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Lessons From For-Profit Institutions About Cutting College Costs

By GOLDIE BLUMENSTYK

It's not just the climbing walls and the salaries for star professors that are driving up the cost of college. In some cases, costs go up because the culture and management of traditional institutions are simply not structured to promote efficiency and savings.

At for-profit colleges, it's a different story.

There the "incentives to save money are centralized," notes Guilbert C. Hentschke, a professor of education at the University of Southern California and co-author of a book about for-profit colleges. As a result, several for-profit colleges employ strategies rarely used by traditional institutionsâ€”such as paying instructors by the student rather than the classâ€”that help them make money.

In this era of tight budgets and growing national scrutiny of rising college costs, might some of the same bottom-line practices work as cost-cutting approaches for nonprofit colleges?

The Chronicle looks at three strategies that help for-profit colleges succeed financially and in some cases pedagogicallyâ€”strategies that might reduce costs in traditional higher education.

Lesson 1: Create faculty pay plans that tie compensation to demand.

American Military University, a fast-growing all-online institution, has an unusual approach to compensating faculty members. It pays them by the student rather than by the course.

University leaders say the "variable-pay model," a cornerstone policy of the institution since its founding in 1991, allows it to keep its expenses and students' costs down while making it possible to offer niche courses like "Civil War Medicine" and "The History of Piracy."

"We can have very small majors," says Frank McCluskey, provost and executive vice president of the American Public University system, of which American Military is a part. He came to the system from Mercy College, in New York. In some of the majors at American Military, he says, courses run with six or seven students. "In my old college, this course would never run."

The university and its sister institution, American Public University, pay instructors $130 per student in undergraduate courses and $150 per student in graduate courses. The maximum pay per course is $2,500, an amount Mr. McCluskey says is "in the ballpark" for teaching gigs of this type, where the instructor does not design the course but just teaches it.

(Courses are designed primarily by teams drawn from the pool of the universities' 140 full-time faculty members, in consultation with instructional designers. Mr. McCluskey says full-time instructors are paid "competitive salaries". The university employs about 600 adjunct faculty members.)

While demand also factors into faculty salaries at traditional colleges, the idea of paying instructors based on the number of students who sign up for their classes would stand thinking about faculty compensation on its head. That could be a good thing, says Mr. Hentschke, particularly at institutions where the bestâ€”and best-paidâ€”professors now often teach classes with the fewest numbers of students.

A pay-per-student model "could counteract the inequities that come from the classic system," says Mr. Hentschke. Or, to avoid creating new inequities, colleges might consider a hybrid of the system, with guaranteed base pay but extra compensation for those with fuller classes.

A former adjunct instructor himself, Mr. McCluskey says he realizes the pay scales his institution offers would present hardships for instructors trying to support a family or even just themselves.

Still, as he notes, many colleges now employ working professionals to teach their online and continuing-education courses, and many of those people are happy to teach at these pay levels. Indeed, American Military has just hired a U.S. Park Service ranger employee with a master's in American history who is based out of the Antietam National Battlefield to teach about the Civil War.

Mr. McCluskey acknowledges that the universities profit under the system, but he insists it's not unfair: The system works "not on the backs of the adjuncts but on the heart of the adjunct."

Others might argue the system is exploitive, or perhaps one more sign of the eroding faculty job market. But clearly some potential faculty members don't find it too offensive to consider. Mr. McCluskey says the universities have 1,000 rÃ©sumÃ©s from would-be faculty members.

Lesson 2: Treat space as an asset with a measurable value.

The executives who run DeVry University and the institutions of Corinthian Colleges Inc. routinely cite a statistic you rarely hear from presidents of traditional colleges: the number of square feet per student.

Those executives also know what their optimum ratio should be for maximum profitability. (They aim for 30 to 50 square feet per student, depending on the program.)

For-profit colleges hawkishly track their use of real estate because they know it is their second biggest cost, after salaries. It's a major cost at traditional colleges, too.

"When you're not using your facilities well, your cost of educational services is higher," says Jerry R. Herman, an analyst of the for-profit education industry at Stifel, Nicolaus & Company, an investment bank.

DeVry figured that out a few years ago and has gradually been shrinking some of its facilities, in some cases selling off larger campuses and replacing them with smaller "centers." The company has also begun relying more on leased space, an approach long embraced by most other for-profit companies.

By recognizing the inherent value of real estate, "you can put cash back on the balance sheet and reinvest in other ways," says Joan Bates, director of investor relations for DeVry Inc., the parent company.

Traditional nonprofit colleges, by contrast, have more incentives to own land and facilities, since they are exempt from property taxes and can often borrow money tax free to pay for construction. As a result, many are, as Mr. Hentschke notes, "in the real-estate business in a major way." At traditional colleges, he adds, space is treated "as a scarce but free good."

But, of course, owning real estate is never free.

As a rule, traditional universities don't measure their success on how efficiently they use space, although a number of consultants say that's a mistake. "I could make a pretty strong argument that they should," says James H. Roth, vice president for health and education at Huron Consulting Group.

Harvey H. Kaiser, another consultant who specializes in space planning, says a few institutions, including the University of North Carolina system, have begun to focus on ways to better track and use their space. As a general practice, however, "it's really random," he says.

The one exception: Research universities are very good about calculating the use and expense of space in laboratories because they can recover some of those costs through the overhead rate they charge on grants. Space is a critical component of that calculation, says Mr. Roth, so institutions have an incentive to have "a fairly sophisticated process" for tracking it.

Lesson 3: Use the college's buying power to get students' textbooks cheaper.

Once they have registered for a class, the 330,000 students at the University of Phoenix are safe from at least one unpleasant surprise of college life: the $100-plus tab for the textbook.

Instead, Phoenix students pay a per-course fee of $75, which gives them full electronic access not only to the textbook assigned for their course but also to the thousand or so textbooks used in Phoenix's other classes.

The textbooks are part of a larger library of electronic materials that the university calls Resource.

Phoenix began Resource in 2000, when it made a deal with three publishers that accounted for 80 percent of all of its assigned textbooks.

The idea was to save students money, but the new system also fell in line with emerging practices in professional fields, where the use of online resources seemed to be growing, says Adam Honea, Phoenix's provost.

Mr. Honea says the publishers were reluctant at first because in 2000 there were fewer ways to protect their copyrighted material from being pirated once it went online. Now they like the system because it gives them something they can't get from the traditional textbook market, he says: a sure thing. "They get some money from every single student."

Phoenix makes a profit, too, though it won't disclose how much. Mr. Honea says it negotiates an annual per-student price with each publisher, which gives the university access to a set number of books for the year.

"Early on, it was our size that allowed us to break into the market," says Mr. Honea. And even today, he allows, the approach would probably work only on a large scale. Also, at Phoenix, individual professors don't choose which textbooks to assign; that decision comes from a central committee of faculty members.

The idea of having the college manage textbook purchases has yet to take hold at traditional institutions, even at big ones where thousands of students taking "Freshman Composition" or "Introduction to Psychology" use the same two or three textbooks, or at institutions where large departments have agreed on a common set of textbooks.

Mr. Hentschke, whose book *New Players, Different Game: Understanding the Rise of For-Profit Colleges and Universities* (The Johns Hopkins University Press, 2007) highlights the distinctions between for-profit and nonprofit colleges, says he understands why something like Resource might not find a ready home in traditional academe, despite demands to contain costs. The problem, he notes, is that "the folks who have to make the cuts are not the people who make the textbook decisions."

George Otte, director of instructional technology at the 400,000-student City University of New York, says the Resource idea could certainly work at many institutions, including his own, particularly now that students are becoming more comfortable with books in electronic formats.

But, he says, academe's hesitancy to challenge faculty independence is not the only barrier. "There is a certain inertia factor in the publishing industry as well," he says.

In higher education, "we do not change that eagerly or quickly," admits Mr. Otte. "But neither do the publishers."