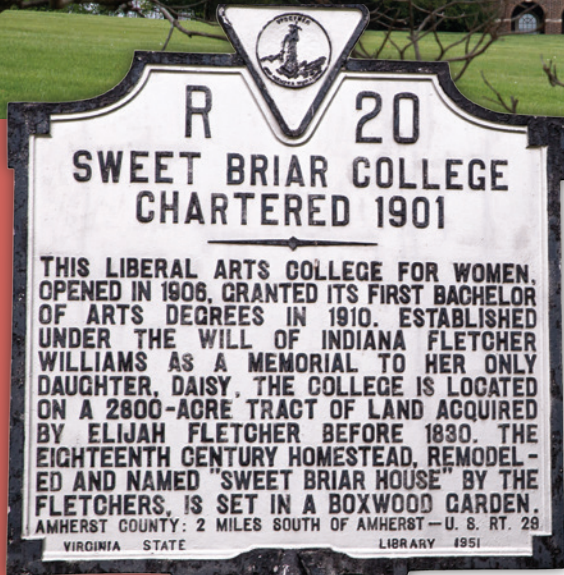


Too Small To Succeed?

The hard facts of education economics are putting some small colleges at risk

BY HELEN FESSENDEN



The Sweet Briar campus and historic marker.

In March 2015, the administrators of Sweet Briar College, a bucolic women's college near Lynchburg, Va., needed to make a major announcement. Gathering students in the main auditorium, the school officials dropped a bombshell: The board had voted to close the college due to ongoing financial pressures. They had just one technical glitch — their microphones weren't working. While students were struggling to hear the announcement, the press release had already gone out, so many saw the news on their phones instead.

"It was totally chaotic," recalls Holly Rueger, now a senior. "Hundreds of students began crying, no one knew what was going on, and the press was already gathering outside. We were in shock."

The news spread almost instantly among the school's devoted alumnae. Within a week, a massive fundraising effort had begun, ultimately bringing in almost \$22 million over the next two years. That infusion,

backed by a legal settlement, helped the college hang on, albeit with a reduced staff and student body. Under new leadership, it's now channeling the fundraising support into a longer-term survival strategy.

Sweet Briar's plight generated media attention due to its storied reputation and the energetic alumnae response. But the episode — coming amid closures or near closures of other small, cash-strapped schools — has contributed to a growing debate among education experts on whether a college can in fact be too small to survive.

Market Pressures

The conventional wisdom is that today's students prefer larger schools, especially in more urban settings, because those institutions offer more in the way of amenities, choice of studies, and internships and job opportunities around them. So as demand shifts, small schools will suffer.

And the evidence does point to increasing pressures on small colleges — well after the Great Recession. From the academic years 2010-2011 to 2014-2015, full-time equivalent undergraduate enrollment at four-year institutions (both public and private nonprofit) rose 3.7 percent, from about 7.63 million to 7.91 million. But enrollment at small four-year colleges — those with 1,000 students or fewer — dropped about 15 percent, from about 227,000 to 193,000.

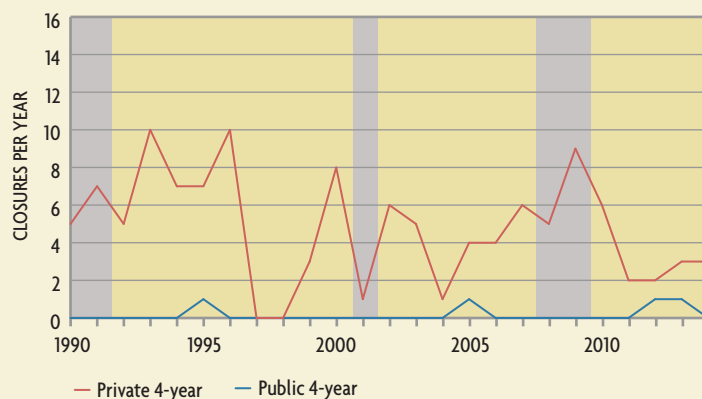
According to a 2015 report by Moody's Investors Service, which issues financial ratings for hundreds of colleges and universities, small schools are also experiencing slowing revenue growth. In 2010, about 30 percent of small private colleges (which it defined as running annual operating costs of \$100 million or less) had annual revenue growth under 2 percent. By 2014, that share had risen to more than 50 percent. Moody's has also projected an uptick in closures, although historically the closure rate tends to fluctuate — and outright closures are rare. (See chart.) The tally of closures in any given year is less than 1 percent of the number of public and private four-year institutions, which is around 2,300.

Experts note that the trend of financial stress is largely confined to private, nonprofit institutions. Public schools, despite budget cuts in recent years, rarely close because they still can count on state and federal support on a relatively predictable schedule. Highly selective private schools also have better financial health, on average, because they tend to reap more endowment income, post higher retention and graduation rates, and generally don't have to worry about revenue dropping off due to enrollment declines. (There is also the matter of for-profit private schools, which have been closing at a much higher rate in recent years, but this is due to legal challenges and federal policy changes.)

The vast majority of small nonprofit private colleges, by contrast, are not highly selective. At the same time, they're extremely tuition-dependent, which leaves them more vulnerable when they suffer a drop in enrollment. A school's tuition dependency ratio is the share of revenue that comes from tuition, as opposed to public funds, investment income, or other sources. According to Moody's, the smallest colleges have an average tuition dependency ratio of 75 percent; a typical private nonprofit college, by contrast, draws between 30 and 40 percent of its revenue from tuition. And women's colleges and historically black colleges and universities (HBCUs) are in an especially tight corner: They face a shrinking pool of prospective students as educational opportunities for these once-excluded groups have expanded broadly.

"The small nonprofit private schools are on the edge of the free market," says Kevin Carey, an education expert with New America, a Washington, D.C., think tank. "They have to figure out a way to survive mainly off of tuition. They don't need to make *more* money than what is needed to fill classrooms and dorms, but they can't make less."

College Closures Over Time



NOTES: The institutions in the sample are four-year degree-granting schools (classified as institutions of higher learning before 1995-1996). Institutions that merged are not counted as those that closed. Recessions are shown in grey. Data are through 2014.

For a list of recent college closures in the Richmond Fed's district, see the article online at: http://www.richmondfed.org/publications/research/econ_focus/

SOURCES: U.S. Department of Education, National Center for Education Statistics; National Bureau of Economic Research

A Risky Model

The particular risks of size and tuition dependency have dominated the research on what puts an institution at risk. For example, a 2009 working paper by Iowa State University researchers analyzed a sample of 824 private schools from 1975-2005 to find some common vulnerabilities in the 11 percent of the institutions that closed over those three decades. In terms of resources, the biggest risk factors (holding other factors constant) were student body size and endowment per student — in both cases, the smaller the number, the greater at risk. The paper noted that small schools are especially disadvantaged in that they don't enjoy the same economies of scale that larger schools do — for example, by dispersing the burden of a fixed cost upon a bigger student population. Selectivity also played a major role in long-term financial health. But once other risk factors were accounted for, it didn't matter to a school's stability whether it had a liberal arts focus or a professional one, perhaps because many students who attend nominally liberal arts colleges still pursue professional degrees. Single-sex status also didn't matter once the researchers adjusted for the common risk factors — it was just that many of the women's schools that closed or merged in that sample happened to be small and cash-strapped to start with.

Other researchers have highlighted similar risk factors. A 2013 Vanderbilt University comparative study by then-doctoral students Dawn Lyken-Segosebe and Justin Cole Shepherd took a more recent sample of school closures (2004 to 2013), pointing out that those affected schools, totaling 57, shared features such as small enrollment size, low revenue per capita, and tuition dependency. The researchers noted that tuition dependency poses an especially high risk for schools that face a downturn in enrollment or that have to tackle a major expense like capital improvements, because they lack the buffer of public appropriations or investment income. Noting that a fairly

high number of closed institutions (14) had a religious affiliation, the authors suggested that this feature may in fact be a more recent risk factor as well. This finding would contrast with other research suggesting that religious schools are generally financially stronger due to an “enrollment advantage” of more dedicated students. The effects of the Great Recession may have overridden this advantage by making such students more willing to consider cheaper alternatives, according to the authors.

Another common feature that troubled institutions exhibit is a sudden and substantial jump in tuition “discounting.” It’s become common practice for almost all schools — whether private or public, financially healthy or not — to reduce the tuition sticker price through a mix of financial aid and work-study programs. But if a school suffers from a drop in enrollment and tries to recruit and retain students more aggressively, it will often try to do so through sharply increasing the discount without necessarily finding offsetting funds elsewhere. According to the National Association of College and University Business Officers, the average “discount rate” for undergraduates at private colleges has risen substantially in the past decade, from around 35 percent to almost 43 percent, consistent with the trend of increasing financial strains for certain schools.

A Lucrative ‘Ace’

As they face these challenges, some schools are seeking new and sustainable revenue sources while trying to monetize their “niche” qualities. In the Richmond Fed’s district, one of these colleges, Emory & Henry College, checks the boxes on some of the risk factors noted above. It’s a small liberal arts college (around 1,000 students, with many from low-income families) and was discounting its tuition at a relatively high rate of about 50 percent to stave off declining enrollment. It also happens to be in an economically hard-hit corner of Appalachia, in rural southwest Virginia. “What we needed,” says President Jake Schrum, “was a new ace in the hole.”

This ace, his administration decided, would be to build on an idea proposed by his predecessor: establishing new graduate-professional programs in the health sciences for occupational therapy, physical therapy, and physician’s assistant training. So in 2016, the school finished a \$20 million project to refurbish an empty hospital in Marion, Va., while beginning to admit students for two of three programs. By next fall, Schrum expects close to 180 students will be enrolled, each paying \$30,000 annually in tuition and graduating with sought-after professional degrees.

“This region is aging and economically challenged, and there’s a desperate need for more medical care,” says Schrum. “Our strategy hits the sweet spot of generating income for the school while serving the communities around us.”

The administration hopes this new revenue stream will not just help the professional programs but provide some

financial support for the programs on the main campus to help retain students through mentoring and keeping tuition affordable for those who need it. “This is the turnaround year,” Schrum says. “Next year, we expect to break even.”

The school is also devoting other resources toward boosting its retention rates. This strategy is meant to help students launch into professional life, but it’s also important for the school’s finances by maintaining tuition inflows. As part of this effort, the school closely involves parents to keep students focused on graduation and finding a job. Schrum notes most students — almost two-thirds — are the first in their families to go to college and therefore are more likely to drop out. And roughly 40 percent get federal Pell Grants, which indicates a large share from low-income families. Yet the school’s six-year graduation rate (54 percent) is not too far below the national average for private nonprofit schools (64 percent) despite its more vulnerable demographic profile.

Saving Sweet Briar

Sweet Briar, like many other women’s colleges, has grappled with declining demand for years. Only around 2 percent of college graduates today attend a single-sex college. From 1960 to 2015, women’s colleges in the United States and Canada plummeted from 230 to 47, with many merging with all-male schools or going coed. Despite their small numbers, however, it has been found that their graduates still outperform and outearn other women when it comes to professional advancement, even when controlling for family income, school selectivity, and other variables. Graduates of women’s schools make up 20 percent of all women in Congress and more than 33 percent of female members of Fortune 1000 boards, for example.

As with selective small coed colleges, some well-known women’s schools (like the remaining members of the “Seven Sisters” in New England and the mid-Atlantic) flourish in terms of recruitment and finances. But Sweet Briar, a relatively isolated campus, found itself losing students and falling into the same revenue trap as many others. By 2014, undergraduate degree-seeking enrollment had fallen to 561 from 647 in 2008, while the rate of tuition discounting jumped from about 41 percent to 57 percent. It channeled more money into upgrading its facilities, but that failed to boost its numbers.

These factors all came together in early 2015 when its board voted for closure — even though the school had a relatively healthy endowment of \$85 million at the time. Galvanized, its alumnae immediately began a “Saving Sweet Briar” campaign that has so far kept the school afloat. In summer 2015, former Bridgewater College President Phillip Stone was brought on for the interim. After persuading some core faculty to stay on and boosted by the fundraising campaign, the school stayed open with diminished enrollment of around 236 degree-seeking undergraduates and reduced staff. Those numbers rose to 320 students in the fall of 2016, and Stone says he now expects the student

body to increase by about 100 each year for the next few years and eventually reach 800. (Stone was succeeded in May 2017 by Meredith Woo, formerly an academic dean of the University of Virginia. He was interviewed for this story while still serving as interim president.)

As part of its turnaround, the school is channeling resources into science, technology, engineering, and math (STEM) majors to market itself as an environment where women can learn to succeed in well-paying, male-dominated fields, says Stone. It is one of only two women's colleges to offer an engineering program, and Google has sent representatives to Sweet Briar in the past few years, including during its Engineering Week this spring. "We're working with more tech firms now that more and more are looking to recruit and promote women," he says. "This will be a very big part of our strategy looking ahead."

As for new and sustained revenue, the school is considering multiple approaches. Stone notes that one strategy is to recruit more foreign students, who are more likely to pay full tuition. Stone's goal is to increase their numbers to around 10 percent to 15 percent of the student body. On the horizon, Stone also envisions new revenue-building masters' degree offerings to leverage Sweet Briar's natural setting: conservation and environmental science. These professional degrees, he suggests, may be open to both men and women.

Changing Students, New Missions

Historically black colleges and universities have long been recognized for their outsized role in producing black leaders in law, medicine, engineering, and science. Access and relative economic mobility, especially for lower-income students, have historically been selling points of HBCUs. These schools, which were established as the only alternative for blacks when the vast majority of colleges and universities were all-white, are located predominately in the South and mid-Atlantic, and a third of all HBCUs are in the Richmond Fed's district. (See "Knowledge=Power," *Region Focus*, Summer 2004). But they, too, have to compete harder than they used to for students and are facing growing financial strains and dropping enrollment share. From 1976 to 2014, the share of black students enrolled at HBCUs dropped from 18 to 8 percent in the wake of educational desegregation and active competition among non-HBCUs to recruit top black applicants.

Today, the number of HBCUs with federal accreditation totals around 100, split between public and private, although both often get many different forms of state and federal money. Both public and private HBCUs also have a distinctive set of risk factors. First, they tend to have a higher share of lower-income students on federal aid, such as Pell Grants, and this source of support is more likely to vary over the years because it's subject to annual congressional appropriations. If the amount of aid falls or tuition rises, many of these students are likely to switch

to community colleges. Moreover, a substantial share of HBCUs — about half — is small, with fewer than 2,000 in enrollment. Finally, retention is a challenge, especially for those who are the first in their families to attend college; among these students, a higher dropout rate feeds into the revenue strains. The combination of all these factors could make the financial dilemma at HBCUs more acute.

"The spiraling cost of education has pushed many students who might otherwise go to HBCUs to community colleges," agrees Johnny Taylor Jr., president and CEO of the Thurgood Marshall College Fund, an organization in Washington, D.C., that supports and represents public HBCUs. "For HBCUs to adapt, they need to make the case to prospective students that they offer an affordable education that leads to a good job."

One course of adaptation for many HBCUs is expanding their student pool with other minority students — notably Latino — as well as those from abroad. Today, about 20 percent of students at HBCUs are non-black. This strategy, however, has sometimes come under criticism by some for changing the character and mission of HBCUs. More broadly, Taylor describes the overall climate for HBCUs today as "very challenging." But he also notes some examples of HBCUs that are innovating with new revenue streams and strategies to keep enrollment steady. In North Carolina, for example, Fayetteville State University has expanded its online programs so that the large (and mobile) military-base population around it can take fuller advantage of its offerings, including part-time and professional certification programs.

The Utility of College

Stephen Porter, a professor of education at North Carolina State University and co-author of the Iowa State University study, believes prospective students have been evolving in their views of a college education in a way that has affected small schools in particular, well after the Great Recession.

"Students and parents are both much more price sensitive than five or 10 years ago," he says. "This probably has a lot to do with rising tuition at both private and public schools and rising student debt. Even though many private schools discount a lot, they're seen as expensive."

Now more than ever, he notes, "a student's selection of a particular college is shaped by how that decision will lead him or her to a career," he adds. "If a school has a high nominal price tag but isn't selective, and doesn't have programs and support networks to lead you to a job, then it's at a disadvantage."

These trends can be seen in one of the most comprehensive education surveys in the United States, "The American Freshman," published annually by the Cooperative Institutional Research Program at the Higher Education Research Institute at the University of California, Los Angeles.

When high school seniors were asked why

they selected their particular college over others, 60 percent in the most recent survey (2015) answered it was because its graduates “get good jobs.” That share was up 5 percentage points in just three years and was also the highest ever for that question, which has been asked since the 1960s.

Do these converging trends mean that small schools will eventually become obsolete? Carey, of New America,

sees potential for many of these schools to turn around, especially by expanding their digital programs and bringing in a broader array of students who can benefit from them. “A school can keep a small and intimate campus for those who want it and still reach thousands more across the country,” he notes. “But for many of these small institutions, whatever they do, they need to go beyond their traditional model to stay viable.” **EF**

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maybe everyone will forget about it, but I don’t think so.”

“They will if it works and they won’t if it does not work,” Chairman Alan Greenspan responded. The FOMC voted in favor of the swap with the Treasury, with Melzer and Lindsey opposing. (Broaddus was not a voting member in 1995, but he too voiced opposition to the arrangement at the meeting.)

A Pyrrhic Success?

The operation accomplished its immediate goals. President Clinton authorized the \$20 billion loan from the ESF on Jan. 31, 1995. An additional \$17.8 billion from the IMF and \$10 billion from the Bank for International Settlements brought the total aid package up to nearly \$50 billion. With this assistance, Mexico was able to meet its demands and avoid default, but it did suffer a severe recession. Eventually, its economy recovered and it repaid its loans in full and ahead of schedule.

Still, the event raised a number of lasting questions. Intervening to prevent the default of companies or countries creates a moral hazard problem; international investors might take larger and larger risks in the future if they believe they are protected from the consequences

of failure. The 1995 intervention was more than 10 times the size of the loans made to Mexico in 1982. And just two years later, the international community would fund a \$118 billion loan to Thailand, Indonesia, and South Korea to prevent another crisis.

The Mexico intervention also raised serious questions for the Fed. The Treasury ultimately never called on the Fed to swap its foreign currencies with dollars to finance the loan to Mexico, but the event still sparked a discussion about how such operations might affect its credibility and independence. By the late 1990s, the FOMC voted to close nearly all of the Fed’s swap lines. The decision was short-lived, however. During the financial crisis of 2007-2008 and the subsequent debt crises in Europe, the Fed revived them to provide foreign central banks with dollar liquidity. Continuing the Richmond Fed tradition, then-Richmond Fed President Jeffrey Lacker dissented against the swap arrangements in 2011, reiterating the argument that they amounted to fiscal policy.

“I think Richmond has done a good job keeping this issue in front of the FOMC for a long time, but I can’t say we’ve completely sold them on it,” says Broaddus. “That’s still a work in progress. And it may always be.” **EF**

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