KENNEDY & COMPANY
Innovative Strategies for Higher Education

FALL 2016

The Discount Rate Dilemma: Making the Next Move Count

OVERVIEW AND CHALLENGE:

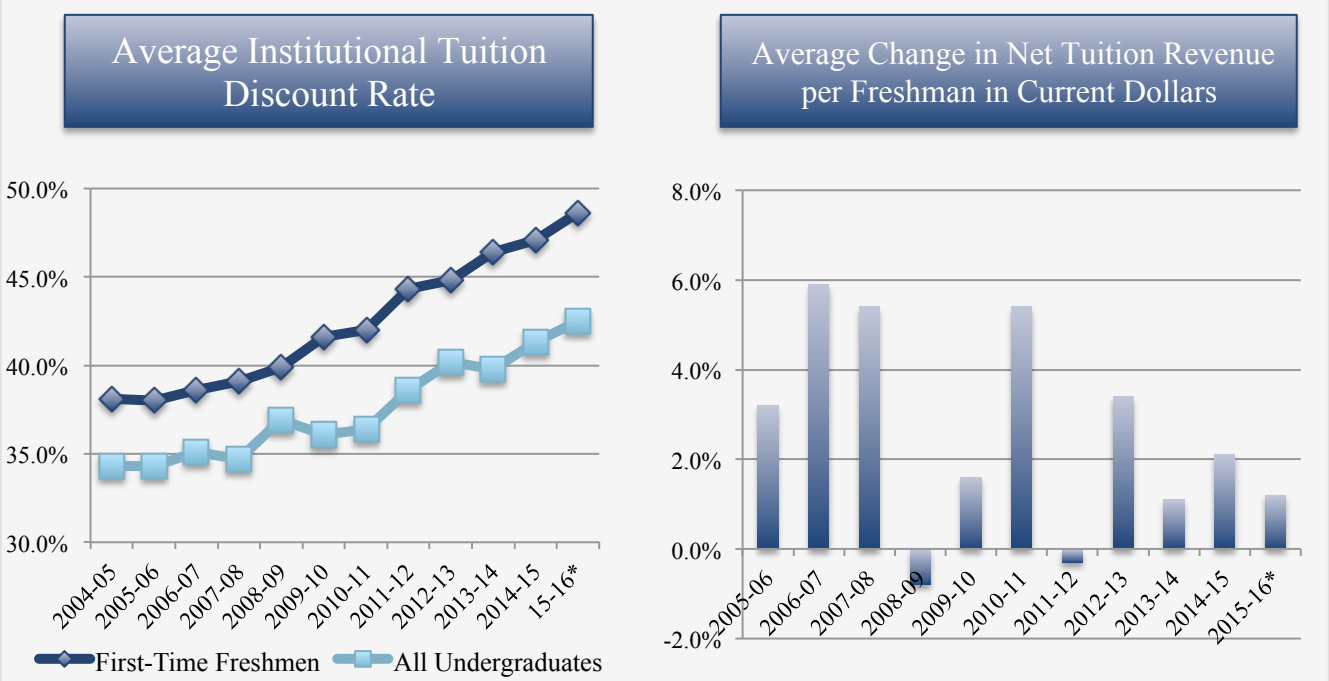
The last several years in the higher education industry have been marked by a changing environment where the game of tuition discounting no longer yields the desired result of growing student enrollment and increasing net tuition revenue. At many colleges across the country, net tuition revenue growth has been very small or even declining, prompting college leaders to call into question current discounting strategies and seek new business models.

Changing demographics (populations and income) have pushed competition to expand (geographically), and new competition has spurred pricing competition among schools and *redefined* prospective student expectations on scholarships, creating an entitlement where 88.2 percent of first-time students on average receive an institutional grant.

NACUBO's latest webcast, Rethinking Tuition Discounting Strategies features invited speaker, Ben Kennedy, managing partner of Kennedy & Company

UNDERSTANDING INDUSTRY TRENDS:

NACUBO's 2015 Tuition Discounting Study, accepted by many as the authoritative research on discount rates, shows climbing discount rates and stagnant net tuition revenue at private, non-profit colleges and universities. The fact that both the freshman and "all undergraduates" discount rates are



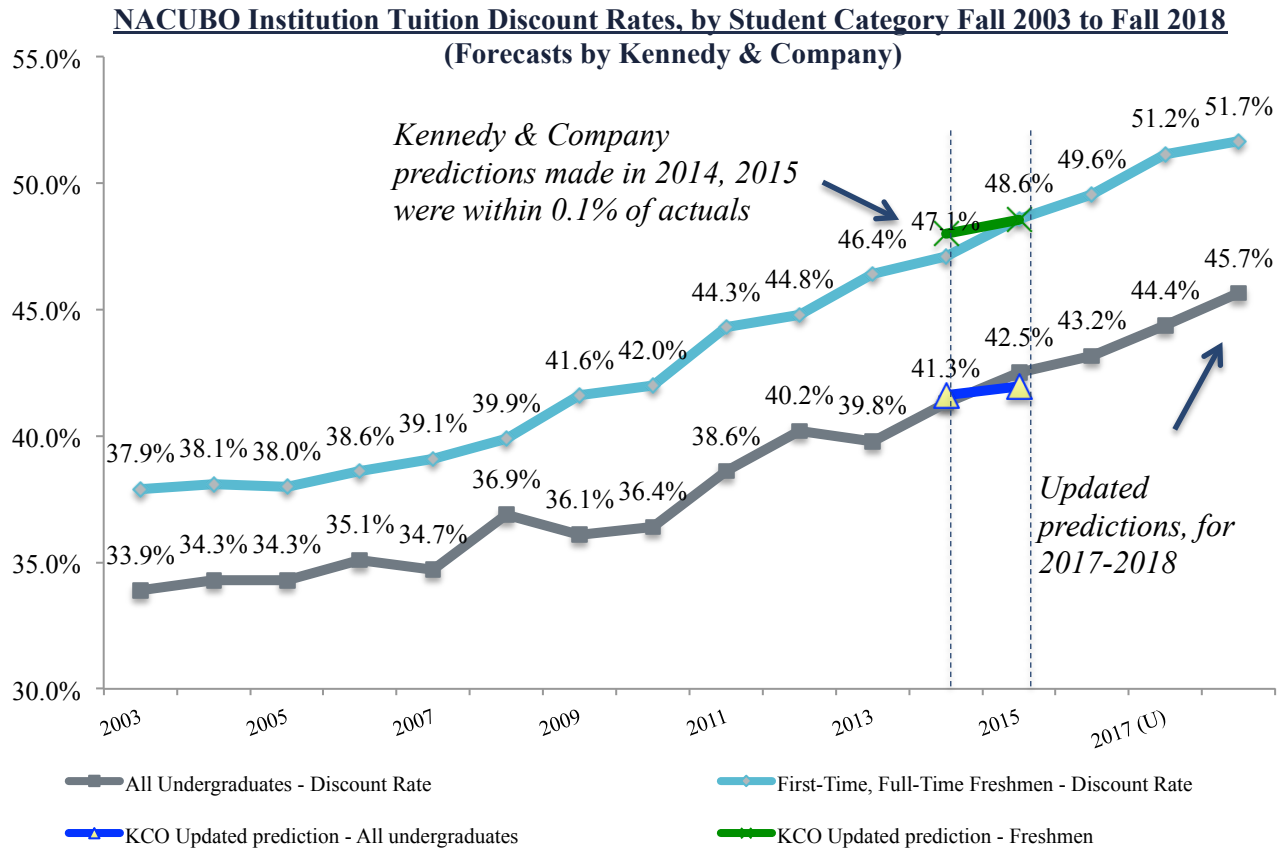
Source: NACUBO Tuition Discounting Study, various years. *Preliminary Estimate

Understanding Industry Trends – Continued

at record highs again this year is not surprising. The average discount rate for freshman in 2014-15 was 47.1 percent, and is expected to rise to 48.6 in 2015-16. The discount rate for all undergraduates is also on the rise. The climbing discount rates have put pressure on net tuition revenue growth, estimated at 1.2 percent in 2015-16. In fact, Kennedy and Company found that net tuition revenue growth has averaged only 1.91 per year since the recession in 2008. Popular strategies that institutions used in FY15 to increase revenue include: increasing enrollment and focusing on retention (28 percent), making substantial changes in financial aid packages (27 percent) and implementing tuition pricing strategies (24 percent).

Forecast: tuition discount rates will continue to rise

Kennedy & Company projects freshman discount rates will finally cross the 50 percent mark in 2017 and will be nearly 52 percent in fall 2018. Reductions in state appropriations seem to spur the biggest leaps directly or indirectly. The all undergraduate and freshman discount rate appear to be related: the 4-year average freshman discount is highly predictive of the next year's undergraduate rate.
This outlook for higher education institutions suggests that there will be difficulties in growing net tuition revenue into the future. Before institutions can determine the next steps in the complicated game of competitive strategy, they need to first reexamine the context of how their institution arrived at their current position.



Source: 2015 NACUBO Tuition Discounting Study with additional analysis by Kennedy & Company

The Downward Spiral of Price Integrity

What started out as perhaps one college or university providing a scholarship to a new student, decades later has now become a *network* of competing colleges using institutional grants to leverage enrollment. Scholarships have become larger and larger, going to more and more students, making the sticker price of education ultimately a preliminary "asking price." Unique discounting strategies that give a college or university a competitive advantage for one or maybe two years are erased later as competition catches on to the institution's discounting policy.

One example of how colleges have lost price integrity is through scholarship tables aimed at prospective students and parents in an effort to be transparent and help net price calculations. Widespread use and publicity for 2- or 3-category tuition discounting offers has made scholarship shopping possible and easy, necessitating ever-increasing offers to compete for freshmen.

Sample 2-Category Discounting Table				
	ACT Score			
GPA	32+	28-31	24-27	20-24
3.8+	90%	70%	50%	30%
3.5-3.8	70%	50%	30%	10%
3.2-3.5	50%	30%	10%	5%
2.9-3.2	30%	10%	5%	0%

On average, 88% of first-time, full time freshman students received an institutional grant in 2015-16.
Source: 2015 NACUBO Tuition Discounting Study

The Bed Bath & Beyond Effect ©

Standardized scholarship offers lead perspective students to experience what Kennedy & Company calls the "Bed Bath & Beyond Effect"— where people plan or want to shop at Bed Bath & Beyond, but will *only* do so when they have their 20%-off-any-item coupon.

"Shopping with a coupon at Bed Bath & Beyond has begun to feel like a given instead of like a special treat, and that's bad news for the chain's bottom line," - The Washington Post, September 30, 2015

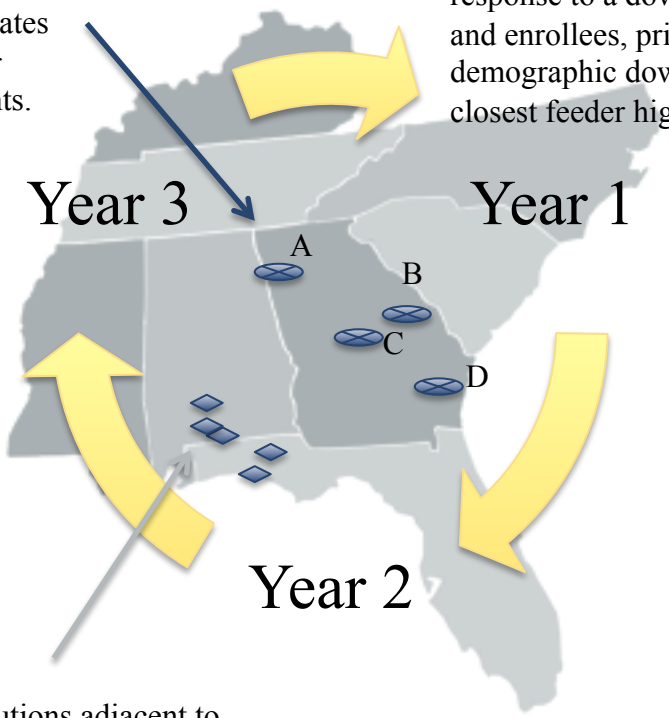
If the coupon is forgotten, customers often will not go to Bed Bath & Beyond, or will shop somewhere else for an item. In the case of colleges and universities, the Bed Bath & Beyond effect happens when a student decides to enroll at an institution only when he or she has the scholarship or other published discount they believe they are entitled.

Illustrative: Discounting Leads to Pricing "Arms Race" with Geographic Competitors

Situation: Colleges A, B, C, & D are hypothetical geographic competitors within 300 miles of each other that all have overlap in cross-applications. The closer the proximity, the more the overlap.

Year 3: College A is feeling the effects of B & C and will raise rates in Year 3 to counter declining enrollments.

Year 1: College A raises their discount rate by 2% across all categories, in response to a downturn in applications and enrollees, primarily driven by a demographic downturn among their closest feeder high schools.



Year 3: Colleges A & D are adversely affected by Colleges B and C and their new discount rates. As a result, College D raises its discounting rates because enrollment from its feeder schools is now flat in reaction to B & C raising rates in year 2.

Institutions adjacent to the region are impacted as well, and take steps in their own enrollment ecosystems.

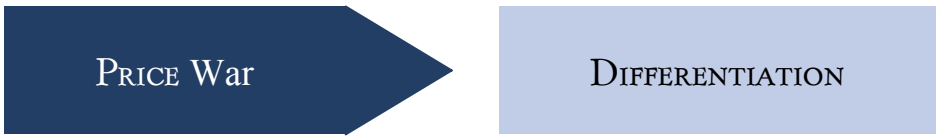
Year 2: Colleges B & C are adversely affected by College A in Year 1, so they increase their discounting rate by 3% in order to maintain enrollments.

This cycle of discounting is detrimental to Colleges A, B, C, & D because they are competing on price as commodities with a similar value for similar prospective students.

Avoid the Arms Race of Tuition Discounting

Changing an institution's discounting strategy is not something that can be done overnight. At many colleges and universities, shifting strategies often needs to be a multi-function decision (board, finance, budget, enrollment, marketing). In the long run, not playing the same "discounting game" is, likely, imperative. So, what can your institution do to avoid the arms race of tuition discounting? Try shifting from a price war to one of differentiation.

> *"No matter who wins, the combatants all seem to end up worse off than before they joined the battle."*
>
> -Akshay Rao in Harvard Business Review



Typical Examples: Points of Differentiation

- Academic areas of excellence
- The campus experience – clubs, athletics, community integration/interaction
- Commitment to student success, resources, tools
- Unique academic experiences – co-ops, immersions, practicums, research

But how can colleges effectively enroll students based on differentiation?

Other Industries: Driving Differentiation over Price

Many prominent companies—think of—Apple, Ben & Jerry's, Airstream, Starbucks, and Whole Foods—have carved out their space in each of their competitive markets by relying on a differentiation strategy.

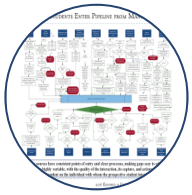
One specific example of a company that decided to not enter a price war, but instead engage in differentiation is Porter Paints. In a market full of companies that make paint— Behr, Glidden, Benjamin Moore, Sherwin-Williams—Porter Paint decided to focus on producing paint for a specific customer—the professional painter – and not selling to individual customers. This model has kept them profitable since 1921.

Source: Porter, M. E. (1998) Competitive strategy: Techniques for analyzing industries and competitors. The Free Press: New York, NY.

Sharpening the Tuition Discounting Strategy

Moving away from a discounting-based enrollment strategy to a differentiation strategy involves multiple functions on campus: the academic enterprise, admissions, financial aid, marketing, student affairs (and more). Here are a few of the best differentiation-based tactics we recommend and help colleges implement:

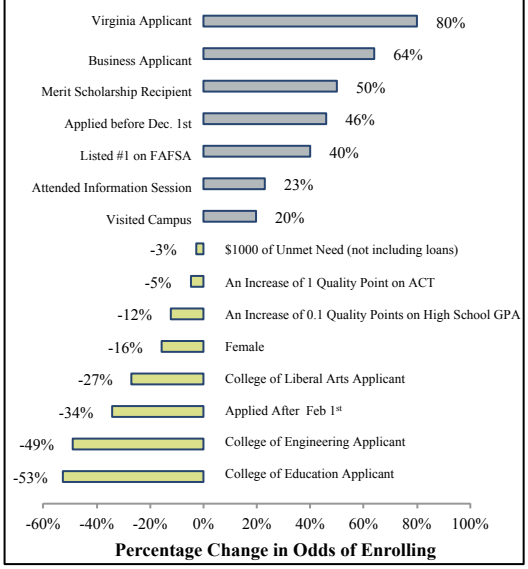
Relationship-Based Recruiting: If your approach to recruiting at a few of your biggest feeder high schools is based on numbers and not student segmentation, consider an individualized recruiting approach where admissions counselors use CRM data and a few typing questions to build relationships with individual students.



Frictionless Enrollments (Student Services): If yield has dropped or the number of melts/walkaways has increased, it may be that your enrollment process is simply too cumbersome and time-consuming for the hard-to-serve student. Identify what parts of the process take the most time and cause the most "friction" for prospective students, and work to fix them.

Find More High Propensity-to-Yield *Applicants:* Using the same propensity-to-yield model (Figure 1) that underlies your discounting matrix, identify which factors in your dataset might provide *useable* clues to how to identify likely students outside of your typical enrollment areas.

Figure 1: Sample Influential Known Factors of Enrollment Decisions



Incentive-Based Discounting & Pricing: Drive student behavior about how many credits to take (e.g., 12 versus 15), and which majors to pursue (e.g., high capacity) with tuition discounts that drive course consumption behavior.

Switch from Categorical to Individualized Discounting Strategies: To avoid the trap of "entitlement discounting"—where students know (or can discover) what scholarship they are entitled to at your institution—identify more than just 2 or 3 meaningful data points (SAT/ACT, GPA, School). Create customized scholarship awards based on 4 to 6 statistically relevant factors (Figure 1) from the student's application. This greatly increases the chances that each student's award may, in fact, be unique (non-commoditized) and based on a more personalized reading of his/her application. Unique awards also reduce the number of scholarship appeals based on a similarly-situated student in a prior year receiving a higher award.

Final Thoughts

Our Takeaways

✧ **Be Proactive –** Reversing rising discount rates is easier to do when rates aren't yet sky-high, but making large changes to strategy takes time and requires engagement from multiple functions and levels of the university. Implementing a new strategy that breaks away from incremental tuition discounting can take 1-2 years to implement.

✧ **Recognize the Barriers to Breaking the Cycle** – Recognize the risk and get other leaders on-board so the institution can (calmly) weather a dip in enrollment while a new strategy takes hold. Use changes in leadership as opportunities to transition to new processes and focus on special efforts.

✧ **Don't Rely on Tuition Discounting as a Silver Bullet—**Paying attention to the basics of recruiting, marketing and communication strategies, and improving student services can often be more important to improving yield.

Our Point of View

Now is the time to rethink current discounting strategies that have resulted in an arms race with competing institutions. Kennedy & Company encourages its clients to shift from an incremental discounting strategy to one of differentiation in order to gain control of discount rates. Primary research and analysis of enrollment trends and institutional grant expenditures along with demographic data from local sources should be conducted in order to craft a new, sustainable discounting strategy. We encourage clients to move beyond adaptation—necessary for survival in the current environment—and push them to become innovative so they can be more insulated from changes from external conditions.

About Kennedy & Company:

Kennedy & Company is a boutique consulting firm focusing exclusively on the unique challenges and opportunities of higher education institutions. From improving enrollment, student success, and financial sustainability to shaping online education and academic portfolio strategies, we forge true partnerships with our clients to understand their institutions and co-create real solutions.

Phone: (703) 623-5713
Fax: (703) 740-5778
www.KennedyandCompany.com
Email: Info@KennedyandCompany.com