AN *INSIDE HIGHER ED* SPECIAL REPORT

Cut Too Deep?

Tuition Discounting at a Crossroads

INSIDE HIGHER ED

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BY RICK SELTZER

Executive Summary

For years, college administrators and board members have closely monitored tuition discount rates at their institutions.

But they haven't always been comfortable with high and often-rising discount rates. Nor have they always had easy access to important context explaining why colleges and universities discount the way they do.

These issues are likely to come to a head in today's rapidly changing higher education market. For all the attention tuition discounting receives from campus leaders and higher education experts, many report the practice causes consternation, misunderstanding and reflexive apprehension.

It's easy to understand why the discomfort persists. The tuition discount rate—the percentage of all tuition and fee dollars institutions give back to their students in the form of merit- and need-based grants and scholarships—has been marching steadily upward for years. One of the most closely watched indicators, the average tuition discount rate for first-time, full-time students who attend private colleges, hit 50.5 percent in 2017-18, according to the National Association of College and University Business Officers. It was the first time the marker eclipsed the 50 percent barrier, meaning that for every dollar private institutions collected from freshmen in tuition and fees, those students received more than 50 cents in financial aid funding, on average.

The discount rate for first-time, full-time freshmen at private institutions rose by more than 11 percentage points over a decade and is expected to keep climbing. And the rate for all students enrolled at private colleges surveyed by NACUBO, while consistently lower than the freshman discount rate, also has been on a long upward trend. It hit 44.6 percent in 2017-18.

This would not necessarily be considered a problem today if colleges were using funded aid, or dollars from endowments, to pay for most of their discounting. But they are not. Colleges never actually collect revenue from much of the financial aid that drives up discount rates. It is nothing but a discount on

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Giving your students more ways to pay

Students graduating from high school are faced with many life-changing decisions; and for those choosing to attend college, one of the big ones is figuring out how to pay for it. Whether you're a student or parent, the idea of taking on student debt is a difficult choice and with college tuition prices steadily increasing year over year, this is an alternative more families must consider. With the current student load debt at $1.49 trillion,[1] students and families struggle with how to address these rising costs, while focusing on the goal of graduating.

At Transact, one of our primary goals is to partner with our client institutions to put students and families in the position to make good financial decisions so they can focus on achieving their desired educational outcome. We help by providing billing presentment and payment services to allow them to easily understand financial obligations and meet those commitments with a variety of payment options, including the use of payment plans.

Payment plans offered directly from institutions provide a means to spread out financial obligations over time, easing the burden of large payment deadlines. These plans can play an important role as part of a student's financial plan to cover their obligation to the school. With the average student loan balance running $31,000,[1] having a means to minimize or eliminate this level of debt is significant.

Our commitment to students and their families doesn't stop there. The breadth of our Transact portfolio includes services across campus—from tuition and fee payments (powered by Cashnet) to credential-driven transactions and privileges to security management. Our open solutions provide convenient and secure transaction services to millions of students creating a connected experience when and where it matters most.

At Transact, we deliver innovative solutions that transform the student experience—starting with the question of how to manage financial obligations and continuing throughout the spectrum of campus life.

Laura Newell-McLaughlin
Vice President, Transact Payments

[1]Federal Reserve Bank of New York. (May 2019). Quarterly Report on Household Debt and Credit. Retrieved from www.newyorkfed.org

sticker prices, one that some observers fear is hurting colleges' financial standing. Thus, colleges increasingly are marking down the price of tuition as if they were JCPenney selling a shirt or an auto manufacturer trying to move last year's car models off the lot.

Nor would tuition discounting be a critical issue today if it were serving some of its highest ideals: enabling institutions to enroll students at different price points based on their ability to pay. In a perfect world, doing so grows the number of students who actually enroll in higher education while also allowing the colleges students attend to generate more total net tuition revenue—because they can use lower prices to fill seats that would otherwise go empty. That revenue, in turn, can be put back into the educational enterprise to benefit all students.

Unfortunately, rising discount rates are increasingly failing to translate into more revenue for colleges—or more students. Net tuition revenue per first-time, full-time student in 2017-18 fell by almost a percentage point at private institutions, according to NACUBO. Small institutions have struggled most consistently to raise more revenue in recent years, with net tuition revenue per freshman falling or failing to rise at small colleges in two of the last four years covered by the association's study.

Private colleges aren't the only ones offering discounts. Nor are undergraduates the only ones receiving them. Public institutions have been using financial aid awards to increasingly buy down sticker prices in recent years, and discounting has taken hold at graduate and law schools.

Yet institutions both public and private are struggling to grow net tuition revenue on a year-to-year basis as the number of students enrolled across higher education stagnates and demographic shifts play out across the country. Those demographics change who, exactly, students are, as well as who they are likely to be in the future. Students today are more racially diverse than they were in the past, changing what they expect from college, the services they need and where they enroll. At the same time, stagnant income growth across large swaths of the country and unequal wealth distributions are impacting families' ability to pay for college.

Tuition discounting was long criticized, however, even when overall student enrollment was growing and net income was rising. Some colleges drew fire for using merit aid, also called non-need-based aid, to lure the most attractive students to their campuses—even if those students could afford to pay more for college. Discounting has also been attacked as creating an opaque market that detaches sticker prices from the actual cost of providing a student with a college education. And some fear sticker prices have risen so high that they dissuade many prospective students from applying to college in the first place, particularly students from underserved backgrounds.

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EXECUTIVE SUMMARY

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Even those who historically have extolled discounting's benefits worry that ever-rising discount rates are starting to squeeze margins, diminish returns and bankrupt institutions. This question is being asked with increasing frequency: How long can sticker prices and discount rates keep climbing before the model reaches its breaking point?

No simple or single answer exists. Discount rates affect institutions of various sizes, market positions and wealth levels in different ways. Some stressed campuses that are currently unable to enroll and retain enough students may already be at their breaking point. Some other strong institutions could easily discount more in the future without creating significant problems for themselves.

New pricing strategies are being tried, like tuition resets and out-of-state tuition matches. Might they shake up the existing discounting paradigm, reconnecting sticker prices to the cost of educating a student? Might they at least buy colleges more time before a reckoning arrives?

A key question going forward is whether colleges can find ways to compete less on price and more on their other characteristics. For example, consultants extol the virtues of emphasizing an institution's value to students, whether that be by building signature programs that stand out in consumers' minds, promoting in-demand academic programs or recruiting by promoting a campus's other offerings, like popular athletic teams. While these strategies may not be new, might they be executed better to refocus students less on price and more on what makes specific colleges and universities unique?

Meanwhile, finance experts point out that there are two sides to balancing a budget. If tuition discounting really has reached a point of diminishing returns in a country where student cohorts are expected to shrink into the future, does higher education need to focus more on cost containment?

Clearly, the tuition discount rate is just one of many characteristics by which a college or the higher education sector as a whole should be judged. Still, it remains a uniquely important metric, because it can provide insight into many aspects of an institution's operations and the market in which it competes.

In order to successfully navigate the future, all leaders at a college or university, from enrollment manager to board member, will need a nuanced view of discount rates and the trends affecting them. This special report seeks to explore those trends and recent developments in discounting. It will review different strategies campuses are deploying as they seek to bolster their budgets and will suggest possible best practices institutions can follow.

No single strategy or set of practices will be useful for every campus. But by exploring key concepts and developments in discounting, leaders can better evaluate their own institutions to prepare a course of action for a smaller-margin future that for many will require smarter pricing and better management.

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CREATING A TUITION PRICE AUCTION

Colleges and universities arguably benefit from asymmetric information under the existing college pricing and admissions system.

The institution, not the student, knows how much it actually costs to provide an education. It is also given the opportunity to collect applications and evaluate its pool of prospects for factors like interest in enrolling and ability to pay—all before it makes financial aid offers that buy down prices for certain students.

Those students, meanwhile, are shown a high sticker price and a slew of other metrics that they may or may not care about, like college rankings and average SAT scores for admitted students. Most applicants don't know how much a college needs to charge in order to break even. Nor do they know how much a college could afford to discount its high sticker price.

Models exist that would turn the current state of affairs on its head. Consider the way airline tickets are sold, which has been revolutionized in recent decades by options allowing consumers to bid for open seats on flights and by fare aggregators that enable

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prospective travelers to see the net prices they will pay at multiple carriers collected in one place.

Could such models work for colleges and universities, many of which also have excess capacity? Economists and change-minded financial aid experts love to ask that question. And one tried to build a service 20 years ago that would move at least some college admissions to something resembling an auction model.

Tedd Kelly, who had spent more than three decades working as a recruiting and enrollment consultant, started the website eCollegebid.org in late 1999. It was shortly after Priceline.com started shaking up airline ticket sales, so Kelly's venture can be called Priceline for colleges.

Salon in 2000 described eCollegebid.org as "a cross between the auction site eBay, Match.com dating service and Priceline.com, which invites customers to bid blindly for discounted travel tickets." Students from the middle class who were considered overqualified for financial aid were described as a key target demographic.

Those using the site were asked how much they could put toward their first-year tuition. They were also asked their grade point average, standardized test scores and what they were seeking in a college.

"It's that easy," the *Salon* article read. "Complete the form, submit a bid and wait between 10 days and two weeks for a school to contact you. The hitch is that bidders have no idea which colleges are participating; as with Priceline.com, it may be a low-budget Valujet or a high-quality Virgin Air lurking behind the curtain."

Kelly told *Salon* that 15 member institutions had signed up and nearly 1,000 student bids had been made. He reported an average student grade point average of 3.0 and SAT score of 1200.

When he launched the site, Kelly was hoping private colleges that weren't widely known but that offered strong academic programs would be core institutional participants. He also pointed to student resistance to taking on loans as a key problem that his service could address.

"When you get right down to it, families don't want to take out loans, and that's where the problems have been in the past," Kelly told *The Chronicle of Higher Education* in September 1999. "Some colleges want students so badly that they'll give whatever aid is necessary to get them."

Participating colleges were to pay eCollegebid.org an annual fee of $2,000.

The site drew both support and criticism. Some counselors hoped it would encourage "healthy matches" between colleges and students. Critics worried the site would reduce the college enrollment process to a discussion about price, preventing students from finding the best fit on other characteristics like size, location or strength of academic program.

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SNAPSHOT: CREATING A TUITION PRICE AUCTION

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Some details also drew concern. The site initially asked students to commit to an offer within a month of receiving it, instead of conforming to the traditional May 1 deadline, for example.

Ultimately, the site didn't catch fire and revolutionize the admissions process. It only operated for about two years.

Kelly has since died. But his son, Mills Kelly, remembers eCollegebid.org.

"He managed to convince a few people to sign up, but mostly he ran into this sense that it was somehow tawdry," says Mills Kelly, a professor of history at George Mason University and former enrollment management consultant. "Higher education is special. It has sort of a mystical aura of wonderfulness around it. To even say 'discount rate' used to set people's teeth on edge."

Tedd Kelly was asked if he was insane. He wondered what makes college special in comparison to other goods or services.

"There were web browsers," Mills Kelly says. "And so he had this idea that you could take the airline pricing model. If it worked for this very successful and profitable industry, why couldn't it work for higher education?"

Mills Kelly thinks his father's idea came two decades too soon. If someone were to launch a similar service today, reactions from many within higher ed might be the same as they were in 1999. But the competitive environment and student demands may have changed.

Mills Kelly talks about a family member who received three different financial aid offers from a set of colleges, calculated her net cost at all three and called their admissions offices to ask if they could do better. One told her that wasn't how the system worked.

In fact, she replied, that is how the system works.

"She told me there was this long silence on the other end of the phone," Kelly says. "And this person said, 'Let me check.'"

Board members understood the eCollegebid.org concept immediately, according to Mills Kelly. Admissions officers, on the other hand, felt they needed to wash their hands after discussing it.

"I think you would get the same response today from board members," Kelly says. "And I think you would get the same pushback from others."

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