit of higher education and that the traditional degree is its currency. To access federal grants and loans, institutions must be approved by an accreditation agency; individual degree programs or courses are part of the bundle, but they are not individually eligible to receive student aid. To qualify for grants and loans, students must be degree- or certificate-seeking; those taking key courses that build skills but do not culminate in a degree are out of luck.

As unbundling becomes more common, of course, these units of analysis (institutions and degrees) will become less relevant to students. Rather than picking institutions and degrees, students in the unbundled market choose individual courses or discrete programs and learning experiences from a mix of organizations. Regulators' continued reliance on the bundled model has constrained new entrants' ability to compete with existing institutions on a level playing field. If students have a choice between a low-cost program that they must pay for out of pocket and a more expensive one for which they can use grants and loans, many will choose the latter. These constraints have led to a scenario in which potentially disruptive entrants that could lower costs and better serve student needs are at best kept on the periphery of the system and at worst unable to attract students.³

Fortunately, the prospect of unbundling has given rise to a serious discussion of how the government could reform its regulatory regime to level this playing field. In particular, assuming public subsidies will continue to be important in ensuring access to higher education, policymakers will need to address what the government is able to fund and how it exerts quality control. But even if government funding is not a crucial part of the future because low-cost business models and new financing mechanisms emerge, the government—at both the federal and state levels—will still have a regulatory role in licensing education institutions and regulating private funding mechanisms.

Trying to ensure quality across a proliferation of courses and providers is a challenging task in itself; doing so with regulatory tools created a half century or more ago is extremely difficult. The traditional accreditation system seems unlikely to step up and approve these unbundled approaches at the rate they are appearing. An outcomes-based approach would enable a broader array of organizations to operate, but externally validating outcomes can be difficult—it is tough to attribute wage increases or employment to one course versus another educational experience. At the same time, a regulatory policy designed to evaluate these experiences on the front end would be difficult to execute because of the thousands of courses and learning experiences to evaluate.

Because this is an emerging issue, this conversation is evolving. This policy brief attempts to lay out potential approaches and tools—government-administered quality assurance, new approaches to financing, and market-based accountability—that policymakers could use to encourage the emergence of an unbundled market. The idea here is not to fetishize one particular approach but instead to create space for new offerings that can be customized to meet the needs of different students and at prices those students can afford. The paper offers three basic approaches, each including at least two specific pathways that provide a sense of how a policy might accomplish these ends. We also discuss some of the pluses and minuses of each approach.

The different approaches are not mutually exclusive, but they fall into three broad categories. More specifically, the first section describes reforms to federal financial aid policy and regulation that would broaden

eligibility for public money to a wider range of providers. These reforms range from the least intrusive, such as ensuring transparency and letting consumers decide, to more involved government quality-assurance mechanisms, such as outcomes-based regulation. The second section discusses different ways that policymakers might rely on private financing to shift a good deal of the risk to the private market. The third section suggests that policymakers may simply want to wait for the market to mature on its own and let consumer demand and competition drive innovation.

No one tool will be a magic bullet, and pushing for a comprehensive reform to the eligibility rules governing federal student aid programs would be a mistake at this early stage. We have much to learn about this emerging market. Therefore, the most prudent strategy at this stage is for policymakers to experiment with these different approaches and tools and mix and match them to learn about the strengths and weaknesses of each. The key is to find areas to test new regulatory approaches that will maximize our ability to learn about the likely effects of unbundling while limiting taxpayer and consumer risk. Policymakers can then expand those experiments that prove successful while discarding those that are not.

In addition, the lessons of disruptive innovation suggest that attempting to overhaul the entire system is a political nonstarter and a fool's errand. When policymakers try to change existing regulations that fundamentally threaten the status quo, the leading organizations that have built large, successful business models under that status quo will predictably fight to preserve the current order. They will typically win those battles, or at the very least water down any reforms that threaten their position. Regulations are easier to change once a clear alternative to the existing system emerges, complete with new entities that would stand to benefit from changes and have significant resources to support reforms.⁴

Government: Allowing New Providers to Receive Federal Aid

Some reformers argue for expanding the range of providers who can receive federal aid vouchers to include organizations other than degree-granting colleges and

offerings other than certificates and degrees. This naturally raises questions about quality assurance and accountability. How might policymakers create space while also maintaining a modicum of accountability? We discuss three tools here: enhanced transparency to facilitate market accountability; a chartering model; and a new, outcomes-based quality assurance process.

Let federal aid flow to unbundled providers, but require new levels of transparency around prices and outcomes. Pell Grant and federal loan dollars are vouchers; they allow students to take that money to the school of their choice. But the logic of market discipline—where consumers “vote with their feet” by rewarding quality providers with their business—depends on consumers having sufficient information on providers’ cost and quality to make these decisions. The truth, though, is that not all colleges serve students equally well, and it is difficult for students to distinguish the worthwhile investments from the bad ones.

That is because we lack basic data about how well different institutions or programs actually prepare their graduates for life after college. The current system is instead rich in information about the inputs—who colleges select and who they deny, what they spend on education and related expenses, percentages of alumni who give money, and so forth. Attention to these measures drives many colleges to try to outspend their counterparts on selected students instead of demonstrating real value.⁵ But linking colleges to student outcomes after they graduate would require regulatory changes to connect data from different government sources, as well as reforms that would make that information publicly available.⁶ Some states have already built such databases with the assistance of federal funding, but they are limited in their ability to follow graduates across state lines and measure student loan repayment.

An alternative would be to set up a path to eligibility for student aid dollars (or state subsidies, perhaps) that allows providers into the program in exchange for collecting and publicizing outcome and cost data. Various organizations could create dashboards, ratings, and rankings to help students make better decisions about how to use government dollars. With these transparency measures in place, the federal government could open up these funding streams such that aid-eligible

students could choose among both traditional options and the emerging unbundled ones. Some reformers have argued for decoupling accreditation and federal aid eligibility and replacing it with increased transparency and basic measures of financial solvency.⁷

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This naturally raises questions: what outcomes should we measure, and how do they apply to unbundled providers? Unbundled providers may offer one piece of a student’s educational experience, so it may not make sense to measure the same broad outcomes as we would for an entire program or institution. At the same time, policymakers would want to do more than just measure completion rates or the rate at which students pass end-of-course or end-of-program assessments developed by the provider.

One way to confront these problems is to limit eligibility to only offerings that are linked to discrete, measurable outcomes that third parties control. In practice, that could mean limiting funding to offerings that can be linked to at least one outcome from a prescribed set, such as credits accepted for transfer to Title IV–eligible colleges, passage of an established prior learning assessment that is redeemable for credit at an accredited college, passage of licensure or certification exams, or job placement or earnings. In applying for eligibility, providers could choose which outcome measure their program aligns with and then disclose outcome data to any prospective students in regular intervals. Providers that offer courses or programs that do not align with outcomes—those focused on life-long learning or enrichment—need not apply.

The main advantage of the transparency approach is that it is not very intrusive; new organizations that want to receive public dollars could submit to the conditions, whereas others could continue to operate free of public money and additional constraints. Such an approach

would clear away many of the costly, input-based regulatory barriers that currently keep new providers out. And it would also provide students with more information to inform their decisions—perhaps putting pressure on the rest of the system to follow suit if it wishes to remain competitive.

The disadvantages center on the extent to which we can depend on consumers to exert sufficient market discipline. First, education is an “experience good,” meaning it is difficult to evaluate from the outside without actually experiencing it.⁸ An organization that produces top student outcomes may still not be the best fit for a given consumer. Second, evidence from behavioral economics suggests that consumer decision making improves as consumers have more opportunities to make such decisions.⁹ In the traditional higher education market, however, most prospective students will make this decision only a couple times in their lifetime. Third, those whom the current market serves poorly—first-generation students and those from low-income families—have limited social capital that they can draw on to make an informed decision. Even with increased data transparency, sophisticated education providers have incentive to take advantage of this situation by aggressively recruiting uninformed nonconsumers of higher education.

Some elements of a more transparent unbundled market might help consumers overcome these information problems; other elements would make the choice process even more complicated. On the one hand, consumers would purchase higher education in multiple, short bursts and at prices that present less risk and would have opportunities to gain valuable insights. Such a market would lower the stakes of any individual decision. Each purchase would also serve as a learning experience and allow consumers to become better judges of both their own preferences and the providers they can trust.

At the same time, the sheer number of options might overwhelm decision makers. Research suggests that presenting consumers with a wide array of choices may actually decrease their motivation to make a choice at all and lead those that do choose to be less satisfied with their choices than they would be with fewer options.¹⁰ What’s more, the injection of public dollars would likely change consumer behavior by lowering

the stakes of a bad investment decision. Investing with other people’s money can lead students to make decisions that do not reward value and discipline providers.

Employ a “chartering model” to approve select providers. These challenges suggest that expanding eligibility may require additional quality assurance mechanisms beyond simple transparency. A chartering model, in which an independent authorizer plays a consumer protection role on the front end and holds providers accountable over time, could mitigate some of the previously mentioned risks.

Today the federal government essentially outsources the decision of which institutions can access federal funds to recognized accreditors—nonprofit peer-review organizations that, in many cases, were created nearly a century ago by the member institutions (colleges and universities) themselves. These organizations, for many predictable reasons, are not eager or easily able to accredit new types of postsecondary education that look nothing like a traditional college—online course providers, immersive short-term training organizations, exam-based credentialers, and so on.¹¹

To change this, the government could instead create a process by which the Department of Education could recognize new third-party organizations that are empowered to authorize different forms of higher education on the basis of clearly established criteria. The key would be to delineate the basic criteria by which these new authorizers could hold new providers accountable—financial solvency, student outcomes, employer and student satisfaction, and requirements around data and transparency. Reformers might also consider prohibiting evaluation based on certain measures—the assorted inputs and processes that accreditors measure now—to ensure that these new authorizers are not simply captured by the traditional system. This approach would mirror the charter school movement in K–12, in which independent authorizing boards approve new schools and hold those schools accountable through regular renewal processes.

One proposal along these lines—offered by entrepreneur Steve Klinsky and the Center for American Progress’s David Bergeron—calls on the federal government to recognize a new accrediting body, the Modern States Accrediting Agency. Modern States would be designed

to approve both specific online courses themselves—massive open online courses (MOOCs), for example—as well as innovative certificate and degree-granting programs.¹² Its initial incarnation (the Modern States Educational Alliance) is working to create a MOOC-based path to a year's worth of credit. Students would take MOOCs provided by edX—a nonprofit governed by MIT and Harvard that offers free online courses—to prepare for Advanced Placement or College Level Examination Program exams that they can then redeem for credit at a number of colleges.¹³

But the long-term goal is to get Modern States recognized as an accreditor in the eyes of the Department of Education, which would enable it to grant aid eligibility to these new organizations. Klinsky and Bergeron describe Modern States as a “a voluntary association of philanthropies and nongovernmental organizations concerned with increasing access to high-quality education while lowering its cost—groups such as the Bill and Melinda Gates Foundation, the Ford Foundation, the World Bank and so on.” They add, “Employer and labor groups could join as well, as could providers of the innovative courses, student consumer groups and others.”¹⁴ The array of interests would ensure that the organization is beholden not to the interests of its members but instead to its founding mission to further the unbundling while lowering costs and maintaining quality.

The advantage of this approach is that it could create a new path for innovative programs and simplify the authorization process while maintaining quality control. And charter schooling in K–12 education provides lessons for how the authorization process can work well and pitfalls to avoid. As Kevin J. James argued in an earlier paper in this series, independence and capacity are key to a rigorous authorizing process.¹⁵

But there are several questions about the approach, as well as potential downsides. How would the Department of Education authorize one third-party accreditor over other potential groups, especially one associated with foundations that are themselves not free of controversy, without provoking a backlash? Doing this might also feel like a head-on attack on the current accreditation system rather than a small experiment, which could make it more controversial among the supporters of the traditional system.

An accrediting body with a mission like that of Modern States would also face sizable challenges. Given all the educational options emerging, avoiding a backlog of applicants would be difficult. Establishing sound criteria that are not simply input-based and predicated on promises is a significant challenge, particularly when truly new institutions will by definition not have a track record of success. Such an authorizer could easily engender controversy by picking winners and losers—either rejecting worthy options that do not mesh with the organization's vision or keeping poor performing ones simply because they do.

There are other options along these lines as well. The Senate Committee on Health, Education, Labor, and Pensions recently published a white paper that lays out the possibility of devolving the power to recognize new accreditors to the states, as a bill from Senator Mike Lee (R-UT) suggests.¹⁶ States could then create alternative accrediting organizations that would have the power to grant eligibility for Title IV to nontraditional postsecondary offerings.

Create a quality-value index for new entrants. The prior two approaches both allow organizations to receive Title IV dollars once they are approved, which, as previously discussed, poses risks given that the injection of public dollars would likely change consumer behavior by lowering the stakes of a bad investment decision. Federal policy could be more intrusive by opening up a path to student aid based on measures of labor market outcomes and student satisfaction relative to an institution's total expenditures.

This outcome-based measure—a quality-value (QV) index—would create an alternative path to federal financing that would not, at least initially, compete with existing organizations for Title IV dollars.¹⁷ It also would not create all-or-nothing access to federal dollars, as the existing system does. Instead, the better a program performs on the measure compared to its peers, the more of its educational operation it could finance with federal aid. Because more aid would be available for those programs that performed best on the measure, this sliding scale would, in turn, encourage students to make decisions based on quality and total cost.

One proposal for a QV index would have the government add together three measures and would likely

be most applicable for alternative providers, such as coding boot camps or Udacity's nanodegrees, that offer more than just one-off courses. The first measure is a job- or school-placement rate—in other words, does the organization help a student get to where he or she wants to go? The second is how much the students' earnings increase compared to their prior expected earnings over a period of time after leaving the institution, relative to the institution's total expenditures. The third is based on a survey of customer satisfaction: knowing what they now know, would alumni choose to repeat the experience?

This system offers solutions to some of the drawbacks mentioned for other options. Students would feel pressure to make investment decisions based on the track record of one investment versus another because it would be easier to receive financing for programs that offer higher value. A 10-week, focused program with minimal accoutrements that had a good track record of placing students into high-paying jobs and boasted high student satisfaction would be eligible to finance more of its operations through federal dollars than would a traditional two-year experience that had high expenditures and less impressive outcomes. Because the system departs from the current all-or-nothing approach to eligibility, policymakers would escape the current system's constraints that discourage setting the bar for eligibility for Title IV dollars too high lest it curtail access and cause institutions to continue to compete against one another in a veritable arms race—constantly looking for ways to one-up peer institutions when it comes to amenities and student services. Instead, all institutions would experience demand-side pressure to deliver for students at an affordable price. Potential students could also gain insights into whether alumni would choose to repeat the experience. Finally, this would be a more scalable way to measure the quality of postsecondary institutions compared to creating assessments to measure learning and competencies, given that students attend postsecondary institutions to gain many different types of academic or vocational skills and that the various needs of society and the workforce are constantly evolving.

There are some downsides to this proposal as well. A potential one is that by tying funding to outcomes, the government would in essence be declaring what

quality is and making de facto decisions about what to fund and value. That said, the government is arguably doing that already, as it values nearly unbridled access to traditional institutions regardless of quality or cost. This version of the QV index also tries to mitigate worrying about the economic return of a degree by including whether past students would choose to repeat the experience.

It is true, however, that the QV index would likely rate expensive institutions that send graduates into low-paying public-service jobs, for example, as being poor and therefore could lower the government subsidy to those education experiences, particularly if less expensive unbundled options can produce comparable outcomes. More to the point, the formula is open to manipulation based on political motive, which means that the government could have significant influence on the higher education system based on its own whims, not necessarily the priorities of students, society, and employers.

Another big con is that the unintended consequences of a technocratic system like this are unknown, which is a key reason that any experimentation in this area should start small. This is especially true given that the system would be looking at *past* outcomes to determine funding levels, not current quality.

Finance: Have Private Capital Share the Risk

Policymakers have tended to guard against the frailties of consumer choice by using government regulatory power to set standards that will protect consumers from the worst actors—ideas we discussed in the last section. But regulatory policies and political actors themselves have regularly lacked the political will to end financial aid access for programs that underperform. Meanwhile, program integrity concerns have made the government risk averse when it comes to new models that do not fit into the traditional mold.

Another option is to leverage private financing to shape the demand and supply sides of an unbundled market. Specifically, requiring providers and students to raise some of their financing from the private market would rely on private investors to ferret out the most valuable providers and models and steer taxpayer

dollars toward those options. Investors who wish to maximize returns will relentlessly seek out valuable options in ways that consumers are often unable to because they lack the information or the experience (or both) that would allow them to do so. In this way, private financing can exert the kind of market discipline that is so often lacking.

How might policymakers leverage private financing to help promote quality assurance in an unbundled market? Two ideas jump out: requiring providers to put up some of their own capital as a prerequisite to market entry and reimbursing them based on their success (a variation on “pay for success”), and creating space for individual-level financing tools such as income share agreements (ISAs).

Require new providers to cover upfront costs and be reimbursed based on success. Allowing public money to flow to new models is inherently risky. Consider a system where the government allowed eligible students to take need-based vouchers to different unbundled providers. To limit the risk to taxpayers and students, policymakers could require providers to put up private capital—either their own or raised from third-party investors—to become eligible for federal aid. This could take one of two basic forms.

First, new applicants could put up a bond that would be held in the event the provider fails to meet outcome standards. This first approach is quite common at the state level, where regulators often require that postsecondary institutions put up a surety bond.¹⁸

Alternatively, providers could cover the upfront costs of educating aid-eligible students and be reimbursed on the basis of their rate of success. This second approach is essentially a “pay for success” model. A variation on that—the social impact bond—entitles investors to a return if the provider exceeds agreed-upon outcome targets, but it requires a discrete outcome that results in savings for the government. Both models limit taxpayer losses up front. The upfront cost may also scare off providers who are less willing to take on the risk of failure.

The key insight here is that a system that requires new entrants to put up capital gives providers greater “skin in the game” than one in which they get full access to government money. In many cases, providers would have to go to the financial markets to raise the

necessary funds. Banks or investors would only provide those funds to models that have a decent chance of success; fly-by-night providers with a short-term business model would have trouble attracting the necessary investment. Providers with a strong record of success would be a good bet. In other words, such a system would effectively enlist private markets in ensuring quality.

Providers could cover the upfront costs of educating aid-eligible students and be reimbursed on the basis of their rate of success.

In some cases with discrete, measurable outcomes, policymakers might consider a social impact bond approach. Under a social impact bond, an intermediary pairs funding from private investors with an organization offering a particular social service. The intermediary and the government enter into a contract where the private funds cover upfront costs and investors are reimbursed—or paid a return—by the government based on identified outcome measures.¹⁹ One area that seems amenable to a social impact bond approach is remediation—sub-college-level classes offered on a college campus to get students up to speed. Helping students avoid remediation saves money on a cost-per-credit basis and is a clear, measurable outcome.²⁰ With help from investors, unbundled providers might offer diagnostic tools and additional preparation for free or at a low cost and be reimbursed on the basis of their success.

Of course, there are drawbacks to this approach. An obvious one is that such a system might actually have trouble attracting enough firms that are willing to take on the risk of paying for success, especially if government aid goes to low-income students. The upfront costs of educating needy students may be greater than the expected downstream benefit.

Such a system might also be biased against new models that are largely unproven. Investors may favor existing models that have been in operation long enough to have a track record of success, perhaps freezing out ideas

that represent a more radical departure from the status quo. We see this as less of a concern. For one thing, the incentive for investors to fund models with a track record of success is one reason private capital can help with quality assurance in the first place. In addition, promising innovations should be able to attract private capital in the absence of government money, giving them a chance to build their own record of success.

Policymakers should also acknowledge the alternative problem—investors speculating aggressively across many different organizations in an effort to pick a couple of winners. To the extent that providers are reimbursed for outcomes, few taxpayer dollars would be at risk. But failure would cost students time and, in many cases, some of their own money. It might be worth considering how these financing tools may work in concert with the other ideas listed here (transparency or chartering).

Provide need-based grants and create space for private financing that spreads risk across students and investors. At the individual level, policymakers might consider how new private financing tools, in conjunction with need-based grants, can help nudge students in an unbundled market toward high-quality providers. For instance, under an ISA, a for-profit or nonprofit investor provides a student with financing to cover the cost of education in exchange for a percentage of the student's future income for a defined period of time after the student finishes school. There is no principal balance to repay: depending on the level of success after school, the student may ultimately pay more or less than the amount financed.²¹

ISAs are essentially equity investments in students; the investor shares in the profit—or loss—of an investment. Students who enter into an ISA pay more to their investor if they are successful in exchange for being able to pay less if their educational investment does not pan out. This approach provides strong downside protections for students and is also designed to be forward-looking by making it easier for students of all backgrounds to obtain financing than is currently possible under the private loan market. Most important from a quality assurance perspective: because ISA investors earn a profit only when a student is successful, they have strong incentives to seek out the most valuable

programs and support students both during their education and after graduation.²²

When it comes to the unbundled market, ISAs bring a number of strengths. First, investors have every incentive to analyze which courses and programs help prepare students for success. Compared to the individual student faced with myriad choices, ISA providers will have a more sophisticated understanding of the costs and benefits of different programs for different students. As such, they can help drive students toward programs that are likely to help them be successful, protecting consumers and enhancing market discipline.

At the same time, because no taxpayer dollars are put at risk, ISAs open a space for innovative education providers who are currently shut out of the federal financial aid process through accreditation and other regulatory barriers. The combination of available financing and effective underwriting could help valuable pathways emerge from the unbundled market.

If ISAs are privately funded, why do policymakers have any role in this discussion? The ISA market suffers from a lack of legal and regulatory clarity. This uncertainty has constrained the number of investors who are interested in entering the market. Current law is not clear on the enforceability of ISA contracts, and no established federal regulator exists for ISA products. Congress could work to clarify these issues at no cost to taxpayers.²³

Relying on ISA funding to catalyze innovation has some potential drawbacks. As is the case in the pay-for-success context, investors might be wary of untested models if employers have yet to accept them and instead opt for traditional, name-brand institutions. This would leave little funding for nontraditional offerings.

Also, it is possible that if ISA funders were available, riskier students would still have a hard time attracting funding, especially given the unique demands of less structured, more flexible paths. Much of what we are learning about the success of low-income students suggests that high-touch, heavily structured programs promote success.²⁴ Some new offerings, such as boot camps, have this structure; others, such as the first generation of massive open online courses, depart from it. The fact that ISAs would funnel students toward options where they are likely to be successful is a benefit, not a bug. But it does suggest a need to pay attention

to and design demonstration projects with such credit constraints in mind.

In general, policymakers should consider experimenting with a mixed system outside of the existing Title IV framework: the government could provide a basic, need-based voucher to students who qualify, and students could then go to the private market to attract any additional necessary capital from an ISA. Such a mixed system would help limit the risk to taxpayers while also ensuring that their tax dollars flow to worthwhile programs.

Markets: Just Wait, Consumers Have Got This

Policymakers, advocates, and entrepreneurs have experienced plenty of resistance in their efforts to leverage innovation and unbundling by changing the regulations that govern the current system. But all of this attention to policy may be misplaced; it could be that market pressure, not government, is most likely to facilitate the emergence of a high-quality unbundled market.

Disruptive change has swept through other heavily regulated industries because of market pressure. Rarely has success for the disruptors come through a head-on attack against regulations that buoyed the status quo. Rather, the disruption prospered in a completely independent value network outside the reach of regulators. Once the new value network had proven itself to be both viable and superior, and once the bulk of the customers had migrated to the unregulated system, regulators responded to the *fait accompli*. Rarely has revised regulation preceded such disruptive revolutions.

For example, Southwest Airlines did not disrupt the airline industry by seeking approval in the early 1970s from the federal Civil Aeronautics Board for discount prices on long, interstate routes. It began flying short routes within the state of Texas, where the federal regulators lacked jurisdiction. The rates and route structures of interstate trucking collapsed under their own weight in the late 1970s after corporations began operating their own truck fleets that fell outside the jurisdiction of the Interstate Commerce Commission.

The same thing may be occurring in higher education. New low-cost, online, competency-based

programs are able to attract students by partnering with employers that are willing to use tuition assistance programs to pay for students' degrees—an end-run around the federal financial aid system. Organizations such as Udacity have created *de facto* accrediting bodies—such as the Open Education Alliance, made up of employers like AT&T and Google—which have generated new educational pathways and credentials that are accessible, affordable, and often free for students.²⁵

It could be that market pressure, not government, is most likely to facilitate the emergence of a high-quality unbundled market.

By partnering with large companies, these organizations are creating an opportunity for employees to learn what they need to know to move up the management chain within their companies. Employers, in turn, can observe firsthand whether those opportunities enhance the quality of their employees' work. Rather than complaining about the raw material they receive from traditional degree programs, employers have the opportunity to build up the skills of prospective workers through targeted, low-cost instruction and assessment. Because the employer is truly the ultimate consumer of the graduates in training, employers—not accreditors—are the only ones who need to be persuaded of the value of an unbundled education system. In bypassing the system of accreditation and creating a separate and compelling value network of employers, these programs have the power to challenge the status quo.

Of course, in the absence of any public aid, low-income students might still find themselves locked out of opportunities that could help them succeed. If employers foot the bills in this parallel system and some sort of credential after high school is increasingly the key to employment, those who lack that key will be locked out.

But the biggest con to this pathway is its slow and uncertain nature. Although this may be the inevitable direction, organizations, students, and employers will have many issues to navigate in the years ahead to gain

traction, improve, and grow. Even if ultimately successful, many students will continue to be stuck in the current system with all of its limitations.

Conclusion

As the unbundling of higher education accelerates in the years ahead, policymakers and regulators at the federal and state levels will confront a variety of choices in how to facilitate or slow its growth and regulate its quality. Although this unbundling movement is still in its early days, policymakers have a variety of levers—including new mechanisms that allow providers access to student aid, inviting private investors to share in the risk, and hanging back and seeing how the market unfolds—with which to experiment and learn what serves students, employers, and society well and where the unintended consequences of different approaches lie.

With the reauthorization of the Higher Education Act looming and many states reevaluating their approach to higher education accountability and regulation, it is too early to choose one approach and impose it on the entire system. Instead, the time is ripe to experiment with combinations of these different approaches and to evaluate the results. Many of these approaches can and perhaps should coexist as policymakers search for the right mix of transparency, accountability, and skin in the game. America has traditionally been an innovator in higher education—periodically rethinking what it looks like and whom it serves—and today's policymakers have an opportunity to facilitate the next phase of evolution.

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