Cross-Sectoral Competition and Conversions in the Mixed-Form Market of Postsecondary Education

Dr. Bonnie K. Fox Garrity & Dr. Roger C. Fiedler

Mixed-form markets include public, not-for-profit, and for-profit providers competing within a specific industry. The cross-sectoral competition within mixed-form markets such as postsecondary education has increased as the constraints on providers have changed. As the competition has evolved, some providers have chosen to convert from one form of control to another, or have been acquired by a provider from a different sector. This study quantifies the changes in control in the postsecondary education industry over the past 15 years. The trends in the conversions data show that from 1994 to 2002 changes to not-for-profit status were the most common. However, since 2003 a majority of the changes each year have been from public or not-for-profit to for-profit status. In 2007, all conversions that occurred were from not-for-profit to for-profit status. The implications of the changes in constraints and cross-sectoral competition within this industry are examined within the framework of the mixed-form market literature.

Mixed-form markets include public, not-for-profit, and for-profit providers competing within a specific industry (Marwell & McInerney, 2005). Within the industry of postsecondary education, a public institution is operated by publicly elected or appointed officials and derives its primary support from public funds. At a not-for-profit institution the individual(s) or agency in control receives no compensation other than wages, rent, or other expenses for the assumption of risk (Snyder, Tan, & Hoffman, 2006, Appendix B: Definitions). In a for-profit institution the individual(s) or agency in control receives compensation other than wages, rent, or

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other expenses for the assumption of [financial] risk (Snyder et al., 2006, Appendix B: Definitions).

These various forms of providers of postsecondary education in the United States compete in a mixed-form market characterized by growth, increasing costs, increasing prices, and cross subsidy of students (both based upon different costs of providing certain programs and differing levels of net tuition and fees paid by students).

There are many incentives for providers in this mixed-form market to reconsider their initially selected form of control. These include the reduction in private donations, stagnation and reductions of state and local subsidies, deregulation (particularly the inclusion of for-profit providers in a similar legal framework as not-for-profit and public providers), and the portability of Pell grant aid, coupled with the for-profit providers’ access to market capital to fuel growth, and the potential economies of scale of large institutions. Some institutions have chosen a new form of control while others have merged with or been acquired by an institution from a different sector. This article provides the first study of the numbers and directions of these changes in control within the postsecondary education market in the United States.

**Theoretical Framework and Relevant Literature**

Mixed-form markets are markets in which public, not-for-profit, and for-profit providers coexist and often compete to provide goods and services. The literature indicates that there is competition between these providers and that they may be considered to be adversaries (Becchetti & Huybrechts, 2008; Bagnoli & Watts, 2003; Marwell and McInerny, 2005; Steinberg, 1987). In postsecondary education, traditionally each form of provider served a particular niche. However, growth and expansion have lead to direct competition among all three forms of providers for all levels of postsecondary students, most notably at the 4-year and above levels of students. For-profit provision of postsecondary education has grown more rapidly than not-for-profit or public. For-profit enrollment has grown at an average rate of 9% per year over the past 30 years, although overall
enrollment in postsecondary education has grown by only 1.5% (Wilson, 2010). For-profit providers now enroll more than 10% of postsecondary students in the United States (Wilson, 2010). Table 1 includes the relative market share of each group of providers in 1993 and 2004.

 Competition in Mixed-Form Markets
 Marwell and McInerney (2005) identify a five stage process to describe how competition between not-for-profit and for-profit providers develops in a mixed-form market. The first step is market identification where a not-for-profit identifies a social need and often provides a service to clients at a price that is less than the costs incurred. However, whenever there is a decrease in private donations and government subsidies, the not-for-profit becomes more dependent on revenue generation to meet costs.

 The second step is market growth. As a not-for-profit establishes the legitimacy of the need identified and their ability to fulfill that need, a market is created. Other not-for-profit organizations will often enter this market as long as the need (or at least a portion of the market’s need) remains unsatisfied.

 The third step is increasing cost of providing the service as not-for-profit organizations grow to meet the increasing demand for their services. This growth often results in additional administrative needs which increase the costs of providing the services.

 The fourth step is increasing price (or need for revenue) which is a direct result of the increasing costs. The increased need for revenue can

<table>
<thead>
<tr>
<th>Control</th>
<th>1993</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public</td>
<td>73%</td>
<td>67%</td>
</tr>
<tr>
<td>Not-for-profit</td>
<td>21%</td>
<td>22%</td>
</tr>
<tr>
<td>For-profit</td>
<td>6%</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source of these data are IPEDS 1993 and 2004.
be satisfied through donations or through increased prices charged to those served. Cross subsidy can be used to off-set increased costs of provision of a limited subset of the institution’s services. This practice may delay the entry of for-profit providers into a market as the profit potential of a particular good or service may be obscured to those outside of the not-for-profit organization. If prices are increased to be equal to or greater than costs for a service and the market continues to demand the service, for-profits may then attempt to enter the market.

The final step is cross-sectoral competition marked by the entry of for-profits into a market traditionally served by not-for-profits and publics. Marwell and McInerny (2005) have identified three potential pathways for markets in this stage: stratified, displaced, or defended.

In a stratified market not-for-profits serve low-income consumers with costs of provision subsidized by donors and for-profits serve higher-income consumers who pay market rates. In a displaced market not-for-profits are pushed out by the for-profits who have entered the market later. This is often a result of a lack of sufficient donations to cover increasing costs. Displaced markets also may occur when there is rapid expansion of the pool of consumers willing and able to purchase the service. In a defended market, not-for-profits use fundraising, regulation, or legitimacy as arguments to defend against the entry and growth of for-profit providers.

Changes in Constraints and Control

Within a mixed-form market, individual institutions have the opportunity to reassess and possibly change their form of control to suit the current conditions. Changes in constraints, according to Goddeeris and Weisbrod (1998), may encourage organizations to consider changing form. These may include changes to tax laws or regulations and changes in the availability of private donations and government grants and contracts.

For example, if constraints change and conditions are more favorable for for-profit providers, not-for-profit or public institutions could reassess and potentially change their form. Therefore, one method to assess the current market conditions in a mixed-form market is to investigate recent changes in control among providers in that market.
Changes in control may be a result of an internal decision to change form or a result of merger and acquisition activity. There have been waves of merger and acquisition activity in U.S. economic history and these waves have been concentrated within certain industries and even within certain geographic regions. This has lead researchers to conclude that merger and acquisition activity may be driven by factors such as shocks to an industry’s structure; deregulation; technological innovations which can create excess capacity and the need for industry consolidation; and supply shocks (Andrade, Mitchell, & Stafford, 2001). These factors are all similar to the changes in constraints described by Godderis and Weisbord (1998) that may encourage an institution to change control. Therefore, there may also be waves of conversion activities in mixed form markets, similar to the waves of merger and acquisition activity observed in some industries. A wave has been observed in the changes of control in the hospital industry in the 1980s and 1990s. Some were the result of merger and acquisition activity and others were the result of individual organizational choice.

Changes in Control in Mixed-Form Markets

As one example of a mixed-form market, conversions in the hospital industry in the United States have resulted in an extensive literature on changes in control. However, similar conversions in postsecondary education have not received the same level of analysis in the literature.

The hospital industry saw widespread change of control activity in the 1980s and 1990s with an average of 1% of hospitals converting each year (Needleman, Chollet, & Lamphere, 1997). Many hospital conversions were the result of merger and acquisition activity. Unfortunately, similar information has not yet become available with regard to these same changes in the field of postsecondary education.

Merger and acquisition activity in the hospital industry peaked in the mid-1990s as a result of changing payment arrangements and increased enrollment in managed care plans (Cuellar & Gertler, 2003; Young & Desai, 1999). This lead to the need for increased size to negotiate better rates with payers (Harrison, McCue, & Wang, 2003). Constraints on
Medicare reimbursements and a shrinking inpatient market (Young & Desai, 1999) also created conditions favorable to mergers and acquisitions. The merger and acquisition activity slowed in the late 1990s when constraints changed including the increased public scrutiny of the conversion of not-for-profit hospitals to for-profit status and subsequent legislation in many states allowing additional state level oversight of such conversions. More than 30 states passed laws calling for increased scrutiny of deals between not-for-profit and for-profit hospitals to ensure proper handling of charitable assets (Bellandi, 1999). Antitrust activity (FTC) reinvigorated review of and challenge to hospital mergers and other transactions (Cuellar & Gertler, 2003).

Literature on mergers in higher education focus on countries such as South Africa and Australia as well as Great Britain where the government encouraged consolidation in the late 1990s. However, some of these countries do not have well established mixed-form markets of postsecondary education. Many of the articles focus on human resource and organizational culture issues related to mergers rather than causes of the changes (Harman, 2002; Harman & Meek, 2002; Rowley, 1997). The literature does not contain specific mentions of changes in control of United States based institutions.

**Methodology**

Data are gathered annually from all Title IV participating postsecondary institutions in the United States by the National Center for Education Statistics. These data are available through the Integrated Postsecondary Education Data System (IPEDS) database. Data on the institutional control of each postsecondary institution were gathered from IPEDS for the years 1993 to 2007. These data were matched by unit ID so that a change in control could be identified from one year to the next. When possible, each change was confirmed through additional research. This included the Carnegie classifications; however, current Carnegie classifications are based upon 2003–2004 data so this step was only useful for the earlier years in the study. Institutions that were missing control data for one year
were not included in the totals for that year or the next year. No data were released by IPEDS for the year 1999, so that year is omitted from the study. Therefore, the total changes listed for 2000 include 2 years of cumulative changes. We identified 265 institutions that changed control at some point during the study timeframe.

RESULTS
The results in Table 2 show that less than .4% of all institutions in the United States changed control each year of the study. While the total number of institutions converting each year is relatively small and consistent, the trends in direction of conversion over time provide stronger insight into changes within the industry. The total number of institutions converting from for-profit to not-for-profit, 93, is similar to the number converting from not-for-profit to for-profit, 90. However, from 1994 to 2002 most conversions were from for-profit to not-for-profit. From 2003 to 2007, most conversions were from not-for-profit to for-profit. The trend is extreme in 2007 where there are no other conversions except 16 from not-for-profit to for-profit control. While some of the institutions that changed control in this study are two-year institutions or less-than-two-year vocational institutions, recent changes have included Grand Canyon University, Ashford University (formerly known as Franciscan University of Iowa), and Heald Colleges.

DISCUSSION
While the total number of conversions may lead to the conclusion that no form of control offers significant advantages over any other, the trends over time suggest that in the past not-for-profit control offered advantages, while more recently for-profit control may offer advantages including access to capital for quick growth while still being eligible for federal student aid on a nearly equal basis with other providers.

Operational distinctions between institutions of different forms may be limited as the educational offerings and educational models of each

<table>
<thead>
<tr>
<th>Year</th>
<th>New Control</th>
<th>Public</th>
<th>Public</th>
<th>Not-for-profit Public</th>
<th>Public For-profit</th>
<th>Not-for-profit</th>
<th>Did not Change Control</th>
<th>Institutions</th>
<th>Changed</th>
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<td>5 1 2 17 4 4</td>
<td>9956</td>
<td>9989</td>
<td>.33%</td>
<td></td>
<td></td>
<td></td>
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<td>1995</td>
<td>1 0 0 1 0 0</td>
<td>9956</td>
<td>9958</td>
<td>.02%</td>
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<td></td>
<td></td>
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<td>1996</td>
<td>1 0 0 13 1 10</td>
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<td>9693</td>
<td>.26%</td>
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<td>1997</td>
<td>4 2 2 16 1 6</td>
<td>9573</td>
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<td>1998</td>
<td>2 0 1 11 0 3</td>
<td>9594</td>
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<td>.18%</td>
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<td>2000</td>
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<td>9195</td>
<td>9225</td>
<td>.33%</td>
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<td>2001</td>
<td>4 2 2 11 1 6</td>
<td>9435</td>
<td>9461</td>
<td>.27%</td>
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<td>2002</td>
<td>3 2 2 8 1 4</td>
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<td>2005</td>
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<td>2007</td>
<td>0 0 0 0 0 16</td>
<td>6889</td>
<td>6905</td>
<td>.23%</td>
<td></td>
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**Note.** No data were released by IPEDS for 1999, therefore the 2000 numbers contain two cumulative years of changes in control.
Changes in Control in Mixed Form Markets

form have been adopted to some extent by the other forms of institutions. While it may be premature to speculate about the kinds of operational modifications that occur when there is a conversion of control of an institution, regulatory agencies would expect changes in board membership and a change in the primary form of financial support.

Postsecondary education is a mixed-form market that has evolved to the fifth stage of Marwell and McInerney’s model. While not-for-profit and public institutions identified the markets (stage 1) at the Baccalaureate and graduate levels of education, the for-profits identified and continue to dominate the vocational training market. However, for-profit providers have aggressively moved into the 4-year-and-above levels of education enrolling approximately 5.8 percent of students at 4-year-and-above institutions in 2004 (Fox Garrity, Garrison, & Fiedler, 2010).

The market of postsecondary education has shown growth at all levels (stage 2) with approximately 54 percent of the US population completing one or more years of college by 2008 according to the US Census Bureau (http://factfinder.census.gov) and an annual enrollment growth rate of 1.5% (Wilson, 2010). Adding to the most recent growth has been the economic recession which has encouraged enrollment of nontraditional students as they prepare for new careers.

Consistent with the third stage of Marwell and McInerney’s model, the costs of providing postsecondary education have increased dramatically driven by inflation, extraordinary inflation of energy and health-related employee benefits, the perceived need to provide an increasing array of amenities to attract and retain students (and the tuition they pay), and the growth of many institutions (Williams June, 2003).

As a result of both increasing costs to provide education and the reduction in donative resources from private donors and the government, tuition rates have risen at rates higher than the general inflation rate for several years (stage 4). This has lead to scrutiny of tuition increases by the federal government.

Also predicted in the fourth stage of Marwell and McInerney’s model, cross subsidy of students is a common practice within postsecondary education. In many cases all students on a campus are charged the same
tuition rate regardless of the major they choose or the classes they choose to enroll in. Some majors and some courses on a campus may carry substantially higher costs than others leading to a cross subsidy of one student (for example, in a gross anatomy lab science course) by a student in a less expensive course (for example, an English course). Cross subsidy of students is also common when one student pays full tuition and another student is granted an institutional scholarship (or discount) (Winston, 1999). The student paying full tuition is likely subsidizing the education of the student with the scholarship. These common practices of cross subsidy in postsecondary education may have delayed the entrance of for-profit providers into the baccalaureate and graduate levels of education since the profitability of certain programs and students may not have been readily apparent. However, recently for-profit providers have moved into these levels of education quite aggressively. For example, by 2004, more than 11% of the students at for-profit institutions were studying at the graduate level (including doctoral students), up from just 3.3% in 1993. For-profit institutions awarded 5.1% of all Master’s Degree granted in 2004, up from just .7% in 1993 (Fox Garrity et al., 2010).

With the aggressive growth of the for-profit providers, postsecondary education has reached the fifth stage of Marwell and McInerney’s model, cross-sectoral competition, where for-profits may threaten to replace not-for-profits. The size and strength of the market does not make complete replacement of not-for-profits by for-profits probable, but the evolution of the market is likely to continue on one of the three paths identified: stratified, displaced, or defended.

If this market were to become stratified under Marwell and McInerney’s model the not-for-profit and for-profit providers would both remain in the market with the not-for-profits serving lower income students with the costs subsidized by donors while the for-profits serve the wealthy who would pay full price. This is the opposite of the trends within the market currently where for-profit institutions serve more low income students than other institutions. For-profit providers received 16.6 percent of the Pell Grants (need-based grant aid) awarded in 2004 while enrolling 11 percent of the FTE students (Fox Garrity et al., 2010). This is partially
a result of the unique market feature of portable student aid in the forms of Pell Grants and subsidized student loans. The advent of these student aid programs replaced a model of direct subsidy by the government to institutions. Now the model employs a portable aid model allowing each student to decide which institution will receive the government subsidy. Currently, for-profit providers are serving the lower income students subsidized by federal government funds and the not-for-profits and publics are serving a larger portion of the higher income students who are not as likely to be subsidized by government funds.

The second and third alternatives from Marwell and McInerney’s model are more likely to occur. In a displaced market for-profit providers would push out not-for-profit providers as donations and government subsidies drop below a level where the not-for-profits can continue to operate with rising expenses and where there is growth in the market. As early as 2003, the Chronicle of Higher Education was reporting the record levels of expenses, the difficulty in attracting private donations, and decreases in government subsidies to institutions (Williams June, 2003). Portable Pell aid and the influx of returning adult students with federal assistance have created an influx of students who may not have attended postsecondary education in the past. This influx of new students with a desire to participate has fueled the already heated competition to attract students and their tuition dollars (Williams June, 2003). There are reports of cities where demand for postsecondary education outstrips the available seats in classrooms (generally referring to public institutions) such as Sacramento, California. These regions have been referred to as “fertile ground for a for-profit revolution” in the title of an article by Keller (2010) due to tremendous unmet demand driven by the limited funding for public postsecondary educational opportunities.

However, similar to the hospital industry in the 1980s and 1990s (Goddeeris & Weisbrod, 1998) there may be a general issue of overcapacity in the postsecondary education market even though the seats may be limited in the public institutions. In 2005, there was more than 1 seat available for every minimally college qualified graduate in the United States.
(Hoxby, 2009). Overcapacity in the hospital industry has been cited as one cause of consolidation (Andrade et al., 2001; Goddeeris & Weisbrod, 1998).

While it is unlikely that all not-for-profit and public providers would be excluded from the market, the institutions that have changed from not-for-profit to for-profit control and the rapid growth of student enrollment at for-profit providers provide evidence that the displaced model may be the new state of the market.

There is also evidence that the third form of market competition is emerging. In a defended market the not-for-profit and public providers fight back against the entry and growth of the for-profit providers. According to Marwell and McInerney (2005), the grounds used would often be those of fundraising, legitimacy, and regulation.

One form of legitimacy enjoyed by most not-for-profit and public institutions is regional accreditation. Many for-profit institutions hold national accreditation which is granted by different bodies with different standards. Many regionally accredited, not-for-profit and public institutions will not accept transfer credits from nationally accredited institutions. However, some for-profit institutions have been granted regional accreditation, particularly by the North Central Association of Colleges and Schools which is considered to be the regional accrediting body most friendly to for-profit providers. In particular, Kinser (2007) notes that publicly traded for-profit institutions have sought out regional accreditation as a “mark of legitimacy” (p. 243). There are also reports of for-profit providers acquiring regionally accredited not-for-profit institutions specifically for the value of gaining regional accreditation (Glader, 2009). One specific example is the Jack Welch online MBA program which is a component of a formerly not-for-profit, regionally accredited institution acquired by a for-profit organization (Glader, 2009). After an acquisition, a regional accrediting body reviews the new institution to determine whether to continue the accreditation, but generally in the absence of extreme changes in curriculum or faculty, the accreditation is maintained. However, within the past two months, there has been increased scrutiny of this process with Senator Durbin, Assistant Majority Leader of the Senate, specifically urging that
accrediting bodies no longer allow for-profit colleges to acquire accreditation by purchasing not-for-profit institutions (Field, 2010).

Other evidence of a defended market is the constant struggle within Washington, DC related to the specific laws such as the Higher Education Act as renewed. During the most recent renewal process, the for-profit providers waged a strong battle to have some of the regulatory restrictions specific to for-profits removed, while not-for-profits and publics fought hard to increase those same restrictions. The result was a loosening of the restrictions without a complete abandoning of the distinctions between the sectors of institutions.

Media coverage of changes in control, while limited, suggest that the trend observed in this data of conversions to for-profit control is continuing. The authors have gathered data on twelve pending or completed acquisitions during 2009 and the early months of 2010. These include ten where the acquirer is for-profit and two where the acquirer is public.

The predictions of the future path of the conversions in postsecondary education may be informed by the past path of hospital industry conversions. In the hospital industry the initial targets of acquisition bids during 1992–3 were hospitals in dire financial straits, however by 1995–6 the acquired hospitals were financially successful institutions (Phillips, 1999). Current acquisition targets in education are financially troubled institutions (Blumenstyk, 2010). Further research is suggested to determine if more financially solvent institutions become the target of future acquisitions and conversion activity in postsecondary education.

Another relevant change in the hospital industry that should be monitored in the postsecondary education industry is the shift in public perception of for-profit and not-for-profit hospitals. Reports of fraudulent practices at for-profit hospitals adversely affected public opinion in the mid-1980s; however, by 2002 a majority of those surveyed believed that for-profit hospitals provided higher quality care while not-for-profit hospitals had lower costs (Schlesinger, Mitchell, & Gray, 2004). Several instances of fraudulent practices at for-profit postsecondary institutions have been reported over the past 5 years. If the trends in the hospital
industry hold true, those incidents may soon be forgotten by the general public. While the perceptions of quality shift, perceptions of price may as well. Currently the for-profit postsecondary institutions charge tuition that is between the average public and not-for-profit tuition rates. Any changes in the relative price structure and public opinion should be monitored.

Hospital conversions were a result of three major forces according to Goddeeris and Weisbord (1998). One factor was changes in constraints such as tax laws, regulations, and the availability of private donations and government grants and contracts. Additionally, cross subsidiation was common until third party payers moved toward standardized payment rates and active price competition. Third, overcapacity within the hospital industry lead to consolidation in healthcare. All three of these circumstances currently exist within the postsecondary education industry, leading to the conclusion that conversions of postsecondary institutions will most likely continue.

In addition to the trends observed in the hospital industry, there are aspects which are unique to the educational environment. Some aspects worthy of future research are the relationships between conversions and the predominance of online versus classroom course delivery, the expenditures and effort required to meet and maintain accreditation standards, and the ratio of instructional to overall costs. Each of these factors may influence conversion decisions or outcomes.

**Conclusion**

Conversions of postsecondary institutions are expected to continue in the future. Most changes are predicted to be to for-profit control because the dominant direction of changes is guided by current constraints which make certain forms of control more appealing.

Within the mixed-form market of postsecondary education, the pathway that will define future competition may take the form of stratified, displaced, or defended. Currently the market is stratified, although in the opposite direction than Marwell and McInerney’s model would
predict. While some not-for-profit providers may be displaced by the increased competition for students, the current market is also marked by characteristics of a defended market. Whether the defense will be successful or not will determine the future course of the market of post-secondary education in the United States.
REFERENCES


Changes in Control in Mixed Form Markets


