Schools of hard knocks

Facing heavy-handed government regulation, America's for-profit colleges are reforming themselves.

"EGREGIOUS, outrageous, violated everything we stand for": Don Graham's denunciation of recent activities by some employees of his own firm is stark. On August 4th a report by the Government Accountability Office (GAO) found evidence of deceptive recruitment tactics by 15 of America's leading for-profit colleges, including one operated by Kaplan, which accounts for the bulk of the profits of Mr Graham's Washington Post Company. Some of the colleges, which also included the giant University of Phoenix, insisted that the incidents—which ranged from misleading potential students about tuition costs and likely post-graduation salaries to encouraging them to file fraudulent loan applications—were isolated. But the mood is turning against them.

For-profit colleges, which range from beauty schools to institutions that resemble traditional universities, were already under attack. In June Steve Eisman, a hedge-fund manager who made a lot of money during the financial crisis by shorting bank shares, told Congress that the for-profit education business was as destructive as the subprime mortgage industry. Congress already seems eager to add to regulations that the government plans to introduce in November.

The markets sense weakness in the industry. Shares in Apollo Group, which owns the University of Phoenix, are worth half what they were at the start of 2009. The Washington Post Company has lost nearly one-third of its value since April. Shares in Corinthian Colleges have fallen 70% in the same spell.

Yet for-profit higher education is one of the greatest success stories in American business. Since 1976, when it was founded by John Sperling, a history teacher at San Jose State University who was frustrated in his efforts to provide courses for students with full-time jobs, the University of Phoenix has grown into an institution with over 450,000 students. Many of them study online, although the university also has more than 200 campuses across America. It is now America's second-largest university system. Kaplan, best known for its test-preparation courses, is a 75-campus organisation with 112,000 students learning everything from law to nursing.

In the academic year 2008-09 America's for-profit colleges enrolled 3.2m students, 23% more than the year before and 59% more than in 2004-05. Cuts at public and non-profit colleges boosted the for-profit sector's share of students to 12%. Total revenues of the 3,000 or so for-profit colleges have soared to over $29 billion from under $10 billion a decade ago, calculates Jeffrey Silber of BMO Capital Markets.

According to critics such as Mr Eisman, this is a bubble like the subprime mortgage crisis, with a "churn 'em and burn 'em", commission-driven approach to student recruitment and a ready supply of government-provided debt. On this last point, at least, he is right.

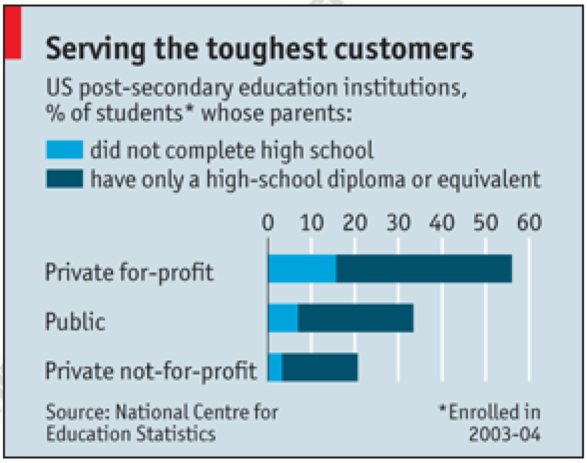
Packing them in

The American government has an unusual model of financing higher education, in which it lends to students who decide at which educational institution they spend the money. In most other countries, the government subsidises educational institutions directly. "In the United States, for-profit colleges are competing for students directly with public and non-profit colleges; everywhere else, they are filling niches ignored by the traditional colleges," points out Doug Becker, the boss of Laureate, a global for-profit outfit.

The recent GAO report offers anecdotal support for Mr Eisman's view that much of the recruitment of students is predatory. Also troubling was another report that found for-profit college students defaulted on their loans at a far higher rate than students at public or non-profit colleges. This the government took as evidence that many students found their courses less useful than they had expected, so dropped out or stopped paying. Among the new rules expected on November 1st is a "gainful employment" requirement that would make a course eligible for government loans only if enough current or past students are repaying their loans.

The gainful-employment rule has been the focus of sustained attack by the for-profit colleges. According to data in a recent government report, even courses offered by many of the leading colleges would fail the gainful-employment test as currently proposed. Default rates of more than 50% are not uncommon—on the face of it, a shocking number. But the government definition of default is wrong, argue the for-profit colleges, not least because it counts as defaulters students who have joined a temporary interest-only payment scheme offered by the government to help ease the transition from student to worker. Mr Graham says the vast majority of Kaplan's students are meeting their loan obligations.

Default rates at for-profit colleges are higher, they point out, because they educate a large proportion of students from poor backgrounds, whose parents did not go to university (see chart). "If you are going to take a chance on a part of the population that is poorer and has no tradition of going to school, your dropout and default rates are going to be higher," says Greg Cappelli, a co-CEO of Apollo Group. Compare a for-profit college with a public or non-profit institution with similar student backgrounds, and the default rates are similar. The danger is that the gainful-employment rule will simply reduce access to higher education for poorer people.



Mr Cappelli insists he is not against more regulation of this already heavily regulated industry, as long as it is done right. That means focusing on the needs of students, not the tax status of the college at which they enrol. The recruitment tactics condemned in the GAO report can probably be found at public and non-profit institutions, too, he says. Likewise courses that offer poor value for money and students with too much debt. New rules should apply equally to higher education institutions of every kind, he says.

A belated house-cleaning

Meanwhile for-profit colleges have started hiring "mystery shoppers" to test their sales practices. The University of Phoenix is working to disconnect recruiters' pay from the number of students recruited. It is also encouraging students to take on less debt. To reduce the number of dropouts, it is offering students a three-week "orientation" during which they can quit without charge. Kaplan plans to go further, regulators permitting, by offering students a full refund if they drop out during their first term. Mr Graham would like such a refund to be made mandatory, to drive the “bad actors” out of the industry.

The leading for-profit colleges hope to survive by putting their own houses in order and by calling for new regulations that apply to higher education as a whole. And they make another, broader, claim. When the full cost of loans and subsidies is added up they are significantly cheaper for the taxpayer, per graduate, than public and non-profit institutions. Given the Obama administration’s ambitious plans to expand higher education, a rush to impose more burdensome regulations may not be such a good idea.

Fonte: The Economist, Sept. 9th 2010. Disponível em: <www.economist.com>. Acesso em: 14 set. 2010.