INSIDE HIGHER ED

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Pricing the Product

By John V. Lombardi February 5, 2008 4:44 pm

In recent weeks we've seen flurries of enthusiasm about various interrelated topics, all about money. We hear of the concern about the relationship between the payout rate from college and university endowments and the rise in tuition and fees. We see confusion about the maneuvering of elite institutions to provide non-loan financial aid to desirable student populations with family incomes ranging above $100K. And we read about the increase in potential payments to division I-A student-athletes. It's always about the money, of course, but in American higher education, we are supremely effective at avoiding intelligible conversations about the two most important issues related to money: What the whole enterprise costs and who pays for it.

Normally, our practice is to pick off an isolated cost, apply it to a particular subset of institutions, and then try to make generalizations about higher education. We look at the tuition and fees of expensive boutique institutions that sell high prestige along with high quality amenities, measure the endowments of the 10% of the institutions that are exceptionally rich, apply arbitrary possible payout percentages to these endowments, and then discuss whether or not we could manipulate these variables to provide more access to these boutique places for poor but worthy students. This is a mostly pointless discussion. If rich institutions choose to spend their wealth in some particular way to enhance their missions, fulfill their sense of social obligation, or improve their market positions relative to other rich institutions, we should watch with interest, but not imagine this is about national educational policy.

The significant issues relate to the problem of the total cost of a college degree on one side and the distribution of that cost to a wide range of paying entities on the other. Most of the argument isn't actually about the total cost because everyone wants what the money buys: smaller classes, better faculty, new facilities, enhanced support for student life, personalized advising, effective job placement, competitive athletic programs, and so on down a long list. We may disagree on the exact combination of these wants, but the purchasing public has clearly indicated a preference for these things. The real issue is who should pay for what we want.

If we can get an endowment to pay, then we have asked past donors to pay for our current and future benefits, and that's surely a good thing for those of us who consume those benefits today and tomorrow. If we can persuade state governments to pay, that's good for those of us who consume, because the money comes from many taxpayers who do not use the benefit. If the federal government pays, that's even better, because the pool of payers is spread widely, and because the federal government doesn't have to balance its budget, the cost can be shifted to future taxpayers. If we as parents and students must pay for the benefits, that's not a desirable outcome. Along the way, each group paying some part of the cost complains about the portion allocated to them.

Each group, rather than looking at the cost and the value of the specific benefits they seek, turn on the institution and complain that all the costs of the institution are rising too fast and argue for a reduction. Few of them argue for a reduction in services, although sometimes one group will propose a reduction in those services provided to another group of institutional constituents. Most of our constituents do not want to worry much about the full cost of the institution's services or understand how the colleges and universities allocate those costs to the various paying constituencies. They just want to pay less.

Universities perform a wide range of functions, but in many of their operations they do not charge consumers for the full, direct costs of the benefits delivered. Take honors programs, for example. These are very popular, but they are expensive, offering special small classes taught by the best faculty, often in well-equipped classrooms, with special support staff. Yet few would argue that we should charge honors students extra because they receive more expensive services. Instead, we charge all undergraduates the same price, and then we include the cost of the honors programs within the price paid by the non-honors students, and even when we do charge a bit extra for honors, it's usually a fraction of the true additional cost. When students and parents complain that college is too expensive and class sizes are too large, the institution doesn't respond by outlining the extra cost to all undergraduates of the honors program.

Similarly, students in chemistry and physics and other lab sciences use more resources than those in English or history, but usually pay only a small fee for the consumable supplies provided, not a premium for the expensive space and equipment the institution provides for their study. Some states, in their funding formulas, recognize this difference and pay more for science than for humanities, but the parents and students do not.

These differences in cost are not restricted to academic variables since student activities of all kinds add substantial cost to higher education institutions, and especially to residential institutions. Some of these costs may be charged directly to the students in the form of fees to cover recreation centers, while others such as social services such as counseling and student activities offices will often end up buried in the general fee bill. Even when there is an explicit fee for a recreation center, however, in most instances all students must pay the fee, even if only some use the facilities everyone pays for. While these mechanisms of burying special program costs into the general campus budget are well developed and common across most institutional types, they nonetheless pose a challenge in explaining the rising cost of college.

If we were willing to replace our current method of pricing our services with a more detailed pricing mechanism, we might find different constituencies of the university with a different interest in supporting various programs. We do this to some extent in big time college athletics (at least in those programs that break even) when we require the revenue generated by the program to match its expenses, driving up ticket, parking, seat priority donations, and other prices to pay for competitive football and basketball programs. We do it in residence halls when we make the residents pay for the cost of the facilities and the programs within them. We do it with parking and food services.

Even so, we resist pricing our academic services differentially. This resistance comes in part from the charmed notion of "college" as four years of self-discovery and preparation leading to the good life. Those four special years should be open for any student to explore any field of knowledge or experience whatever seems appropriate and be supported however it might be necessary until self-discovery occurs or time runs out. Under that notion, we are like an amusement park that charges a flat fee per day to ride all or none of the rides any individual chooses or is able to accomplish within the time allotted; the park charges for the opportunity, not for a specific set of activities. The alternative is the carnival, which charges us individually for every attraction, game, or ride we choose, but only for those we choose.

As the content of higher education becomes increasingly available separately from the context, whether through distance education programs or other delivery systems, the pricing of content and context may also become even more disaggregated within the structure of the traditional college or university campus. We already price MBA programs differentially from MFA programs or MD programs from Vet Med programs, and this postgraduate pricing by specialization may well find its way into undergraduate institutions as a method for dealing with the unrealistic expectations of our paying publics and customers and the opaque nature of our institutional cost analyses.