

# For-Profit Education in the United States:

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## A Primer

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A Policy Paper from the  
Center for College Affordability and Productivity

May 2008

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## **Center for College Affordability and Productivity**

The Center for College Affordability and Productivity (CCAP) is a nonprofit research center based in Washington, DC, that is dedicated to research on the issues of rising costs and stagnant efficiency in higher education, with a special emphasis on developing market-based solutions.

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## **A Brief History of For-Profit Education**

For-profit higher education is not new. In fact, profit motive has played an important role in providing higher education since the Golden Age of Greece, when anyone could open up a private school and teach (Coulson 1999). Competitive for-profit education was particularly prominent in Athens, which led the city to become a beacon of learning (Coulson 1999). For-profit education was all but wiped out during the Middle Ages, but reemerged in the early Renaissance, when private instructors were hired to teach merchants the method of double-entry bookkeeping (Reigner 1959). Since the late fifteenth century, for-profit higher education has continued to develop. During the nineteenth century, well-organized for-profit business schools were founded across America and for-profit education developed into a very important form of higher education (Kinser 2006). Compelled by market forces, for-profit schools sprang up where needed to fill the educational needs of the population.

During the early twentieth century, however, for-profit schools found their markets undercut by the establishment of publicly funded colleges and vocational institutions. Higher education during the twentieth century underwent drastic changes as reformers forcefully argued education was the business of the state, and society could be improved by strong, publicly backed schools (Coulson 1999). Often proponents of state-sponsored education on the left argued the government should use education as a way to shape the minds of the nation's citizens, who were not responsible enough to take care of their own education properly (Coulson 1999). On the right, similar arguments were used as special interest groups saw the government as a means to influence what went on in the classroom. Consequently, the government stepped into the higher education arena, in part, by arguing people were not competent enough to oversee their own education. While the data for this period are scarce, it is safe to say for the period 1890–1972, for-profit colleges were increasingly marginalized by the growth of highly subsidized public institutions (Breneman et al. 2006; Kinser 2006; Ruch 2001).

Starting in the mid-1970s and accelerating through the 1980s and 1990s, for-profit education underwent a renaissance, due in large part to the 1972 reauthorization of the Higher Education Act, which increased the amount of government student aid available to for-profit schools (Kinser 2006; Turner 2006). During this era, the broadened scope of Pell Grants gave rise to an increasing number of for-profit universities offering associates, bachelors, and graduate degrees (Turner 2006). Since 1976, for-profit enrollment has grown at an annualized growth rate of about 11 percent, increasing by a factor of nearly twenty-three. For-profits' market share of higher education has gone from 0.4 percent to nearly 6 percent (U.S. Department of Education, National Center for Education Statistics, 2006a). The robust resurgence of for-profit schools suggests America's nonprofit colleges are failing to meet fully the people's needs. As a result, for-profits are stepping in to meet market demands their highly subsidized counterparts have chronically failed to satisfy. These recent and rapid developments have once again brought for-profit education national visibility.

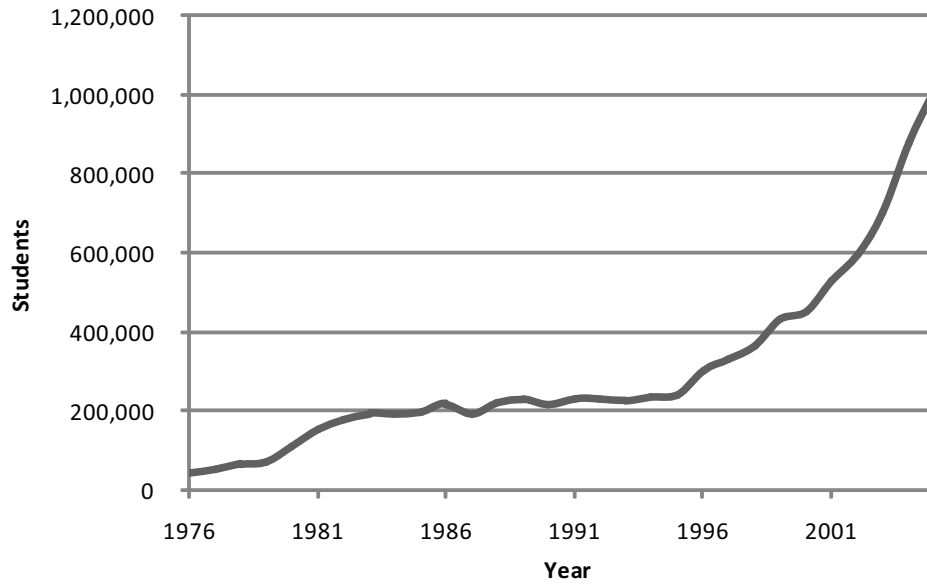
### **Growth**

Since the National Center for Education Statistics began tracking for-profit enrollment statistics in 1976, the for-profit higher education industry has recorded enormous, almost exponential growth.

As shown in figure 1, growth in for-profit enrollment began to accelerate in the mid-1990s and has maintained rapid growth rates to the present. The surge in growth that began circa 1994 can be partly explained by Wall Street's increasing interest in the for-profit education sector (Kinser 2006). Investors

FIGURE 1  
TOTAL FOR-PROFIT ENROLLMENT, 1976–2005

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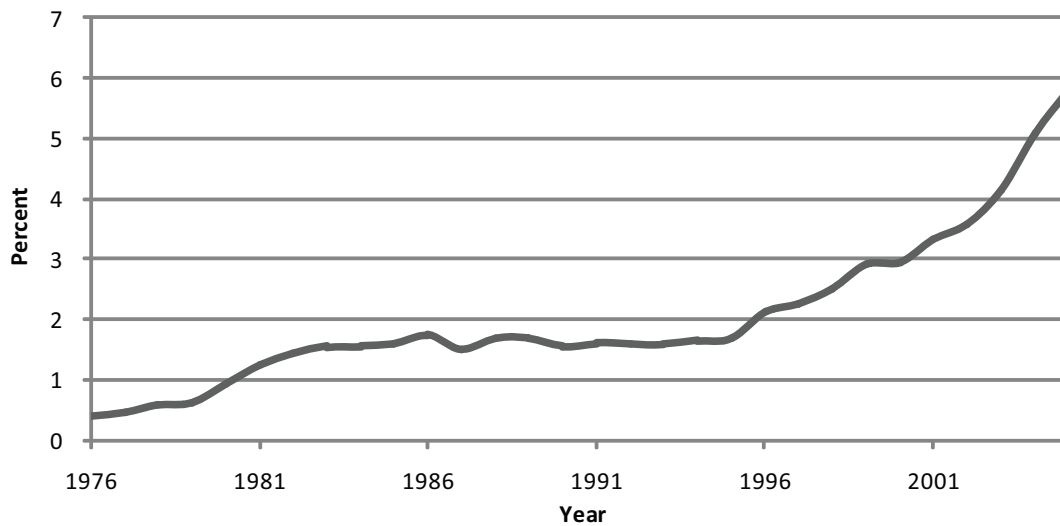


Source: U.S. Department of Education, National Center for Education Statistics 2006c.

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FIGURE 2  
FOR-PROFIT MARKET SHARE AS A PERCENT OF TOTAL STUDENTS  
ENROLLED IN FOR-PROFITS, 1976–2005 (ALL INSTITUTION TYPES)

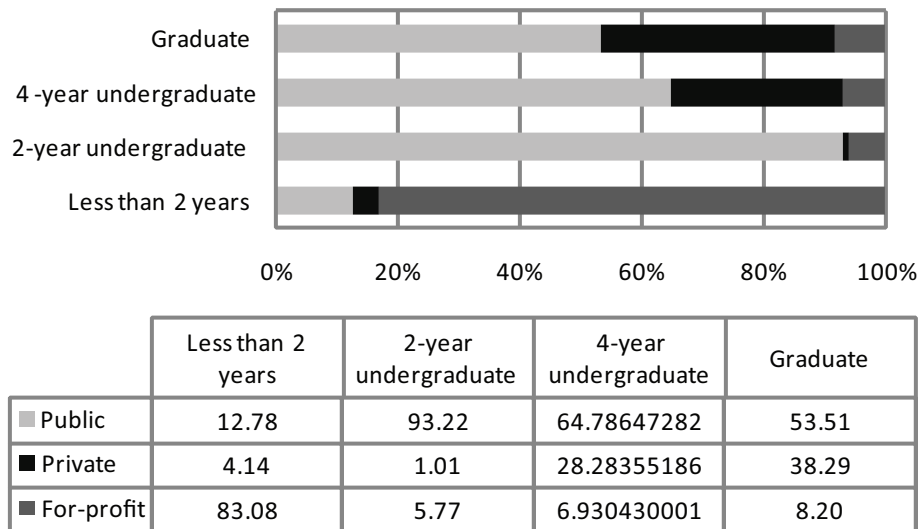
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Source: U.S. Department of Education, National Center for Education Statistics 2006c.

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FIGURE 3  
MARKET SHARE BY FTE ENROLLMENT BY INSTITUTION TYPE, 2005



Source: Knapp et al. 2007.

saw profit potential in for-profit education and drove its growth via financing Initial Public Offerings (IPOs) and venture capital firms. The spike in growth is further explained by for-profit institutions positioning themselves to address a legitimate market demand traditional institutions have increasingly failed to satisfy, providing higher education to underserved geographic areas and demographic groups and being attentive to student needs (Turner 2006).

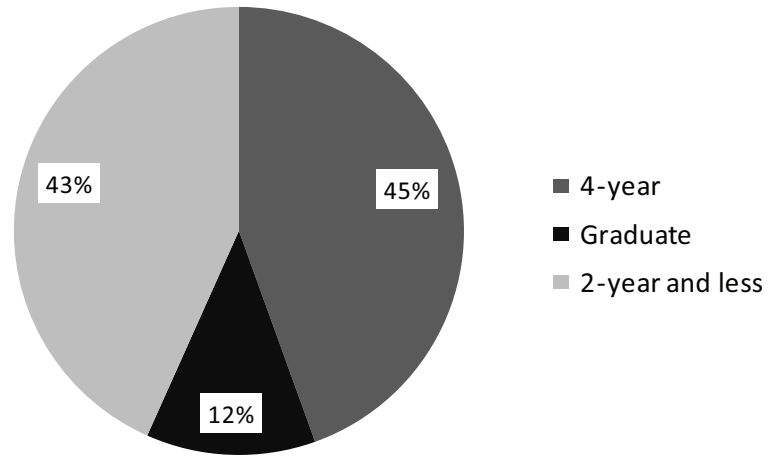
Not only has the absolute change in enrollment been impressive for for-profit schools, but the increase in their educational market share, defined as their share of enrolled students, has also been robust. Since 1976, for-profits' market share has increased by a factor of approximately fourteen, from less than 0.5 percent to nearly 6 percent. Figure 2 illustrates strong growth commencing in the mid-nineties.

Figure 3 shows that, in a small number of years, for-profit education has captured a notable percent of the higher education market. This expansion in market-share has been driven, to a large extent, by publicly traded companies such as Apollo Group and its University of Phoenix (UOP), Laureate Education, Career Education Corporation, as well as others. It is worth noting for-profits also play a critical role in providing education in fewer-than-two-year programs, an area in which nonprofits have been very slow to offer highly demanded services. As a result, the for-profits have stepped in to meet the demand, and enroll over 83 percent of the market. Also, as shown in figure 4, the for-profits, as an industry, are active in all levels of higher education, with much of their efforts concentrated in providing four-year undergraduate degrees.

While the for-profit industry has demonstrated strong growth over the last decade, it has also been subject to volatile enrollment trends. Figure 5 plots year-to-year changes in enrollment.

FIGURE 4  
FOR-PROFIT AS DISTRIBUTED AS INDUSTRY BY ENROLLMENT, 2005

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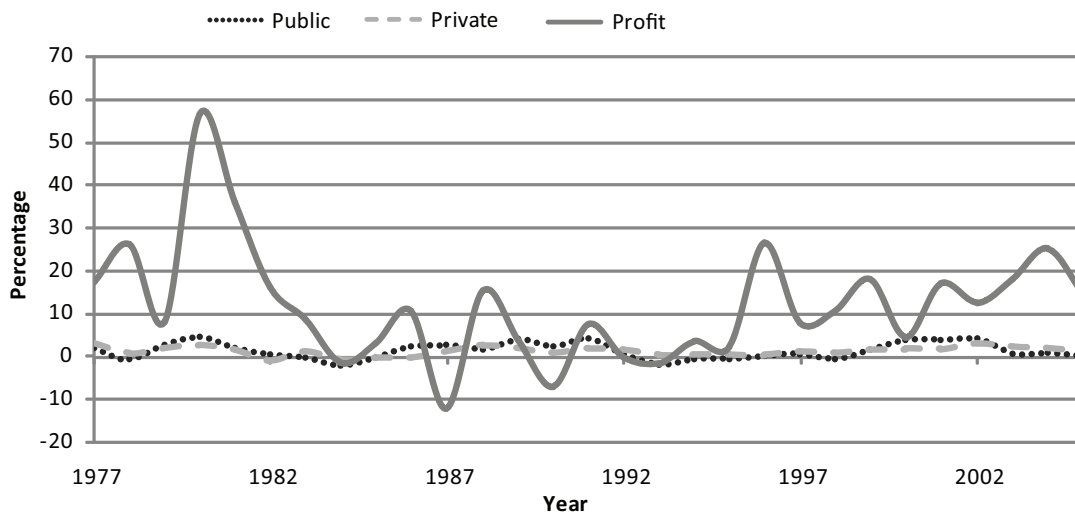


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Source: Knapp et al. 2007.

FIGURE 5  
AVERAGE YEAR-TO-YEAR GROWTH BY INSTITUTION TYPE

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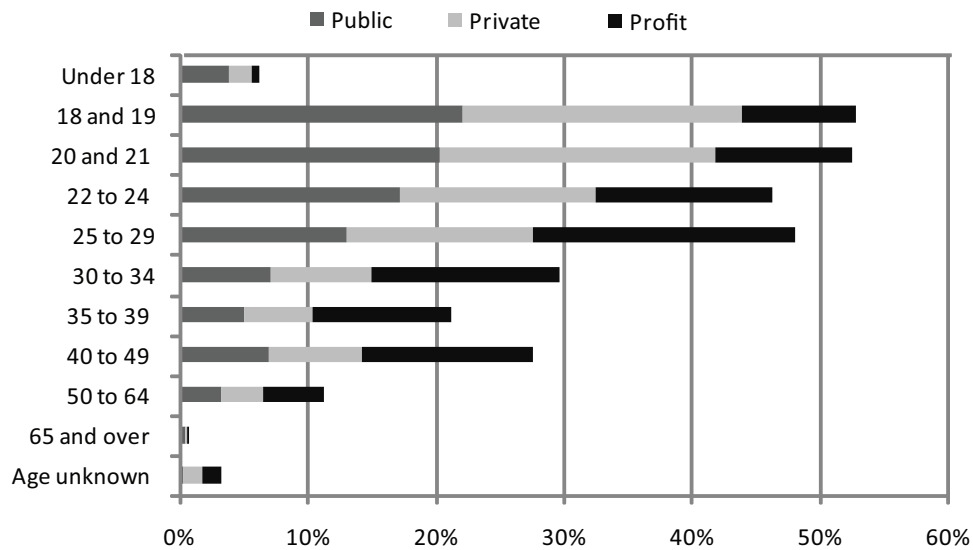


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Source: U.S. Department of Education, National Center for Education Statistics 2006c.



FIGURE 6  
STUDENT AGE DISTRIBUTION BY INSTITUTION TYPE, 2005



Source: U.S. Department of Education, National Center for Education Statistics 2006a.

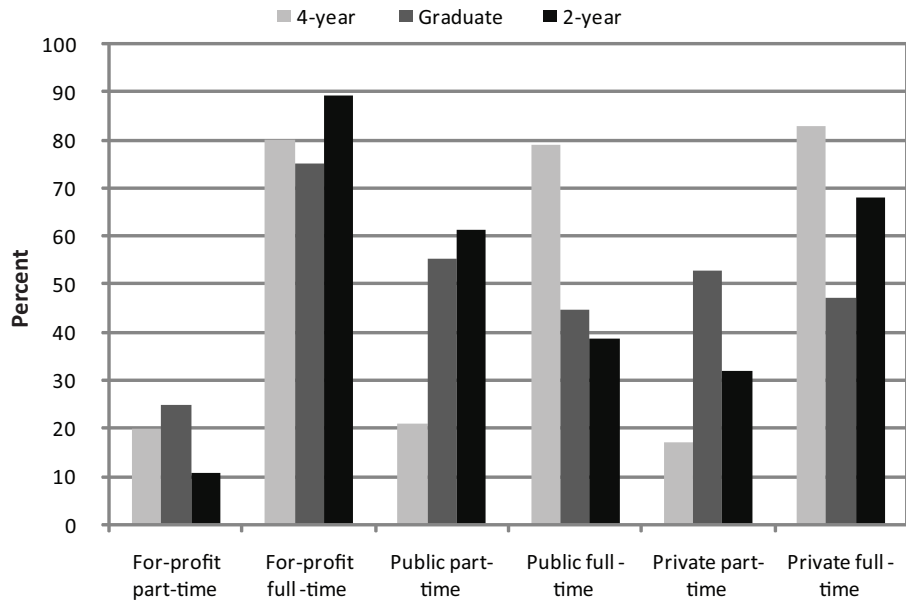
On average, the for-profit sector has experienced a year-to-year growth rate of over 11 percent since 1976, which is impressive compared to higher education's total average yearly growth rate of just 1.6 percent (Breneman et al. 2006; U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, 2006b). As is apparent in figure 5, however, this high rate of growth has also been accompanied by highly volatile enrollment trends. The volatility can be attributed largely to two factors: First, for-profit is a relatively small sector compared to the industry as a whole, and as a consequence, it is affected more by minor changes in national enrollment trends. Second, unlike nonprofit education, for-profit is maturing as an industry, and as a result, the sector is subject to more radical upheavals and revisions in how they do business, which has resulted in significant "creative destruction" within the industry (Kinser 2006).

Another interesting facet of for-profits' growth is the type of students driving the expansion. While the majority of students enrolled in the traditional sector are individuals between the ages of 18–24, the for-profit sector appeals to a slightly older age group (U.S. Department of Education, National Center for Education Statistics, 2006a).

As figure 6 indicates, the largest age group for for-profit education is young adults between the ages of 25–29, compared to 18–24 for nonprofit schools. It is also interesting to note that 43 percent of students enrolled in for-profit education are 30 or older, compared with an enrollment of just 23 percent for the same cohort in the nonprofit sector (U.S. Department of Education, National Center for Education Statistics, 2006a).

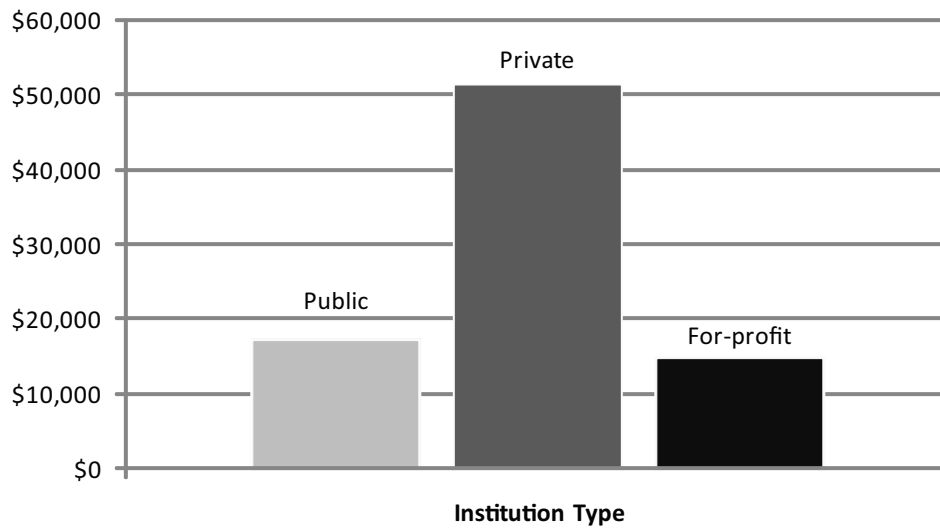
There are several reasons why for-profits attract different age groups. One, for-profits typically structure class schedules around their students, thereby making it easier for older working individuals to hold a day

FIGURE 7  
FULL-TIME V. PART-TIME



Source: U.S. Department of Education, National Center for Education Statistics 2006a.

FIGURE 8  
AVERAGE TOTAL REVENUE PER STUDENT, 2003–04



Source: U.S. Department of Education, National Center for Education Statistics 2006b.

job while simultaneously attending night classes (Turner 2006). Second, for-profit schools have become an attractive means for working professionals to obtain continuing education, often with their employer providing some form of tuition assistance (Breneman et al. 2006). Lastly, for-profit programs tend to be vocation-oriented, allowing older adults who no longer want the full-blown college experience to acquire job skills quickly (Turner 2006). Conversely, younger students tend to eschew the no-frills for-profits, instead opting for the country club-like atmosphere of nonprofit universities.

It is interesting to look at the manner in which for-profit students choose to receive their education. As figure 7 shows, for-profit students often choose to be educated as full-time students. In fact, for-profits enroll a higher percentage of students full-time than do public schools at any level, and enroll about the same number or more students full-time as do private nonprofit schools. This is likely because for-profits are very accommodating to students, making it easier to attend class and hold a job. This implies students attending for-profits are able to attain their degrees quicker, since more time is spent in the classroom per semester.

### **For-Profit Revenues and Expenditures**

Perhaps where for-profits differentiate themselves the most from nonprofits is on the balance sheet. Unlike most colleges, for-profits exist explicitly to make money for their investors. Additionally, for-profit colleges are subject to corporate taxes and regulatory bodies such as the Securities and Exchange Commission (SEC) and Federal Trade Commission (FTC), and receive little, if any, direct government support. Not surprisingly, for-profit institutions differ from nonprofits in how they manage their revenues and expenditures.

The average total revenue per student an institution receives varies dramatically depending on the type of institution. As figure 8 shows, for-profit schools receive the least revenue per student, \$15,063, while public universities receive slightly more and private colleges receive nearly 3.5 times the revenue of for-profits. Breaking down college revenues by source further highlights how for-profit revenues differ from the traditional sector.

In contrast to their public and nonprofit counterparts, 90 percent of for-profit revenues come from tuition and fees. This differs markedly from private nonprofit colleges, where tuition makes up 29 percent of total revenue, and public universities, where it accounts for only 13 percent. These traditional schools derive the bulk of their revenue from federal or state government subsidies, private gifts, auxiliary enterprises, and investment income.

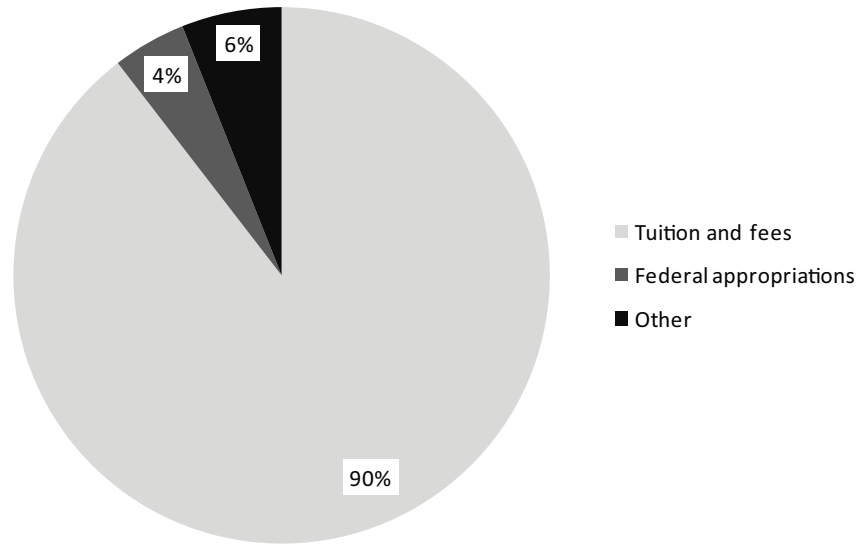
For-profits receive virtually no direct government support (see figure 10). Less than half of 1 percent of for-profit revenues comes directly from government sources, although indirectly for-profits benefit from government grants to students (e.g., Pell Grants). For-profits receive an average of about \$5 per student in direct government support, whereas public and private nonprofits receive an average of \$7,000–8,000 per student (U.S. Department of Education, National Center for Education Statistics, 2006b).

One might infer that, without such generous government subsidies, for-profits must have very high tuition and fees in order to finance their operations effectively. Surprisingly, this is not the case. For-profits charge relatively reasonable tuition.

As figure 11 shows, tuition charged by for-profits is less than what the average private college charges, and is on par with what a public university charges an out-of-state student. This is all the more impressive, since for-profits are able to remain profitable without the large government subsidies received by nonprofit schools.

FIGURE 9  
AVERAGE FOR-PROFIT REVENUE SOURCES, 2003–04

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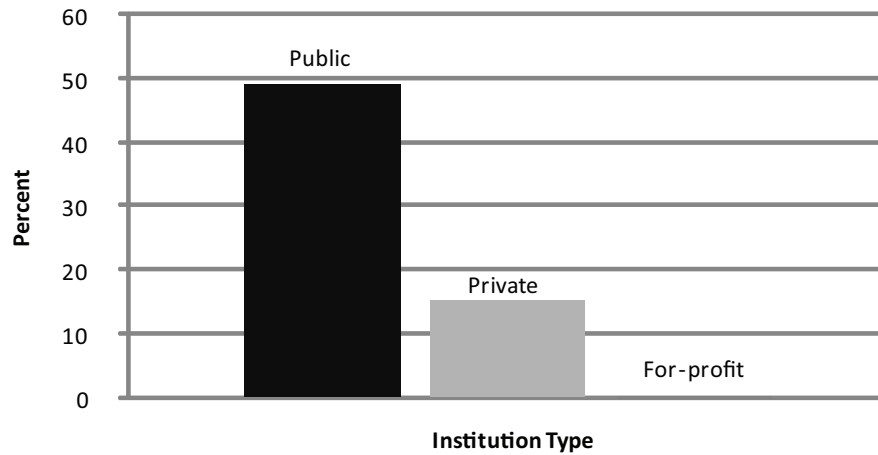


Source: U.S. Department of Education, National Center for Education Statistics 2006b.

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FIGURE 10  
AVERAGE PERCENT OF REVENUE FROM GOVERNMENT, 2005

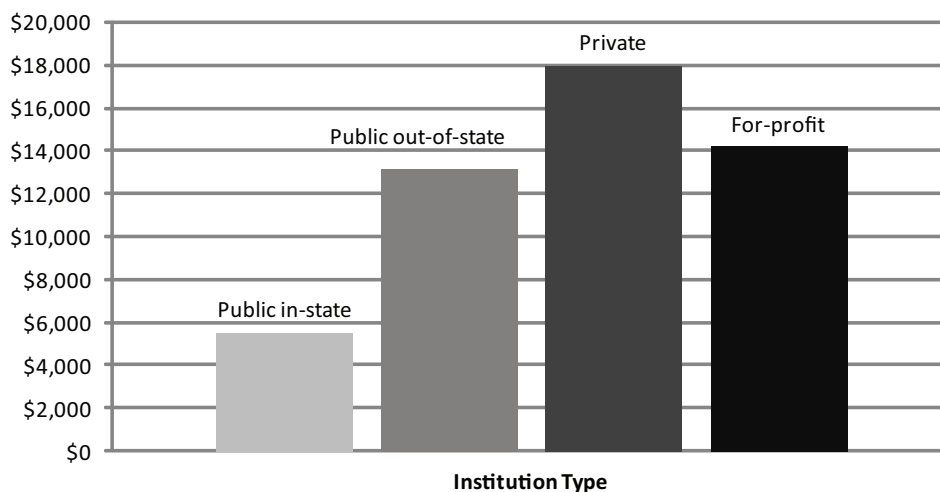
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Source: U.S. Department of Education, National Center for Education Statistics, 2006b.

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FIGURE 11  
AVERAGE TUITION BY INSTITUTION TYPE, 2006–07



Source: Knapp et al. 2007.

For-profit institutions also differ markedly from traditional higher education in how they spend their money. As figure 12 illustrates, for-profits spend less per student than either public universities or private nonprofit colleges. In other words, for-profits typically use fewer of society's resources to educate a student than alternative forms of education, implying that the total social cost of higher education could be reduced by increasing the proportion of enrollments in proprietary institutions.

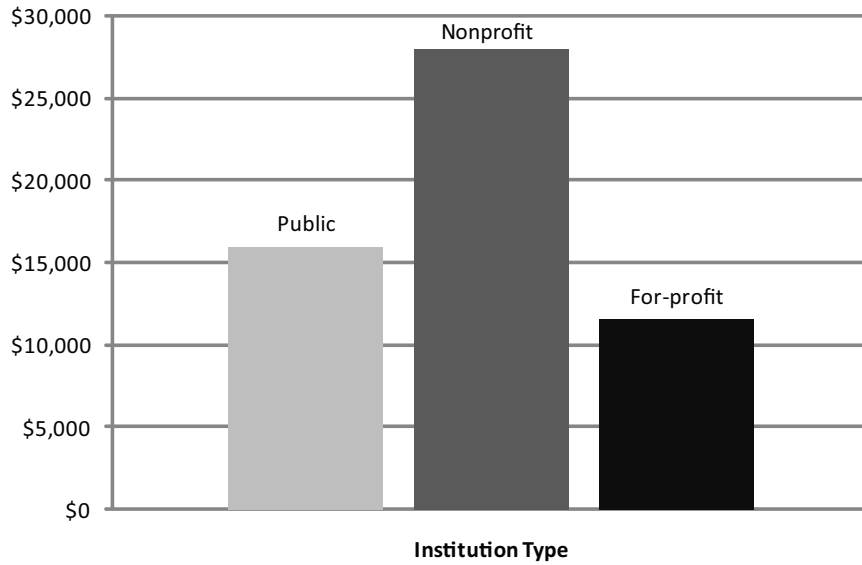
In order to assess the expenditures of for-profit colleges, some metric is needed, and since instructional services are supposedly the *raison d'être* for higher education, we will be concerned primarily with how higher education allocates resources to provide instructional services. There are two ways to evaluate this: First, one can look at total expenditure. Second, one can evaluate expenditures in terms of percentages, judging institutions on how they convert each dollar they receive into meaningful services.

In terms of total expenditure, for-profits lag behind the traditional sector (see figure 13). Both public and private nonprofit schools spend more on instruction than for-profits. Some care needs to be taken here, however, since some instructional expenses listed by traditional institutions appear, in reality, to be research support. For example, professorial salaries are typically considered part of instructional expenses, even though the faculty may spend as much of their time on research as instruction. That caveat aside, higher spending by nonprofit schools is not surprising, since both public and private nonprofit schools bring in more revenues. While for-profits lag in total spending, this pattern does not hold when one looks at the total percent of revenue being channeled into instructional services (see figure 14). Examining spending in percentages tells us how much of each dollar goes to instruction and how much is diverted to other uses.

If considering funds directed toward academic support services, which are critical to the institution's mission, for-profits appear to be even more efficient.

FIGURE 12  
AVERAGE EXPENDITURE PER STUDENT, 2005

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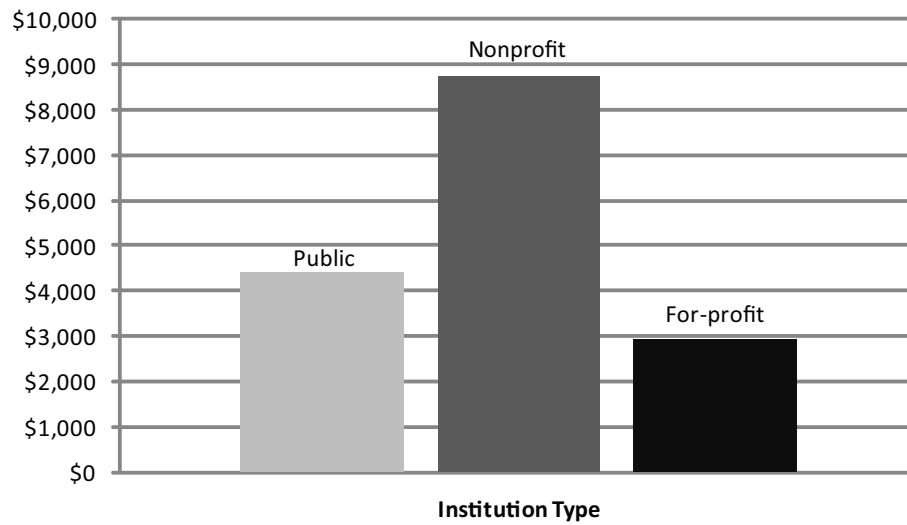


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Source: U.S. Department of Education, National Center for Education Statistics 2006b.

FIGURE 13  
AVERAGE SPENDING ON INSTRUCTION, 2003-04

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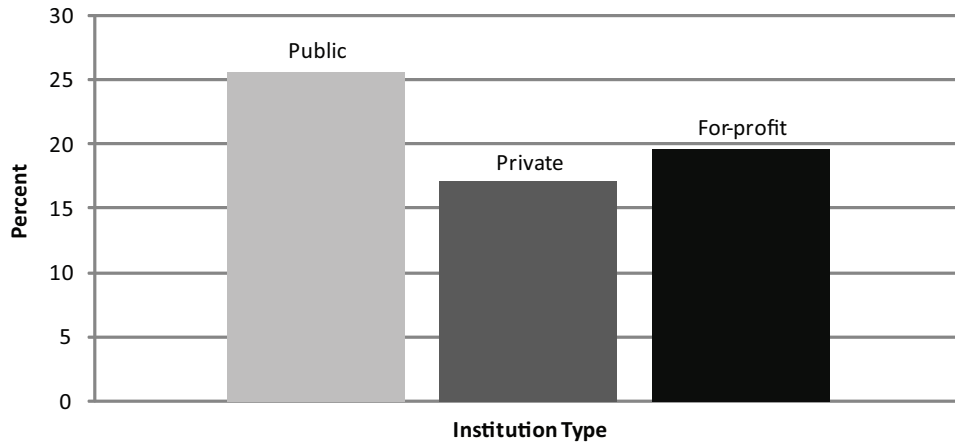


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Source: U.S. Department of Education, National Center for Education Statistics 2006b.

FIGURE 14  
AVERAGE PERCENT OF TOTAL REVENUE GOING TO INSTRUCTION, 2003–04

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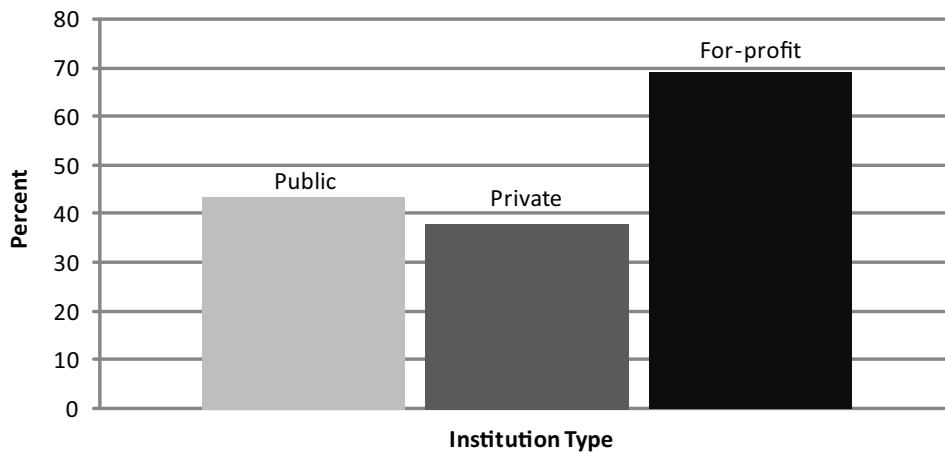


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Source: U.S. Department of Education, National Center for Education Statistics 2006b.

FIGURE 15  
AVERAGE PERCENT OF REVENUES GOING TO INSTRUCTION  
AND ACADEMIC SUPPORT SERVICES, 2003–04

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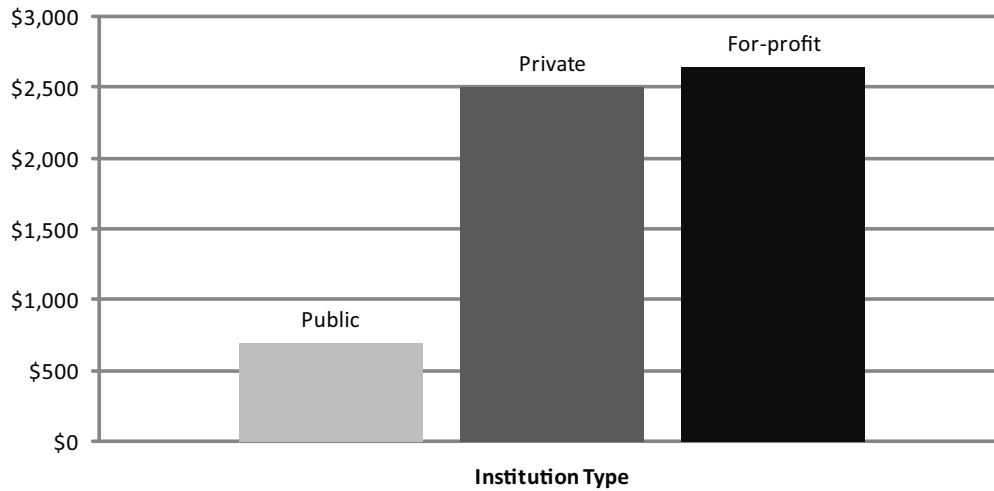


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Source: U.S. Department of Education, National Center for Education Statistics 2006b.

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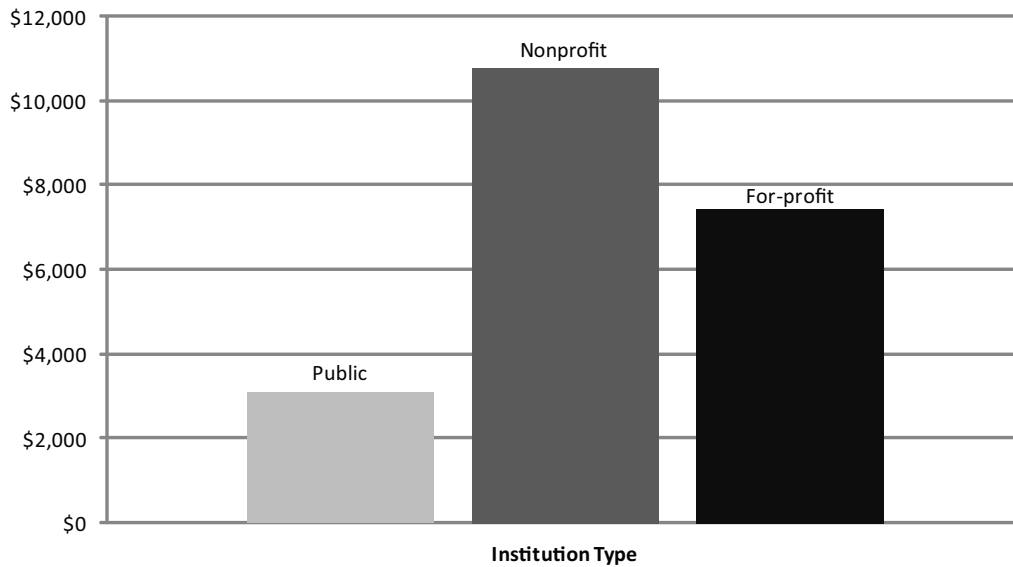
FIGURE 16  
AVERAGE TUITION REVENUE GOING TO INSTRUCTION  
PER STUDENT, 2003–04



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Source: U.S. Department of Education, National Center for Education Statistics 2006b.

FIGURE 17  
AVERAGE ADMINISTRATIVE AND GENERAL EXPENSES PER STUDENT, 2003–04



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Source: U.S. Department of Education, National Center for Education Statistics 2006b.



Figure 15 shows for-profits outperform the traditional sector when it comes to allocating both funds to instruction and the critical resources needed to make instruction possible. For-profits likely excel in this category because they focus primarily on instruction and do not splurge on country-club campuses, giant rock-climbing walls, and other amenities unrelated to education or research.

For-profits' effectiveness at providing education is further highlighted by examining how efficiently tuition dollars are allocated for instruction. Assuming university funds are fungible, for-profit institutions return the most tuition dollars to students in the form of instructional services, as figure 16 indicates. The numbers in figure 16 are calculated by multiplying total revenues per student by the proportion of those revenues coming from tuition fees, and then multiplying that number by the proportion of revenues going for instruction.

It is also useful to compare the expenditures of colleges on noninstructional services. Figure 17 depicts the average expenditure per student on administrative and general expenses.

In absolute terms, for-profits are about midway between public and private nonprofit schools when it comes to administrative and general expenses. On a percentage basis, however, for-profits spend the most on administrative and general expenses. Salaries of top administrators appear to be higher in for-profit institutions, and those institutions also have major general expenses not faced by traditional schools, such as taxes on property and income. Adjusting for taxes would lower the for-profit administrative expenses, making them closer to those found in public institutions.

There is a gap between revenues and expenditures representing profits and some taxes in the case of proprietary schools. That gap, typically \$2,000–3,000 per student, can be regarded as compensation for the use of capital. The remuneration for the use of capital resources is explicitly calculated for for-profit schools (as reflected in profits), but not for public and nonprofit private institutions. Adding in the implicit cost of capital for those institutions would increase the cost advantage of for-profit institutions materially.

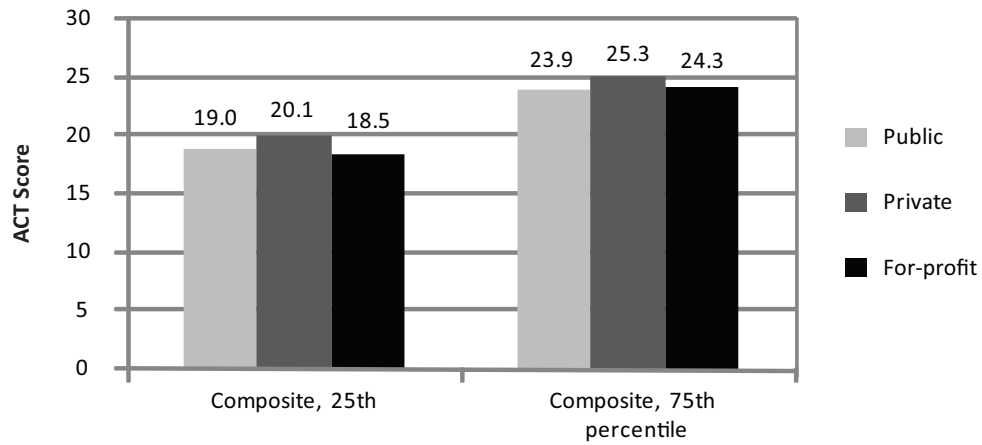
Prior to concluding this section, remember the important caveat stated earlier: the tax environment of for-profit institutions differs markedly from the tax environment of the traditional sector. Like businesses, for-profits are subject to taxes and must pay a percentage of their gross margin to the government every year. The traditional sector, in contrast, is almost entirely tax-exempt. Consequently, and perhaps perversely, the government tends to give more money to the traditional sector as they increase enrollment, yet takes away money from for-profits as they increase enrollment. The tax environment also affects institutions' abilities to raise capital. Money given to the traditional sector can be written off as charitable donations, even if the donation goes exclusively to noneducational activities such as athletics. When for-profits raise capital through investment vehicles such as stocks or bonds, their investors are subject to capital gains taxes. Consequently, for-profits are at a disadvantage when it comes to funding their educational endeavors. If comparable accounting techniques are used, the costs per student are lower for for-profits than indicated in the published statistics.

## Quality

Another area of interest when it comes to the for-profit sector is the quality of the services provided. Higher education is notorious for providing few, if any, reliable measures of performance of the gains in student learning while in college. Therefore, it is difficult to assess the quality of higher education. Nonetheless, there are indicators that suggest for-profit institutions offer educational services comparable in quality to those offered by the traditional sector. One indirect way of assessing the quality of an

FIGURE 18  
MEAN ACT SCORES OF APPLICANTS, 2003-04

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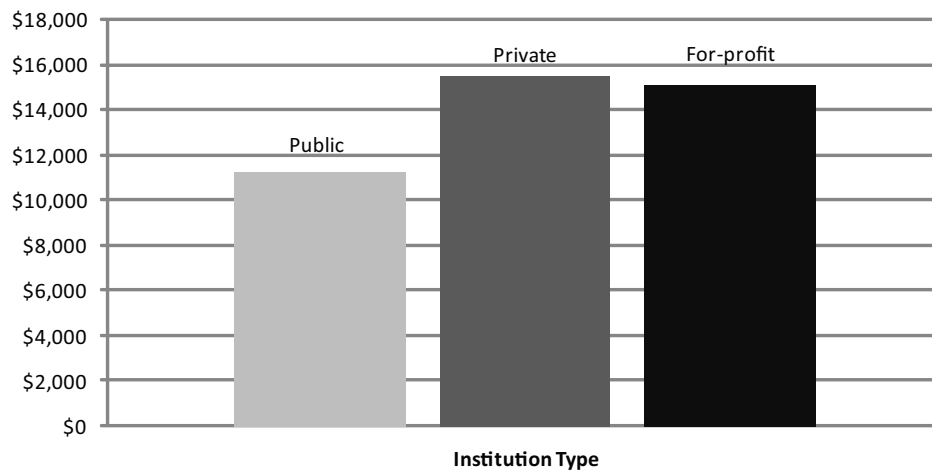


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Source: U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics 2006b.

FIGURE 19  
AVERAGE AMOUNT BORROWED TO COMPLETE AN UNDERGRADUATE DEGREE, 2003-04

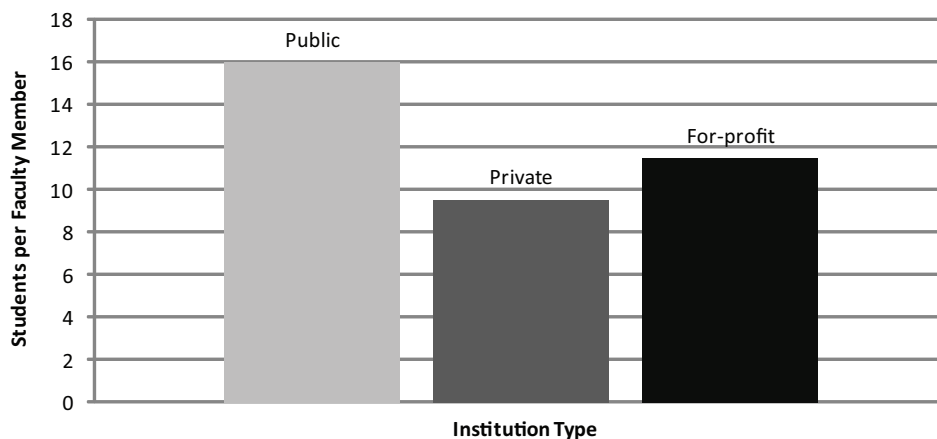
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Source: U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics 2005.

FIGURE 20  
AVERAGE STUDENT-TO-FACULTY RATIO, FALL 2005



Source: U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics 2006c.

institution is to look at the quality of the students it attracts. Since highly qualified students typically have more choices available to them and tend to gravitate toward higher-quality schools, it is probably true that the quality of students attending a school is roughly correlated with the quality of the school itself.

Figure 18 shows that the quality of students attending for-profit institutions is about the same as those attending traditional public institutions, although it is also somewhat below those attending nonprofit private institutions.

Another factor is the cost to the student. While tuition has already been discussed, cost can be analyzed in another way: looking at student borrowing. Student borrowing tells us what amount of future earnings must be given up, in the form of repaying loans, in order to attend the institution. Other things being equal, higher levels of debt detract from the value of the education a student receives.

Figure 19 shows that a student attending a for-profit school takes on an average level of debt slightly less than a student attending a traditional private school, although the for-profit student's debt is more than that of a student at a highly subsidized public institution.

A third, oft-cited measure of quality is the student-to-faculty ratio. Again, we see in figure 20 the for-profit sector is comparable to the traditional sector. We also see a significantly lower number of students per faculty relative to public schools. It is important to note a larger percentage of faculty members are employed only part-time by the for-profit sector than in the traditional nonprofit sector (Kinser 2006). Apollo Group, for example, leads the industry with its use of part-time faculty, employing 22,176 part-time instructors, or 70 percent of their total instructional staff. Nevertheless, Apollo Group has been able to keep class sizes small, averaging between 15–20 students per classroom (Breneman 2006; Kinser 2006). With the exception of Apollo Group, the average industry utilization of part-time faculty is closer to 50 percent (Kinser 2006). Huge lecture halls with a hundred or more students are far more commonplace in public universities than in for-profit higher education settings.

TABLE 1  
FOR-PROFIT INDUSTRY MARKET SHARE, FALL 2005

Company	Percentage
Apollo Group	27.9
Career Education Corp.	9.3
Corinthian Colleges	6.4
DeVry	5.0
Education Management Corp.	7.2
ITT Educational Services	4.6
Laureate Education	24.0
Strayer Education	3.1
Universal Technical Institute	1.6
Others	10.9

Sources: SEC Filings and U.S. Department of Education, National Center for Education Statistics 2006c.

Lastly, it is important to look at the outcomes of students. How does their education pay off after graduation? This question is difficult to answer because there is a general lack of longitudinal data on how well graduates perform after leaving school. If the goal of the attendees is to be employable in their field of study, however, then for-profits seem quite successful. For students, the job-placement rate in careers related to their education ranges between 96 percent (Devry) and 79 percent (Strayer) within six months of graduation (Ruch 2001). Unfortunately, no comparable data is available from the traditional sector, as nonprofit schools do not typically report useful statistics on postgraduation success.

An additional assessment of quality is provided by Wall Street analysts who have calculated the average “return on educational investment.” They concluded that, in 1999, a typical bachelor’s degree from a nonprofit institution yielded a return of 18.7 percent, while one from a for-profit institution yielded a return of 28 percent (Cappelli 1999). Rapidly rising enrollments over time would seem to have been implausible if for-profit schools in general did not satisfy their customers, and a key component of that satisfaction, no doubt, was the expectation of postgraduate vocational success.

### Company Snapshots

While the data presented so far are useful for analyzing the for-profit sector as a whole, they fail to convey diversity within the sector. There is no single description that can fully capture the breadth of for-profit higher education. Table 1 shows that the for-profit sector is made up of several large companies and many smaller niche players.

The individual companies making up the sector vary widely in history, services, and structure. Table 2 captures some of the variation among the major players in the for-profit sector.

A closer look at two of the for-profit sector’s major companies, Apollo Group and ITT Educational Services, sheds further light on the industry. Apollo Group is by far the for-profit sector’s largest company, encompassing a market share of 28 percent. Apollo Group’s beginnings can be traced back to 1973, when

TABLE 2  
COMPANY SNAPSHOTS, 2005

Company	Founded	IPO	Market Cap (in millions)	Loca- tions	Enrollment	Degrees Granted	Tuition
Apollo Group	1973	1994	\$9,212	262	282,300	Associate, Bachelors, Masters, PhD	\$6,500
Career Education Corp.	1994	1988	\$1,379	75	94,100	Certificate, Associate, Bachelors, Masters, PhD	\$14,714
Corinthian Colleges	1995	1999	\$1,131	110	64,500	Associate, Bachelors, Masters, PhD	\$10,440
DeVry Education	1931	1991	\$1,634	86	52,936	Certificate, Associate, Bachelor, Masters, M.D., D.V.M.,	\$11,790
Education Management Corp.	1962	1996*	—	78	80,324	Certificate, Associate, Bachelors, Masters, PhD	\$18,000
ITT Educational Services	1963	1994	\$2,777	99	46,896	Certificate, Associate, Bachelors, Masters	\$19,440
Strayer Education	1892	1996	\$1,468	43	31,372	Certificate, Bachelors, Masters	\$14,500
Universal Technical Institute	1965	2003	\$643	29	16,291	Certificate, Associates	\$18,000– 34,000

\*Went private on June 1, 2006.

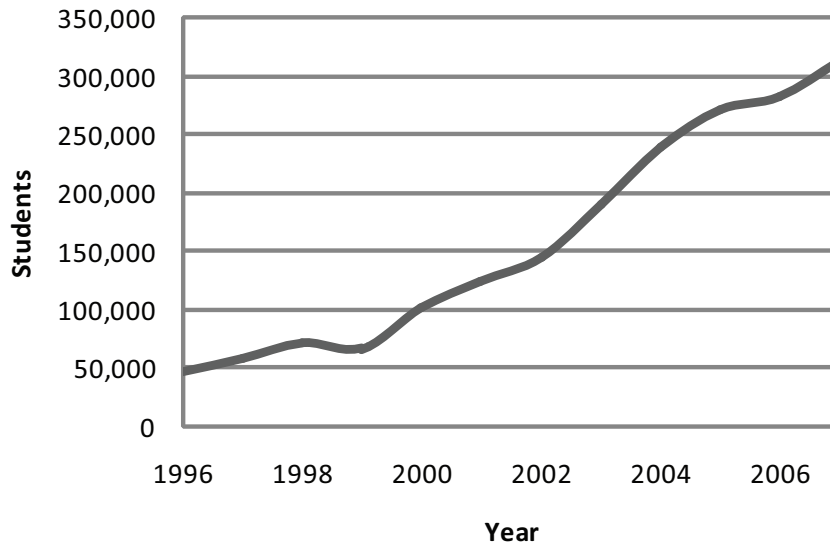
Sources: Kinser 2006; SEC Filings; Chronicle of Higher Education 2006.

John Sperling founded an adult-education program (Kinser 2006). Sperling's program grew into what is now Apollo Group, which went public in 1994 (Kinser 2006). Since going public, Apollo Group's enrollment has increased dramatically (see figure 21). This may explain why a \$1,000 in investment in Apollo on the day it went public is, as of April 25, 2008, worth over \$55,000, and the Apollo stock price has declined sharply since its peak in early 2004.

The surge in enrollment has been driven largely by the expansion of Apollo Group's UOP. Apollo Group's business model for UOP was, until recently, to market to nontraditional students. UOP focused on enrolling older, working adults, eschewing the traditional 18–22-year-old demographic. In fact, until

FIGURE 21  
APOLLO GROUP ENROLLMENT

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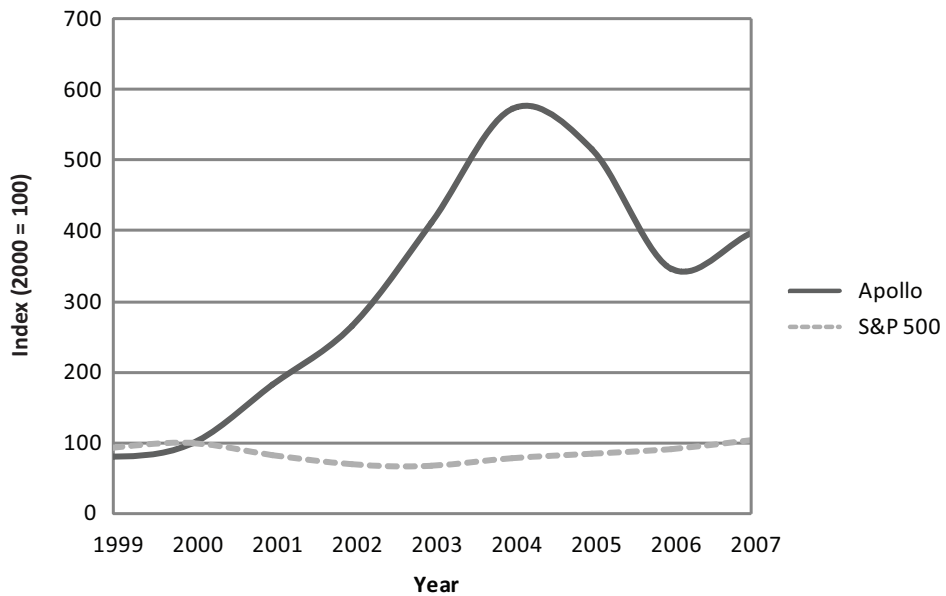


Source: Apollo Group Inc. 1999–2006.

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FIGURE 22  
APOLLO STOCK V. S&P

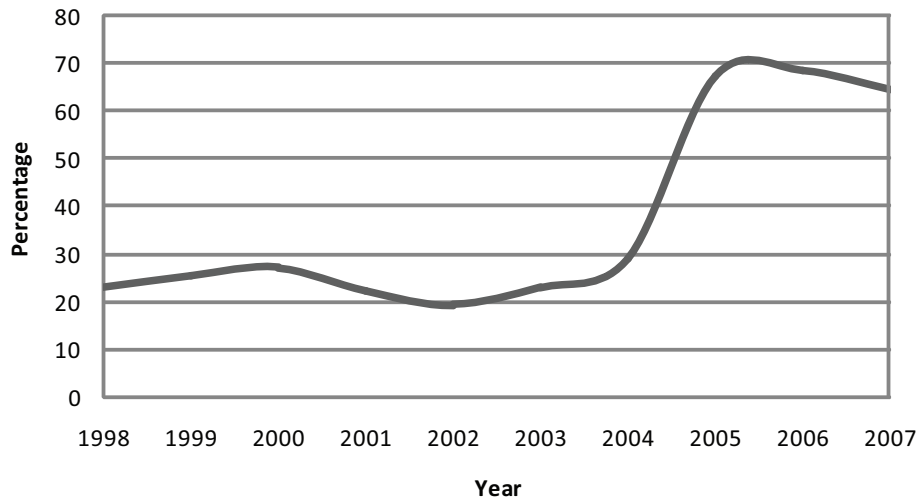
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Source: ITT Educational Services Inc. 1999–2007.

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FIGURE 23  
 APOLLO RETURN ON EQUITY



Source: ITT Educational Services Inc. 1999–2007.

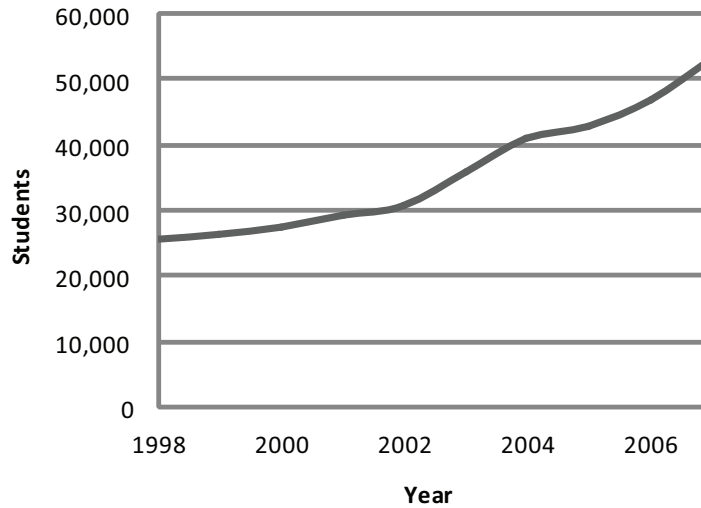
recently, UOP would not accept applicants under the age of twenty-three (Breneman 2006). Additionally, UOP goes to great lengths to accommodate working adults, offering night classes and an online enrollment option. Another key to Apollo Group's success is that they run a very cost-conscious operation. On a per student basis, Apollo has consistently kept general and administrative expenses consistently low. This has allowed it to provide quality instruction while maintaining a profitable margin.

Financially, Apollo Group's strategy has been quite successful (see figures 22 and 23). Apollo's stock has, on average, outperformed the S&P, and the company has produced considerable returns on equity. Note, however, that the company's attractiveness to investors has declined considerably in recent years, going from the equivalent of a dot-com stock with a truly enormous price-earnings ratio to one that currently sells for about 23–24 times annual earnings—a healthy earnings multiple, but one consistent with a mature growth stock rather than a hot new company.

ITT Educational Services, while holding a significantly smaller market share than Apollo Group, has also proven to be a financially successful institution. ITT was founded in 1963 by a publisher of technical training manuals, and opened campuses in Indiana and Ohio (Kinser 2006). ITT quickly expanded, establishing more campuses across the country and in Paris (Kinser 2006). In 1994, ITT went public at \$10 per share and has experienced continued steady growth since then (see figure 24).

ITT, like Apollo Group, markets mainly to working adults and older nontraditional students. Additionally, a large part of ITT's curriculum in its six schools (School of Information Technology, School of Drafting and Design, School of Electronics Technology, School of Business, School of Criminal Justice, and School of Health Sciences) is vocationally focused. General education is scaled back in favor of giving students more practical, hands-on work experience (ITT Educational Services Inc. 1999–2007).

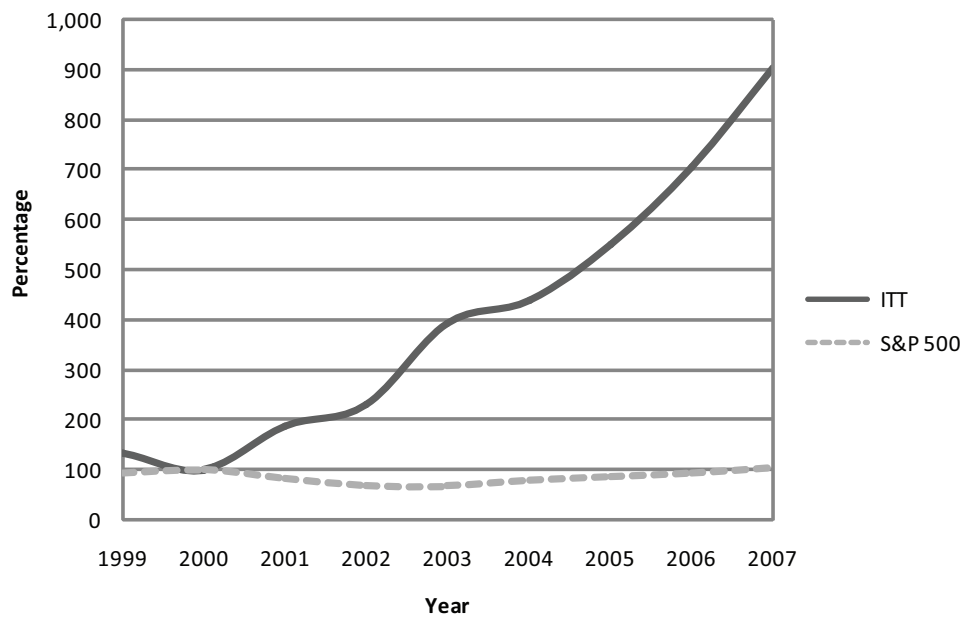
FIGURE 24  
ITT ENROLLMENT



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Source: ITT Educational Services Inc. 1999–2007.

FIGURE 25  
ITT EDUCATIONAL SERVICES STOCK V. S&P

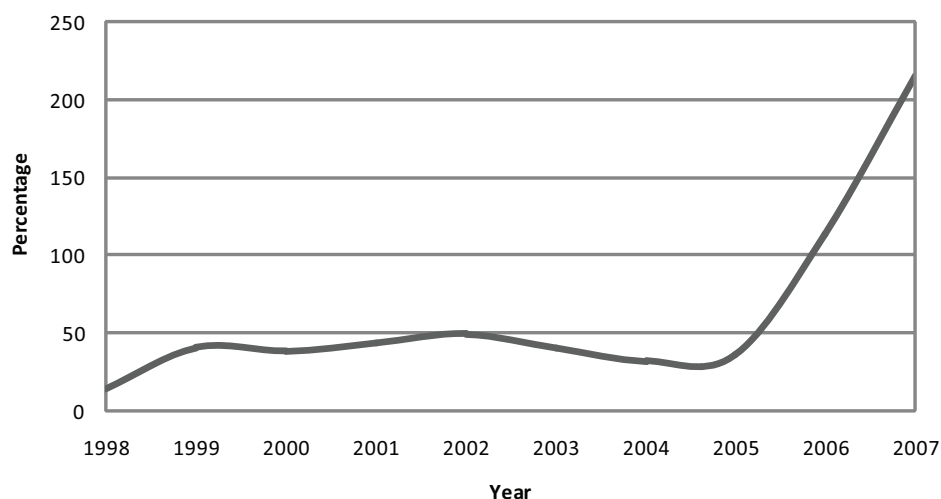


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Source: ITT Educational Services Inc. 1999–2007.



FIGURE 26  
ITT EDUCATIONAL SERVICES RETURN ON EQUITY



Source: ITT Educational Services Inc. 1999–2007.

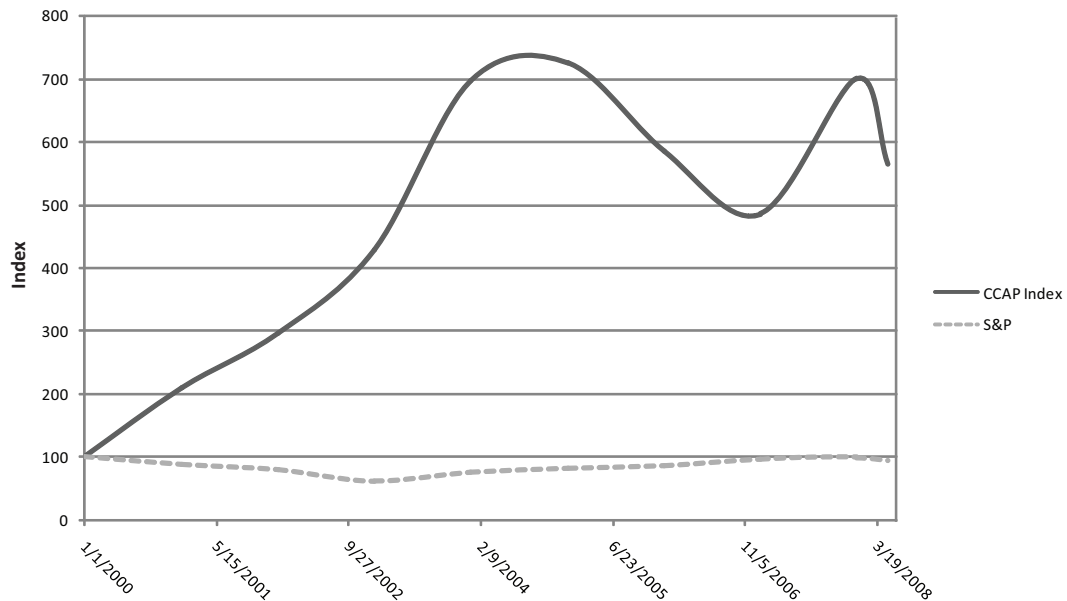
ITT does not run as lean an operation as Apollo. They spend more on instructing each student and substantially more on overhead administrative costs. Nevertheless, ITT's business model has still proven profitable, on average beating the S&P (see figure 25) and boasting an impressive return on equity (see figure 26).

In general, the relentless rise in for-profit stock values so prevalent until about 2004 has come to a halt. The torrid enrollment increase has slowed and governmental regulatory scrutiny and claims of irregularities have grown, hurting some providers severely. In general, investors have decided this is still a growth industry with promise. That extremely rapid growth is probably largely past, so extraordinarily large stock evaluations are not warranted. Still, the overvaluation of for-profit companies is relatively robust, suggesting Wall Street still looks favorably upon this industry.

The general robustness of the industry is illustrated in figure 27. The Center for College Affordability and Productivity (CCAP) has compiled a Higher Education Stock Index in which we included six companies: Apollo and ITT Educational Services, discussed above, as well as Career Education Corporation, DeVry, Strayer, and Corinthian Colleges. We weighted Apollo 50 percent in our index and the other firms at 10 percent apiece, recognizing Apollo's dominant market leadership.

During 2000–05, the Higher Education Stock Index moves up sevenfold at a time of a modest declining aggregate index (as measured by the S&P). From 2005–08, the Higher Education Stock Index falls (about 20 percent through the end of April 2008), while the overall index (as measured by the S&P) shows a modest upward trend. Again, it is wrong to assume from this that investors have turned strongly bearish on this industry, but rather that it is a sign that the growth premiums associated with this industry have been somewhat reduced as the industry matures and enrollment growth slows somewhat.

FIGURE 27  
HIGHER EDUCATION PRICE INDEX



Sources: Yahoo! Finance and CCAP calculations.

### The Secret to For-Profits' Success

The success of for-profit higher education has primarily come from two main elements: their ability to read and respond to market signals and their willingness to build their services around the student, whom they treat as a customer. For-profits have a distinct advantage over nonprofits in that they are exposed to the full gamut of market forces. Market forces, communicated in the form of prices and the “bottom line,” allow for-profits to gather, process, and act on information efficiently. Because of the abundance of information condensed into market prices, for-profits can maximize the allocation of their resources simply by looking at what students are willing to pay and how much it costs to provide their service, and then trying to maximize their bottom line accordingly. Almost by definition, this leads to economically efficient outcomes and gives for-profits an edge over nonprofits, which do not have profits and losses, and therefore must devise alternative, costly, and bureaucratic ways of determining resource allocation.

A related point is that for-profits have a different set of incentives than nonprofits. For-profits live and die based on their ability to maximize revenue while simultaneously containing costs. Consequently, for-profits have strong incentives to keep tuition reasonable in order to attract students, all the while trimming excess costs by minimizing administration, maintaining a competitive work environment, and keeping wages at the market clearing level (Breneman et al. 2006). This causes for-profits to behave significantly differently from their highly subsidized counterparts. Nonprofits have less of an incentive to contain costs because subsidies keep them from bearing the full burden of increasing costs. Consequently, nonprofits are more likely to have an underworked and overpaid faculty, bureaucratic administrations,

and rent-seeking employee groups that resist changes in the status quo. The shared governance model of many nonprofits leads to blurred lines of authority, making decision-making burdensome, costly, slow, and noninnovative. The proprietary schools do not face this huge liability.

Related to that, for-profits are structured like corporations, while nonprofits are structured more like unwieldy government bureaucracies. In nonprofits, most employees are concerned primarily with academic affairs, and relatively few employees deal with business or economic aspects (Ruch 2001). This lends itself to an environment in which most employees are insulated from market forces and are consequently unable to pursue the most efficient use of resources.

In contrast, for-profits have significantly more of a business culture (Ruch 2001). A greater number of employees are aware of the forces of supply and demand and are able to make decisions that maximize utility for the university and its students. A bonus of the for-profit business culture is that it allows for-profits a great degree of agility. For-profit employees are able to see via market signals when there is a shift in student demand and respond quickly. For example, a for-profit dean can look at the financial statements of his college and make an executive decision to shift resources from one department to another, bypassing the cumbersome bureaucracy one would typically encounter at a nonprofit institution (Ruch 2001).

The second major key to for-profits' success is how they provide services to the student. Nonprofits only get a fraction of their funding from students and consequently can afford to be dismissive of some student needs, since students who leave school out of anger do not impose a high cost on the university. For-profits, however, derive nearly all their revenue from students and thus are more inclined to see the students as valuable paying customers. As a result, for-profits tend to be more responsive to the needs and demands of their students (Breneman et al. 2006; Ruch 2001).

Additionally, for-profits focus on providing courses in high demand by students. The result is that the bulk of for-profits' instructional resources go to classes students need to take to be employable. For-profits do not offer or employ faculty in obscure courses that are not in demand and not professionally relevant (Ruch 2001). This cuts costs for the university and allows the savings to be passed onto students.

Moreover, for-profits have no pretenses of performing research or of offering noninstructional community outreach through amenities like football teams, concerts, fancy student recreational facilities, or large libraries. Finally, they keep capital costs down, in part, by using facilities more intensely than other schools, including during evenings, weekends, and summer periods.

## **Industry Challenges**

Over the past decade, for-profit higher education has proved to be a successful, viable alternative to traditional higher education. If for-profits are to continue growing, however, they need to overcome several major challenges facing the industry. One challenge the industry has so far been able to meet and must continue to meet is its unique regulatory environment. Education, in general, is already a highly regulated sector, and the regulatory environment is further complicated for for-profits because such companies are also subject to SEC and FTC regulations. Additionally, for-profits are further burdened by regulation, as they are singled out by the Higher Education Act and must meet requirements not demanded of nonprofit institutions (Kinser 2006).

Another challenge for-profits must overcome is in the area of accreditation. As for-profits have begun to expand into the traditional degree-granting market, they have met resistance from accrediting agencies.

Many regional and specialty accreditors have resisted the growth of for-profits by taking steps to discourage their pursuit of accreditation (Kinser 2006). The ability to gain accreditation is extremely important for the future of for-profits, as it not only lends to their credibility, but also dictates their ability to participate in federal student aid programs. So far, for-profits have met this challenge with some success by turning to national accrediting bodies, typically viewed as being second-class alternatives by the education sector (Kinser 2006). For-profits have also recently been gaining accreditation by essentially buying it. There is an industry trend of for-profits buying up accredited nonprofits in order to gain accreditation. This shows the distortive effects accreditation can have on barriers to entry. To the extent that accreditation works to ensure quality education, it should not be a purchasable commodity. At the same time, genuine educational institutions should not have to face so many obstacles in their quest for accreditation.

A third challenge for for-profits is competition with the traditional sector. If for-profits are to grow beyond a limited market and become truly competitive alternatives to nonprofit higher education, they will have to find a way to capture market share from the heavily subsidized nonprofits. Public subsidies to nonprofits currently serve as massive barriers to entry for for-profits (Winston, Carbone, and Lewis 1999). Moreover, it is unlikely for-profits have the political clout either to lobby for comparable subsidies of their own or to roll back nonprofit subsidies sufficiently to level the playing field. As state budgets come under more pressure from soaring medical costs and other factors, however, state subsidies are becoming relatively less important to public universities, posing an opportunity for for-profit institutions to gain market share in the traditional 18–24-year-old student part of the market. At the rate college prices are rising, if nonprofits do not contain costs and high rates of tuition growth, their competitive price advantages will decline.

### **The Future of For-Profit Education**

If history is any guide, for-profit higher education is here to stay. For-profits have found a secure market niche in which they are able to flourish and outcompete nonprofits. The question is: has for-profit education saturated the market or is there still room for growth? The answer is the future of for-profits most likely is in the hands of the nonprofits. If nonprofits reduce the cost of attendance, it is difficult to see how for-profits can compete on a large scale with such a heavily subsidized industry. If nonprofit tuition fees continue to outpace inflation, however, for-profits will gain a competitive advantage and continue to eat away at nonprofits' market share.

With the forthcoming decline in the size of the 18–24-year-old pool of potential students because of low birth rates in the 1990s, many traditional institutions, governors, and state governing boards are talking about expanding programs in the adult-education market that is the strength of for-profit institutions. This may put pressure on those firms, which will be under pressure to enter more aggressively the traditional age market. In short, head-to-head competition between the two types of institutions may accelerate.

As the adult-education market becomes more saturated and competitive, there is also a strong likelihood for-profits will strengthen their presence overseas. Already, these institutions are actively opening and acquiring campuses abroad. Laureate Education, for example, already has a majority of its locations overseas, where the market and regulatory conditions are more favorable. Privately controlled institutions run by Dallas entrepreneur Randy Best are expanding aggressively in Latin America.

How should public policy toward for-profits evolve? Given for-profits' cost advantages and their popularity with their customers, the nation will lower average costs of educating postsecondary students if the market share of for-profits continues to rise. Greater competition from these schools may force

nonprofits to do something they have resisted: make fundamental changes in the way they deliver educational services. Government-sanctioned regulatory efforts that stifle for-profit competition should be removed. Accreditation needs to be greatly simplified and made purely outcomes-based, for example. For-profit schools are part of the solution—not the problem—facing American education in the future.

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