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AGB Priorities

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Tuition Discounting and Prudent Enrollment Management

BY LUCIE LAPOVSKY

EVERYONE IN HIGHER EDUCATION wants to ensure that our institutions can provide equitable access to students. At the same time, we want to be sure that we are attracting the appropriate quality and quantity of students and that the institution is maximizing net revenues. How we set the price of tuition—and how we discount that price—to accomplish these goals are of great interest today, in both the public and independent sectors of higher education.

Tuition pricing and discounting strategies affect your institution's financial equilibrium.

At most colleges and universities, the first question campus officials are likely to ask is how the *price* of tuition relates to the *costs* of providing an education. For the most part, the published price—tuition—has very little relationship to the cost of an institution's operations. This is true for two main reasons: Almost all institutions have other sources of revenue to apply to their costs, and almost all institutions do not receive all of the gross revenue that one would assume tuition provides, mostly as a result of financial-aid or discounting policies. Steadily, the published price of a college education today is becoming less meaningful.

The pricing and competition landscape of higher education is changing significantly in other ways. We used to talk only about the public sector and the nonprofit private sector. We now are facing stiff new challenges from the for-profit sector, which no longer can be ignored. The public sector also is undergoing significant change. Faced with diminishing public appropriations, it is beginning to reevaluate its pricing policies. Miami University of Ohio (see case study on page 10) is in the forefront of this change, but other public universities are looking to make significant pricing changes as well. In their efforts to attract out-of-state students, the flagship campuses of many public universities have been mimicking the discount strategies private colleges have used to shape their classes.

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She acknowledges the assistance of **Loren Loomis Hubbell**, senior vice president and chief financial officer at Mercy College, for gathering and analyzing the NACUBO data.

Priorities

Does tuition discounting increase revenue by increasing enrollment, or does it take resources away from needy students and hamper program improvements by subsidizing students who would have attended anyway?

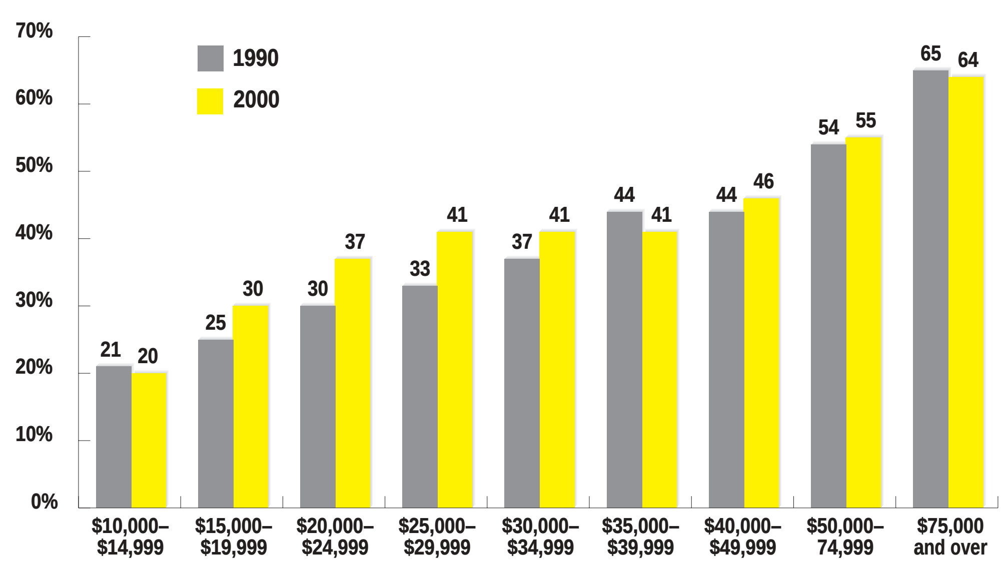
This issue of *Priorities* explores pricing and discounting strategies as they are used to shape enrollment and support financial equilibrium. It presents data collected by the National Association of College and University Business Officers (NACUBO) from private colleges and universities over the past 14 years to provide a framework for showing the evolution of the use of discounting and for discussing the issues that discounting raises for all institutions.

Demographic Shifts. Before discussing how college and university officials set the price of tuition and why that price is often discounted, some information about who we can expect to attend our campuses will provide a useful background.

The traditional college-age population—those Americans between 18 and 24 years old—is projected to expand from now till the end of the decade, according to the U.S. Census Bureau. But the growth in the target population of colleges and universities will be different from that of prior decades. White, non-Hispanic, traditional-age students will increase by a routine 3 percent, but Hispanic and black students are projected to increase by a monumental 21 percent and 12 percent, respectively. This growing population will come largely from families in which neither parent has gone to college.

As the demographics continue to shift to bring more minority and low-income students to campuses, higher priced colleges and liberal arts colleges are going to have increasing difficulty recruiting students who are both able to pay the asking price and who are truly interested in the product they are offering. Table 1 shows the significant differences in the college-going rates by income class. The data are displayed for 1990 and 2000. The college-going rate of 18 to 24 year-olds who come from families with incomes between $10,000 and $14,999 is 20 percent, compared with 64 percent for students of the same age who come from families with incomes greater than $75,000. Boosts in the college-going rate occurred during this decade for 18 to 24 year-olds who come from families with incomes between $15,000 and $34,999, though their rates of college attendance are still more than 20 percentage points below the higher income students.

Table 1: Estimated College-Going Rates by Family Income



Source: Brian Zucker, Human Capital Research.

Questions for Boards to Consider About Tuition Discounting

- **Are we at capacity?**
- **What does our student body look like economically, racially, ethnically, geographically, by gender, and by ability? Do we like this balance, or do we want to alter it?**
- **What are our current pricing, financial-aid, and discounting policies? How do these policies support our level of enrollment and mix of students?**
- **What strategies could help us change the size and composition of our student body to better meet our desired enrollment goals?**
- **Do we need to increase our net revenue from tuition? How can we increase it without sacrificing our enrollment goals?**
- **What program and facility changes could help us achieve our enrollment goals? What will they cost, and how long will it take before they will have an impact?**
- **How do we balance increased expenditures in financial aid versus program and facility expenditures to achieve our enrollment and net-revenue goals?**
- **How will a change in tuition (significantly up or down) affect our enrollment?**
- **Do our pricing and financial-aid policies reflect our institution's values?**
- **What should the board vote on? Tuition? Financial-aid policies? The discount rate? Net tuition?**

Understanding Tuition Discounting. In recent years, the press has published much about tuition discounting. It is a basic concept: Some students are charged less than the published tuition price to attend a college or university. These accounts have raised difficult questions about where higher education is moving in terms of its pricing and financial-aid strategies. They include the following:

• Will tuition continue to increase?

• Will colleges and universities continue to provide scholarships to significant numbers of students?

• Will the published price of tuition continue to lose meaning? If so, what will be the consequences?

• What is the effect of tuition pricing and discounting strategies on access to higher education?

• What is the effect of tuition pricing and discounting strategies on cost containment, on resources available for program enhancements, on the quality of higher education, and on the financial equilibrium of higher education?

• What is the difference between employing a "high-price/high-aid" strategy versus a "low-price/low-aid" strategy?

• Finally, why do colleges and universities continue to implement tuition-discounting strategies, given that they are taking a terrible beating in the press and in Congress over tuition increases—even though the net price to students is rising at a much slower rate than the published price?

There now exist 14 years of tuition, financial-aid, and enrollment data from a large sample of independent institutions that took part in the NACUBO tuition-discounting survey. The data show that an overwhelming majority of institutions have increased financial aid for students at a rate faster than that for published tuition rates.

Illustration by Andrew Skwish

The resulting net-tuition figures show that institutions' real revenue growth has been decidedly lackluster or, in many instances, negative from one year to the next.

In fall 2003, the average discount rate across what some call the "medallion" institutions (the elite national and liberal arts universities that usually earn a top-50 ranking in *U.S. News & World Report*) was 36.1 percent for freshmen, compared with 41 percent among the "other" private institutions, which comprise far greater numbers of students. This contrasts sharply with the situation in 1990, when the average discount rate was 26 percent at both sets of institutions.

The discount rate at the private institutions in the NACUBO database has increased by more than 50 percent during the same period. There is a significant difference in the change in the discount rate at the medallion institutions and change at the rest. At the medallion institutions, the discount rate increased 33 percent during this period while the discount rate at the non-medallion institutions increased a whopping 58 percent. Table 2 illustrates these rates.

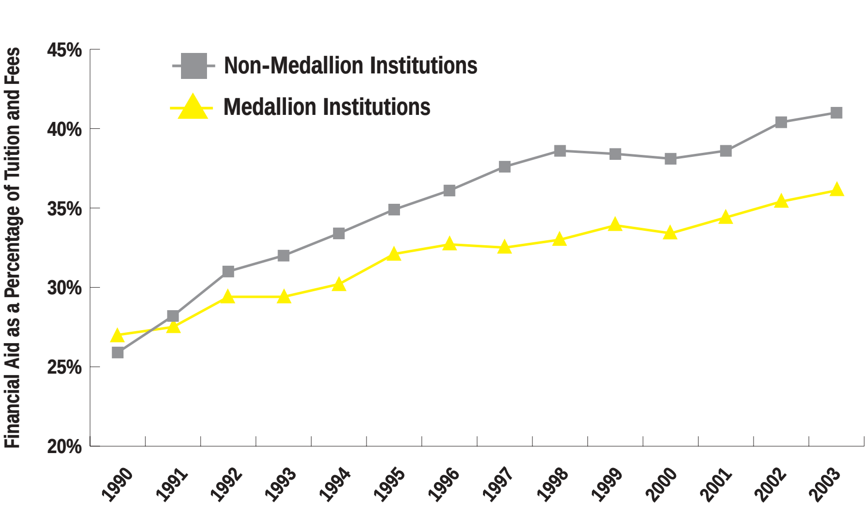
Parent Willingness to Pay. Two key factors in the increases in tuition discounting at medallion institutions over the past 14 years are the decline in federal and state aid and the changing demographics of the traditional-age, college-going population, which have yielded more low-income, first-generation college students. By contrast, much of the increase in tuition discounting at the non-medallion institutions has been the addition or substitution of merit aid or characteristic-based aid (aid awarded to students with certain desirable skills or attributes). In 1990, many of the non-elite private institutions and almost all of the medallion institutions provided only need-based aid, with the exception of athletic scholarships at some of these institutions.

Today, just about all of the non-medallion colleges and even some of the medallions are providing merit aid to enhance the marketing of high-priced educational services to price-sensitive middle-class and affluent families who often are able but unwilling to pay the published price. Today, the family income of students at four-year public institutions in many states is higher than at the private colleges; this is further evidence of this phenomenon of unwillingness to pay the published tuition price.

What's more, most institutions are strategically packaging their need-based aid, offering different packages to equally needy students who possess different characteristics. Those students who are most desirable to the institution—say, an excellent cellist or a dedicated classics scholar—will receive a much higher percentage of their institutional aid in the form of grants rather than work-study opportunities or loans, or they may receive a much smaller gap in their financial-aid package—that is, more of their need will be met by the institution.

At the heart of this issue is the confluence of each institution's need for a robust revenue stream to pay for the things that keep it competitive and the degree to which families are willing to pay the published price of tuition. The core of the strategy is to provide incentives to those "desirable" students who are able to pay to attend the institution in amounts according to the traditional need-based aid formulas but who are unwilling to pay the sticker price. Thus, one must ask whether discounting actually increases the revenue available by increasing enrollment or whether it takes resources away from needy students or from programmatic improvements by subsidizing students who would have attended anyway. The answer to this question differs by institution, and the answer in the aggregate is unclear.

Table 2: Average Tuition Discounts: Full-Time Freshmen



Case Study

Wells College Uncouples Quality and Price

In fall 1999, Wells College, a small private women's school in western New York, slashed its annual tuition and fees by 30 percent, from $17,540 to $12,300. This bold action was motivated by a need to increase enrollment and a desire to improve the quality of the student body. Before the tuition change, almost every student at Wells was receiving institutional financial aid.

Over the past five years, the results of this action have been positive: Enrollment has increased 25 percent; the quality of the student body has improved; and there has been a significant increase in the number of middle-income students. The net tuition per student was the same at the higher and the lower prices, and the increased enrollment has provided added net revenue.

Before it made the change, Wells invested in research and in educating its board, students, faculty, and staff. "Wells needed to 'myth bust' around the realities of net tuition revenue and the applicant pool," according to President Lisa Marsh Ryerson. "It needed to show that quality and price were not related in the minds of the applicant pool." Wells competes with public colleges as well as with other private colleges in New York. Its research showed that many of its lower priced public competitors were perceived as high-quality institutions.

To persuade the Wells board to make this move, the administration provided reams of data and financial models showing the impact over the short and long term. Wells coupled the tuition cut with changes in its financial-aid strategy. Its discount rate fell from 62 percent to 46 percent immediately, and the percentage of students receiving institutional aid declined from almost 98 percent of the freshman class in fall 1998 to 87 percent in fall 1999.

The college also made significant changes in its merit-based program; it moved from awarding a few very large scholarships to providing awards to one-third of the entering class. The new awards bolster curriculum objectives by providing internships in the freshman year and $3,000 in support for an experiential learning activity in the junior year.

Wells's leaders felt comfortable making the strategic change largely because they thought the college was in a position of strength. It had just finished a successful capital campaign, so funds were available for the initiative. Wells invested significantly in public relations so that it could control the messages associated with the tuition change, and it emphasized in a publicity campaign the school's value proposition and its commitment to "access and affordability."

The Wells board continues to examine significant data as it monitors the results of this experiment. Officials plan to continuously reevaluate the pricing and financial-aid policies in order to maintain the college's competitive position and to periodically grow enrollment.

At many institutions, tuition discounting is a necessary strategy to fill all the seats in the class. Other institutions use discounting to shape the class—that is, to ensure enrollment of adequate numbers of students with certain characteristics the institution values. Institutions that discount tuition to shape their classes believe that the institution will become weaker if it fails to attract enough "strong" students.

Tuition Versus Net Tuition. The average published price of tuition at the medallion institutions has increased almost 100 percent over these 14 years, from $14,119 in 1990 to $27,606 in fall 2003. By comparison, the average published price of tuition at the non-medallion institutions increased 112 percent from $9,495 to $20,115. Unfortunately, the net tuition of the non-medallion institutions increased only 70 percent, while the net tuition of the medallion institutions increased 76 percent during this time. Thus, while the relative price gap between the medallion and the other institutions narrowed, the gap in net tuition widened, giving the non-medallion institutions fewer tuition dollars per student in both absolute and relative terms, compared with the dollars at the medallion institutions. Table 3 on page 8 shows these trends.

A few institutions have experimented with significant reductions in their published price, most notably Muskingum College in Ohio and Wells College in New York (see the case study on this page). The condition usually present for a price reduction is a situation in which all or almost all students are receiving institutional

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As institutions employ tuition discounting as part of their overall enrollment strategy, the "sticker price" of tuition has become increasingly meaningless.

financial aid, and the college wants to reposition itself in terms of price so that it can compete more effectively with its peers. Muskingum hired Gallup International to conduct its public-relations research, results of which indicated that a price decrease would be well received (though the research also indicated that parents and students still wanted scholarships as well).

In 1996, Muskingum reduced its tuition price by 35 percent and its average scholarship award per student by 67 percent. It continued to discount its tuition to most of its students even after it lowered its price, though the discounting was significantly less. This strategy worked; Muskingum experienced a significant enrollment increase the following fall.

Since the Muskingum experiment, a few colleges each year have lowered their published price to reposition themselves. But this trend has not taken off. For example, from 2001-02 only two institutions in the NACUBO study reduced their price, and none did so from 2002-03.

Many institutional officials fear that students relate price to quality and that a lower tuition price leads students to relegate that institution to a lower quality group. This phenomenon has come to be known as the Chivas Regal effect, after the brand of high-priced scotch that some perceive as possessing a higher quality. There is not much empirical evidence for this phenomenon, but seasoned observers strongly believe it exists. The Chivas Regal effect, however, has led many institutions to raise their published price regularly so that they can offer tuition discounts to selected students. Institutional officials have found that parents and students respond well to scholarship offers, which are awarded based on the "outstanding" characteristics of the student.

This is clearly the motivation for the high-price/high-aid strategy that many institutions continue to use; in fact, we are likely to see more public institutions moving in this direction in the future. People like to buy everything "on sale"; we like a "good deal." Discounting allows us to feel we have achieved this end.

Scaring Students Off? Might a high price keep some people from applying to your institution? Perhaps. One strategy several institutions use to reduce the number of prospective students who are "scared off" by a high published tuition price is to publicly announce that a student with certain characteristics will receive a scholarship from the institution. For example, some institutions give full-tuition scholarships to any valedictorian or salutatorian, and others provide a discount to all students who come from a certain geographic area. Essentially, institutions are trying to find ways to create greater demand while maintaining flexibility in awarding aid and not risking a price change that might harm their competitive position.

To the extent that merit-based or characteristic-based aid strategies have been substituted for need-based aid, this enrollment-management approach has reduced educational access to the economically disadvantaged. At the same time, it has provided financial subsidies to many students whose families are able to pay the published price of tuition. Clearly, if an institution could fill its classes with "appropriate" students without discounting (however it defines such students), there would be more funds available to improve programs or less need to raise tuition as quickly as it has been increasing.

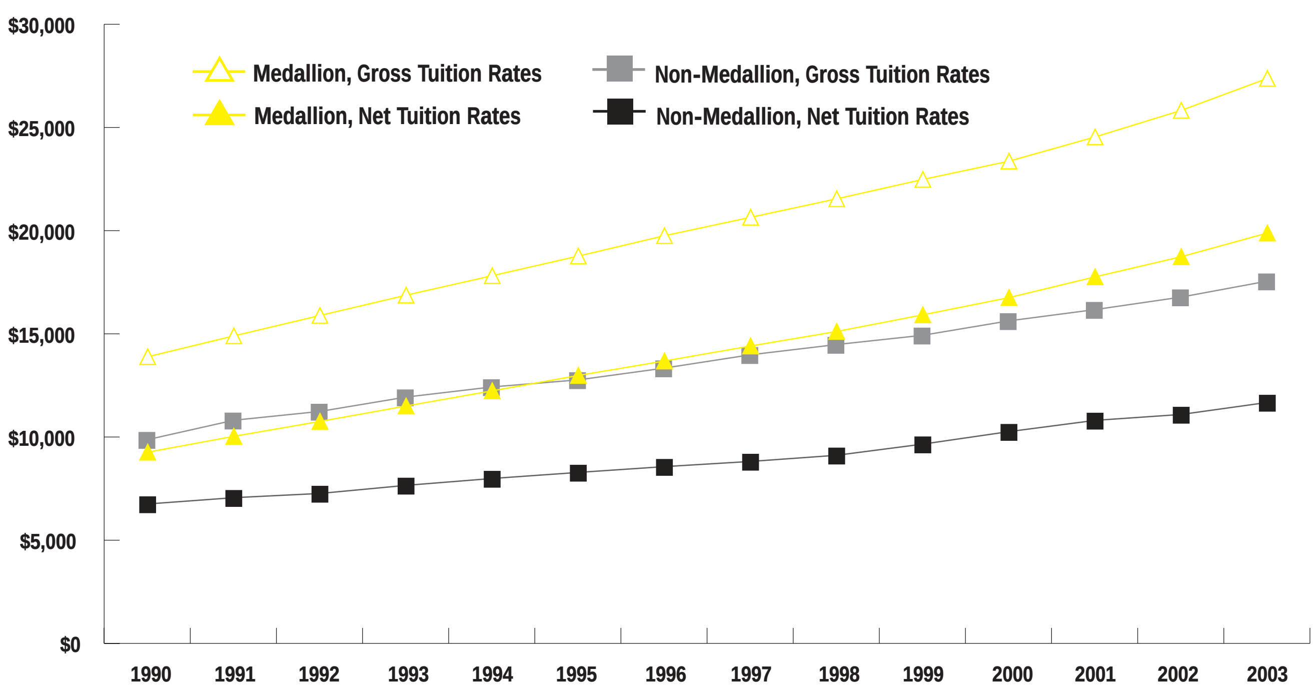
The tendency to provide greater subsidies to the middle class has been exacerbated in recent years by federal and state policies. Federal tax credits and individual retirement accounts for education are clearly middle-class benefits because participation depends on having available cash. Similarly, the trend towards merit-based state financial aid, following the lead of Georgia's HOPE scholarship program, also is primarily a middle-class subsidy in that children from affluent families are more likely to attain the good grades it takes to qualify.

Who Pays Full Price? Enrollment continues to grow at independent higher education institutions in the United States, and the number of students who receive institutional financial aid continues to grow significantly at all schools except the medallions. In fall 1990, 47 percent of the students at the medallion institutions received institutional financial aid, compared with 65 percent at other private institutions. In fall 2003, the average percentage of students receiving institutional aid at the medallion institutions had increased only 11 points to 58 percent, while at the other institutions it had increased 22 points to 87 percent of the students. Table 4 tracks aid awarded to full-time freshmen.

In fall 2003, 57 percent of the non-medallion schools awarded institutional aid to more than 90 percent of their students. This year, for the first time in the NACUBO sample, six of the medallion institutions awarded aid to more than 90 percent of their students. Providing aid to such a high percentage of students has led many parents and students to "bargain" for aid with the institutions they are considering. The ethos is that no one pays full price, and it is not too far from the truth at the non-medallion institutions.

Institutional aid formerly was granted to students primarily to enhance access to higher education for those without financial resources, and this is still true to a large extent at the medallion institutions. Today, however, most institutions are providing institutional grants to shape their classes, and many, if not most, employ financial aid as a recruitment and retention tool.

Table 3: Average Gross and Net Tuition: All Institutions



The average size of the financial-aid award along with the number of students who receive awards determines how much an institution spends on financial aid. While the percentage of students receiving aid has increased significantly over the last 14 years, the average award as a percentage of tuition has been a much more stable variable. The average institutional award at the medallion institutions has increased from 59 percent of tuition to 63 percent; at the non-medallion institutions, it has increased from 40.5 percent of tuition to 47.5 percent. The medallion institutions aid a much smaller percentage of their students compared with the non-medallion institutions, but their average awards are much larger both in absolute dollars and as a percentage of their tuition. Table 6 on page 11 charts this trend.

There is a wide range in the relationship between tuition and net tuition. For example, among institutions with a published tuition of $10,000, the net tuition ranges from less than $5,000 to just under $10,000. The differences in the relationship between net tuition and gross tuition reflect the college's institutional financial aid or discounting policies and are generally expressed as percentages. Trustees should know their institution's tuition-discount rate.

Managing Enrollment. How changes in enrollment—whether due to tuition-pricing policies or other factors—affect the financial health of the institution depends greatly on whether the institution is able to fill all its seats or has excess capacity. If an institution is unable to attract all the students it seeks, and if it has a lower student-faculty ratio than is optimal, it can accommodate an increase in enrollment with very few additional expenditures. In such a situation, the institution can improve its economic health if there is at least some small increase in net revenue. On the other hand, if the enrollment increase was achieved by increasing institutional financial aid to such an extent that the institution's net revenue fell, then the financial health of the institution will have deteriorated.

When an institution experiences an increase in enrollment and it is already at capacity, the addition of more students ordinarily requires additional expenditures. If the institution has attracted the additional students through significant increases in financial aid, the college will be in the worst of all possible situations, with expenditures up and net revenues down. On the other hand, a college may experience an increase in enrollment requiring an increase in expenditures, which is acceptable if net revenues increase more than the increase in expenditures.

It often is assumed that a positive correlation exists between a college's endowment and its ability to provide financial aid, but there is

Table 4: Percentage of Full-Time Freshmen Receiving Institutional Grants

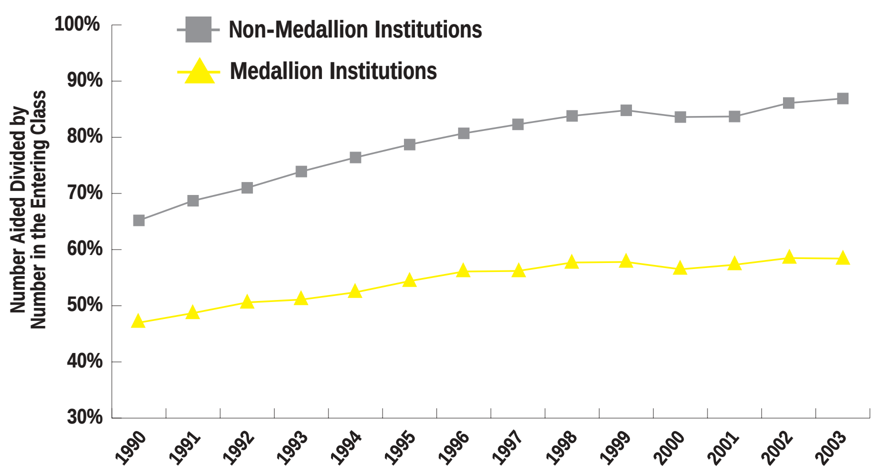
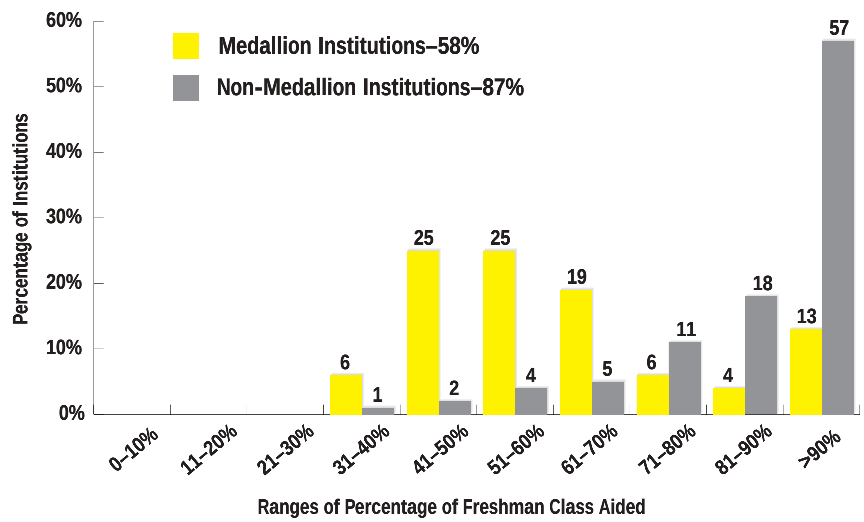


Table 5: Frequency Distribution Percentage of Freshmen Receiving Institutional Aid



no significant relationship between endowment size and the tuition discount. Institutions with small endowments and high discount rates are reallocating their tuition revenue to support their discount strategy and must use their tuition revenues for discounting rather than programmatic expenditures. While there is a slight shift to higher levels of tuition discounting as endowment values decline, the difference between institutions with endowments greater than $1 billion and those with endowments smaller than $50 million is only 6.2 percent—much less than the relative difference in their institutional wealth. Further, there are wide ranges in discounting levels in each tier of endowment, making the averages for each tier less indicative of individual experience.

More simply, relative institutional wealth or poverty does not sharply affect the level of financial aid. Institutional aid is an enrollment-management tool. The granting of aid to a significant percentage of the class is a necessary tool to fill the class with the requisite number and quality of students. Most institutions today are unable to enroll an adequate number of qualified students at their published tuition price. Trustees would do well to ask whether their institution is on a pricing merry-go-round or whether the pricing strategy is a rational method for attracting the best mix of students.

Throughout higher education, the published tuition price has little relationship to the actual cost of providing an education. At the medallion institutions, the published price often is below the true cost because annual gifts and spending from the endowment more than make up for the discounting and provide additional support for the institution. At the non-medallion institutions, especially those with small endowments (the majority of these insti-

Case Study

Miami of Ohio Reshuffles the Financial Cards

Miami University, a public institution with more than 16,000 students in Oxford, Ohio, raised tuition in fall 2003 to a single price of $18,000. In so doing, it abandoned the usual pricing structure for public institutions that sets different tuition rates for in-state and out-of-state students.

With state financial support for Miami University dwindling and the cost of state regulations becoming increasingly onerous and costly, the Miami Board of Trustees considered many options—including trying to become a private institution. University officials calculated that the institution would need to grow its endowment from its current $250 million to $2 billion in order to do without its existing level of state support. As an outgrowth of these discussions, the university decided to pursue a "private college" tuition approach.

The motivations for this radical change were to allow Miami to better control its revenues and to shape its freshman class. The university expects to support students from a broader range of economic classes and have greater flexibility in managing its net revenues from tuition.

Miami's leaders were especially concerned about being able to appropriately serve students who come from families with incomes between $50,000 and $125,000 and who have more than one child in college. In addition, in order to help increase the supply of graduates in subject areas state officials say are needed in Ohio, the university will offer different levels of aid to students who pursue degrees in those areas. This pricing strategy will provide the funds for that flexibility.

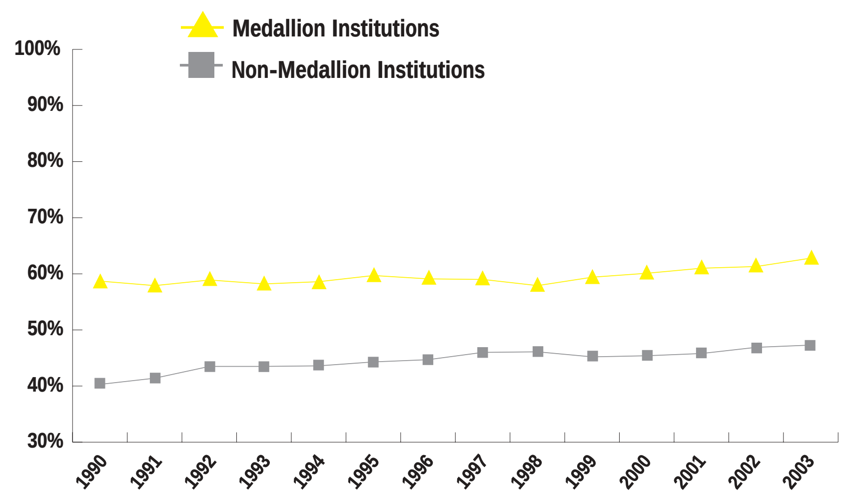
In the first year of the program, all Ohio residents received an Ohio Resident Scholarship (ORS) of $5,000 and an Ohio Leadership Scholarship (OLS) that ranged from $5,000 to $6,200, thus providing all Ohio residents with at least $10,000 in scholarship aid. In future years, the university will begin varying the amounts of these scholarships to provide more need-based aid as well as differential support for students in various areas of study.

The university currently is deciding how much of next year's tuition increase Ohio residents should absorb—or to put it another way, how much their Ohio scholarships should be increased.

tutions), the cost of the educational program usually is less than the published price. The implications for the program resources available to such private institutions are significant, and those institutions with small endowments and little external support face tremendous stresses.

The cost structures of these institutions differ significantly from those of medallion institutions based on faculty workloads, percentage of adjunct faculty in the instructional program, the scope of academic programs, the amount of support services, and the extent of facilities and amenities provided students. As the discount rate increases at a faster pace at the non-medallion institutions, their existence becomes more tenuous as the resources they have to pay for their programs grow more slowly than those at the medallion institutions, and the pressure to provide more services continues to grow. The gap between what is affordable and what is

Table 6: Average Grant as a Percentage of Tuition and Fees: Full-Time Freshmen



Miami officials do not expect to increase the university's net revenue in the first few years of this new pricing policy, but they expect that in the long run the shift will provide enhanced revenue opportunities and the financial tools to better shape its incoming classes. By showing all students the "true" price of tuition, they say, Ohio students will better understand what a "good deal" they are getting with their ORS and OLS scholarships.

The university has some preliminary evidence that it is improving its competitive position with private institutions that offer students large scholarships. Because Ohio students can now boast of receiving a large scholarship from Miami, students feel as valued by the university as do students who receive scholarships from private institutions.

Should other public institutions look at this model? According to Richard Norman, Miami's vice president for finance and business services and treasurer, "All flagship public universities should look at this. It lets you differentiate your price for your in-state students. These institutions all attract relatively high-income students, and these are the students who [may need] some pricing flexibility" to attract them.

Miami University has not allocated funds for public relations surrounding this change. So far, no other institution has followed its lead, though many are monitoring the experiment.

There is no significant relationship between endowment size and the tuition discount, but institutions with small endowments and high discounts must use tuition revenues for discounting, not program improvements.

desired increases and makes the situation more difficult each year.

Public-Policy Implications. Discounting the price of tuition leads colleges and universities to increase their published prices continually until there is no more room to discount. They continue to do this in the face of congressional disapproval, most notably in the form of legislation introduced by Rep. Howard "Buck" McKeon (R-Calif.) that threatened sanctions on institutions that continued to raise tuition beyond certain percentage increases. Although McKeon withdrew the bill, and reauthorization of the Higher Education Act is stalled until 2005, tuition levels continue to rise.

In the face of adverse publicity and threatened government interference, higher education institutions continue the current strategy of raising tuition at a significantly greater rate than inflation, while offsetting much of the increase with significant boosts in financial aid. This practice, which has been commonplace at private colleges for the past several years, now appears to be spreading to the public sector. Many public institutions now offer a variety of scholarship programs to attract high-ability students, student leaders, and other categories of desired students. These institutions also seek to attract out-of-state students who ostensibly pay higher tuition, but many public institutions are luring "attractive" students with discounts in the form of merit aid.

Many people believe that the continued reliance on tuition discounting is in part a response to its widespread use and increased consumer understanding of the practice. Tuition discounting also continues to grow because the competition for academically stellar students is increasingly fierce. This competition is spurred partly by the lower tuition prices charged by high-quality flagship public institutions and partly as a result of the commodity-like marketing presentations and comparisons of educational services through rankings and lists. The latter trend feeds the American consumer's appetite for convenience, service, quality, and low cost.

Whatever the driving forces underlying the shifts toward tuition discounting and characteristic-based aid, it is clear that most institutions will continue to wield aid to attract and retain students whose families are unwilling to pay published tuition prices. Because this approach relegates objectively measured need to a lower strategic priority in the discretionary application of funds (however flawed the federal and institutional financial-aid methodologies may be for determining the expected family contribution), institutions are likely to escalate their competition for students using characteristic-based aid and tuition discounting as tactics.

The jury is out on whether merit aid is being used in addition to need-based aid or whether it is replacing need-based aid. The results of several recent studies are inconclusive. It is clear that merit aid is providing pricing incentives for some students and families who could pay the published price but choose not to.

The Outlook. Colleges and universities face a difficult period as higher education officials try to envision what the landscape will look like in 20 years. As the student population changes, as competition from new market entrants increases, as government support continues to lag inflation and enrollment growth, and as published prices and discounting continue to increase, the stresses on institutions will not abate. But these forces will affect different types of institutions in

How It's Done: Managing Enrollment Through The Strategic Use of Tuition Discounting

Here is a hypothetical situation that demonstrates how an institution actually employs tuition discounting to manage its enrollment and shape its class. This institution has 2,000 applicants, of whom 1,650, or 83 percent, are admitted. Application readers in the admissions office stratify applicants by ratings ranging from A to D, with A going to the most desirable students and D to the least desirable. Most colleges and universities classify applicants according to a similar alphabetical or numerical scale, but the student attributes and weights assigned to them vary widely in complexity by institution, as do the number of ratings levels.

At this institution, 100 percent of students rated A and B are accepted, as are 92 percent of C-rated students and 40 percent of D-rated students. Among the accepted students, 465, or 28 percent, choose to attend the institution. One might intuitively assume that this yield rate (the rate at which accepted students choose to attend the institution) would increase as the reader rating declines. But this is not the case at this institution. The yield rate ranges from 45 percent to 20 percent, with the highest rate among the A-rated students and the lowest rate among the B-rated students. This has occurred because of how the institution awards financial aid. The institution is discounting tuition to A-rated students by 75 percent but is giving B-rated students a discount of only 38 percent. The overall discount rate at this institution is 41 percent, about the national average for private institutions.

A useful way to look at these data is to see what students are paying by reader rating. We know that the published price of tuition is $18,000, and the average net tuition paid is $10,620 (that's 41 percent of $18,000). The average net tuition paid by the A-rated students is $4,500—they're getting a 75 percent discount—compared with an average net price paid of $15,300 for the C-rated students, who are offered discounts of only 15 percent.

You can see in the accompanying tables, which compare the quality of the freshman class with the amount of tuition they pay, that none of the A-rated or B-rated students pays full price. On the other hand, two of the A-rated students are receiving full scholarships; they are paying no tuition.

Analysis of Freshman Class Quality by Net Tuition

	QUALITY RATING				TOTAL	
Net Tuition	**A**	**B**	**C**	**D**	**#**	**%**
$18,000 (full pay)	0	0	20	22	42	9.00%
$15,000 – 17,999	0	0	71	19	90	19.40%
$12,000 – 14,999	0	42	24	9	75	16.10%
$9,000 – 11,999	0	68	10	7	85	18.30%
$6,000 – 8,999	23	5	3	8	39	8.40%
$3,000 – 5,999	90	4	1	7	102	21.90%
$1 – 2,999	20	1	1	8	30	6.50%
$0	2	0	0	0	2	0.40%
Total	**$4,500**	**$11,150**	**$15,300**	**$12,600**	**$10,629**	

Analysis of Freshman Class Amount Paid by Family Income

Net Tuition	**Family Income**				
	$0 - $24,999	**$25,000 – $49,999**	**$50,000 – $99,999**	**$100,000+**	**Total**
$18,000	0	0	15	27	42
$15,000 – 17,999	0	5	50	35	90
$12,000 – 14,999	0	5	40	30	75
$9,000 – 11,999	0	10	70	5	85
$6,000 – 8,999	5	10	10	14	39
$3,000 – 5,999	15	15	50	22	102
$1 – 2,999	3	7	10	10	30
$0	1	0	0	1	2
Total	**24**	**52**	**245**	**144**	**465**

different ways. The competitive landscape for public and private institutions is likely to change as public institutions experience significant tuition increases and the tuition gap between the sectors narrows. The decision of Miami University of Ohio to eliminate in-state tuition breaks but raise available aid certainly bears watching.

The trend toward higher tuitions at all types of institutions may curtail access to higher education for many low-income students—unless a significant recommitment of financial aid to level the economic playing field is accompanied by vigorous efforts to inform prospective students not to be scared off by published tuition prices. Certainly, the return on a family's investment in higher education is unlikely to diminish, given the continuing high marketplace demand for a college degree.

Private colleges and universities are operating in difficult times. The medallion colleges enjoy applicant pools from which they can easily fill their classes with high-quality students several times over. This group of institutions offers financial aid to students primarily to provide economic diversity to a student body. All of these institutions charge high tuitions, and most have significant endowments. There is an "arms race," as Williams College economist Gordon Winston calls it, and these colleges and universities can continue to increase their attractiveness to the pool of elite students because most of these institutions have the resources to compete with one another.

Many non-medallion institutions will continue to have difficulty filling their classes with appropriately qualified students at their published tuition prices. They are indeed on a wildly gyrating merry-go-round of price increases and discounts. For many of these institutions, this does not seem to be working to their advantage. The non-elite colleges face real issues of survival, and each year sees a few of them facing precarious financial positions. On the other hand, the trend toward significant tuition increases at public institutions may help level the playing field and improve the competitive position of some of these small private institutions.

Wanted: New Proposals For Curbing College Costs

Many of the somersaults being turned by colleges and universities that practice tuition discounting might be unnecessary if there were a broader effort across society to reduce the costs of attending college. This past summer, the Indianapolis-based Lumina Foundation for Education released a paper, "Collision Course: Rising College Costs Threaten America's Future and Require Shared Solutions." It was written by Robert Dickeson, a longtime higher education policy analyst, former president of the University of Northern Colorado, and now Lumina's vice president for policy and organizational learning. It is part of a larger "call for solutions" by Lumina aimed at encouraging more dialogue and written debate over how to curb college costs.

Any solutions to this complex problem will involve contributions from multiple parties, Dickeson notes. That's because its roots are also multiple: rising student populations, diminished capacity on campuses, state funding cuts, and new demands for institutional accountability.

The most workable solutions are likely to emerge from six major constituents—namely, colleges and universities, state governments, the federal government, students and families, secondary schools, and the private sector. He offers examples of steps each group could take.

Suggested solutions for institutions include improving efficiency, reallocating existing resources, boosting fund-raising, and growing endowments to create proceeds that can be channeled to needier students.

The "Collision Course" study and the "call for solutions" may be downloaded at *www.luminafoundation.org.*

A Glossary of Tuition and Aid Terms

Institutional financial aid—**the amount of funds a college or university awards to students to help them attend that college. These funds may come from such sources as tuition revenue, annual fund gifts, or restricted funds from the endowment or the annual fund.**

Need-based financial aid—**aid provided to a student based on the family's ability to pay, as determined by government formula.**

Merit or characteristic-based aid—**aid provided to a student based on characteristics other than need. This may include athletic or academic ability, musical or other talent, geographic region of the student's hometown, or alumni legacy.**

Tuition—**the published "sticker price" of attending a college or university.**

Net tuition—**tuition minus average institutional financial aid per student.**

Gross tuition revenue—**published price multiplied by the enrollment. This is the amount an institution would receive if no discounting existed.**

Net tuition revenue—**gross tuition revenue less all institutional financial aid.**

Tuition discount—**a figure determined by dividing net tuition revenue by gross tuition revenue.**

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Additional Reading

- Breneman, David W., James L. Doti, and Lucie Lapovsky. "Financing Private Colleges and Universities: The Role of Tuition Discounting," *The Finance of Higher Education*, Michael Paulsen and John Smart, eds. New York: Agathon Press, 2003.
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Resources Available From AGB

(Call 800/356-6317 for information.)

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- Townsley, Michael K. *The Small College Guide to Financial Health*, NACUBO, 2002.
- "Why Does College Cost So Much?" This short booklet, written and intended for distribution to students and families, explains the facts about tuition and lists sources of information about financial aid. AGB, 2003.

This Issue

Finding the Magic Number

BY SUSAN WHEALLER JOHNSTON

The price of a college education, like the rates we pay for health care, cable television, and a movie ticket, has been rising steadily and to the sounds of much grumbling. The difference with this particular ticket to a better future, however, is that in higher education the "sticker price" often is less than the true cost of providing the service. What's more, many independent colleges and universities reserve numerous seats for students and charge less than the full price of admission—a practice the institutions call tuition discounting.

For most trustees, this process complicates the central task of setting their institution's tuition. To help us think strategically about this complex topic, AGB has turned to an expert and experienced practitioner of policies designed to integrate tuition discounting with effective enrollment management and long-term financial health. Lucie Lapovsky, who just completed a successful tenure as president of Mercy College, is a trustee, economist, and author of numerous articles on tuition and the ins and outs of discounting.

As you will see in her detailed essay, higher education's embrace of selective discounting in response to general tuition hikes is not without risks. Unless your institution has a healthy enrollment, for example, too much discounting can deplete funds that could have gone to academic programs and staff salaries while doing little to raise the caliber of the student body. In addition, critics worry that tuition discounting inequitably shifts financial aid that for decades had been available on the basis of family need.

"At the heart of this issue," Lapovsky writes, "is the confluence of each institution's need for a robust revenue stream to pay for the things that keep it competitive and the degree to which families are willing to pay the published price of tuition. The core of the strategy is to provide incentives to those 'desirable' students who are able to pay to attend the institution in amounts according to the traditional need-based aid formulas but who are unwilling to pay the sticker price. Thus, one must ask whether discounting actually increases the revenue available by increasing enrollment or whether it takes resources away from needy students or from programmatic improvements by subsidizing students who would have attended anyway."

The strategic challenge individual institutions face as they set tuition rates is linked inextricably to the larger challenge faced by society—namely, how to keep the rewards of higher education accessible to the widest slice of the population.

Among the higher education groups active on this issue is the Indianapolis-based Lumina Foundation for Education (see "Wanted: New Proposals for Curbing College Costs" on page 14). AGB is grateful to Lumina for the generous funding it provided to help produce this issue of *Priorities*.

—Susan Whealler Johnston is vice president for independent sector programs at AGB.

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