

Dealing in diplomas

For the University of Phoenix, college is a big business - and getting bigger

01:36 PM CST on Saturday, February 28, 2004

By KATHERINE YUNG / The Dallas Morning News

PHOENIX – Critics dub the University of Phoenix "McUniversity" and "Drive Thru-U." But from its base in this sprawling desert metropolis, the nation's largest private university is shrugging off the nicknames and expanding its reach. Its mission: to turn quality higher education into a lucrative business.

The university's parent company, the Apollo Group, boasts a market capitalization larger than Southwest Airlines'. Profits have multiplied fiftyfold over the last decade. And the meteoric rise in the company's stock price has propelled Apollo founder John Sperling to billionaire status.

Now the champion of education for working adults is training its sights on traditional college students. It plans to serve that market by opening Axia College in Phoenix during the next few months.

"The good news is that because of responsible management, we can accomplish both" quality education and profits, says Todd Nelson, Apollo's chief executive.

Over the last 28 years, the University of Phoenix has built up a moneymaking machine that stretches from cyberspace to campuses and learning centers in 29 states, including Texas.

The key to its business model: keeping costs down while generating new sources of revenue. Fueling all of this is an aggressive marketing campaign, student financial support from employers and the federal government, and a network of lobbyists.

But in its quest for higher profits, some of Phoenix's practices have come under government scrutiny. Two employees have sued the school for billions of dollars, alleging that the university pays enrollment counselors based on the number of students they sign up. And not everyone agrees that the university can serve Wall Street's needs without compromising academic quality.

"One cannot serve two masters," says James Samels, president of the Education Alliance, a consulting firm in Framingham, Mass. "They've got investors, and they have a different mission."

Investors have much to cheer about. Profits totaled \$247 million in the fiscal year ended Aug. 31, skyrocketing from \$4.9 million in 1994 when Apollo went public. The company's total expenses as a percentage of revenue have been steadily dropping.

With no debt and a \$564 million cash cushion, Apollo is positioning the University of Phoenix to become an even bigger force in the \$280 billion higher education market. As enrollment

expands, so will its influence on everything from teaching methods to distributing student loans, experts say. Already, Apollo's \$13-plus billion market capitalization far exceeds the endowments of nearly every private college except Harvard University.

"There's really nothing that limits their expansion," says David Breneman, dean of the University of Virginia's Curry School of Education. "They will go wherever there's money to be made."

With more than 186,000 students in 91 countries, the university is on the verge of winning a license to operate in New York state. And in Texas, it's close to gaining regulators' permission to expand beyond its 5,000 students in Dallas and Houston into Austin and San Antonio.

Keeping costs low

Phoenix gears its classes toward working adults, a growing market that schools have long ignored. Gone are the dormitories, student unions, athletic facilities, health service centers and other costly frills. Classrooms are in rented office space. And the only library Phoenix maintains is online .

But the biggest cost savings come from its faculty. Most of Phoenix's instructors hold full-time jobs and only teach nights and weekends. Phoenix pays professors \$1,000 to \$1,500 on average for a five- or six-week class.

Professors don't get tenure, but they also don't have to design their own courses. That's done for them by groups of Phoenix faculty members who develop the school's curriculum, then roll it out to instructors across the university. The process ensures that a business major in Atlanta learns the same thing as one in Chicago.

In addition, faculty members teach 20 to 24 hours a course instead of the typical 40 because Phoenix students spend many hours on group projects without faculty supervision. These hours and the ready-made curriculum enable the university to find a steady supply of instructors at a lower rate of pay.

"It produces a labor supply for them that they can get at a pretty good price," the University of Virginia's Mr. Breneman says.

"If the typical class enrolls 20 students at \$800 tuition each, revenue equals \$16,000. If the faculty member is paid \$1,600 to \$2,000, that leaves at least \$14,000 to cover all other costs plus profit. So long as demand remains strong, UOP is a veritable money machine," he writes in his upcoming book on for-profit schools.

The university has also centralized accounting, human resources and student services functions. That enables Phoenix to break even in new markets in less than a year on average.

"A big part of why for-profit education can be successful is economies of scale," says Sean Gallagher, an analyst at Eduventures Inc. in Boston.

But generating revenue is every bit as important as containing costs. The more students Phoenix enrolls, the more money it makes.

Over the years, Phoenix has mastered the art of getting students in the door. In 2002, it spent \$32.7 million on advertising for both its online and campus programs, more than any other school except fellow for-profit competitor DeVry University, according to TNS Media Intelligence/CMR.

But the sales pitch doesn't end there. Phoenix excels at helping students who call or visit one of its campuses for the first time, says Robert Tucker, a former Phoenix senior vice president who is now an executive vice president at Cardean University, an online school.

Enrollment counselors help potential students overcome obstacles and follow up with e-mails outlining when courses start and what financial aid is available.

"You are just so relieved that someone has put to rest all of these little nagging problems that you are not going to search anywhere else," Mr. Tucker says.

Selling education

To attract students and maximize revenue, the university offers a growing array of year-round bachelor's, master's and doctoral degree programs in popular fields such as business, health care, education and information technology. You won't find geology or political science majors at this school.

And almost anyone can get in. To qualify for its bachelor's degree program, students must be at least 21 years old, employed and have a high school diploma or GED.

Once the students are in the door, the university earns money a second way. It gives students the option of buying instructional materials online instead of purchasing textbooks from a bookstore.

Mr. Nelson, Apollo's CEO, calls the materials, which are known as rEsource, superior to textbooks because they include simulations, training courses and other study aids. The bulk of Phoenix's students will be using rEsource by the end of March, he says.

At a price tag of about \$60 a student per course, rEsource is expected to generate thousands of additional dollars once its development costs have been paid off.

"It's a beautiful, beautiful thing," says Mark DeFusco, CEO of Vatterott College in St. Louis and a former Apollo vice president. "rEsource is pure bottom line. Publishers should be scared."

Still, the bulk of the university's revenue comes from tuition. Phoenix's business model relies heavily on the federal government and the corporations that fund the students' education. The school lacks an endowment and doesn't receive government appropriations or charitable gifts.

Phoenix isn't cheap. It prices its courses in the middle of the market – higher than most public schools but lower than many private ones. Annual tuition increases are about 5 percent for campus-based classes and about 4 percent for its online program.

Many students say they couldn't afford to attend without tuition assistance. Take Tim Syring, a 43-year-old computer systems analyst in Dayton, Ohio. His employer is picking up the tab for the master's degree that he plans to earn from Phoenix Online this spring.

"Had I had to pay for it, I don't think I could afford graduate school at this time," says Mr. Syring, referring to the \$1,620 in tuition for the course he is taking.

Half of Phoenix's students receive tuition assistance from their employers. And the university derives 62 percent of its net revenue from students who receive help from the federal government's Title IV student financial aid programs. Phoenix is the largest recipient of these federal funds.

But in the last five years, Phoenix and Apollo have come under scrutiny over their compliance with rules regarding these funds.

In March 2000, Apollo agreed to pay \$6 million to settle charges stemming from a U.S. Department of Education audit. The audit found Phoenix did not meet conditions for including study group meetings as instructional hours, erred in including cost-of-living expenses for some students when determining financial need and committed other violations.

Phoenix disagreed with the audit findings – which sought the return of nearly \$55 million in federal loans and grants – but said it agreed to the settlement to avoid a costly appeals battle.

The settlement came less than a year after the Department of Education ordered Phoenix to pay \$650,000 because it didn't refund loans and grants in a timely manner when students receiving federal financial aid dropped out.

More troubles

The fine and settlement didn't end the school's legal troubles. Today, Phoenix faces a lawsuit that could cost it billions.

Last year, Mary Hendow and Julie Albertson, two of Phoenix's enrollment counselors in Northern California, filed a *qui tam* whistleblower lawsuit against the university, alleging that it defrauded the U.S. government out of more than \$3 billion over six years.

The two women accuse Phoenix of basing the pay of enrollment counselors on the number of students they sign up. In 1992, the government banned incentive compensative for college recruiters to stop for-profit schools from signing up unqualified students simply to get federal aid money.

The lawsuit alleges that Phoenix alters documents, maintains fake files and uses code terms to deceive the U.S. Department of Education about its compensation practices.

"It's all about the numbers," one top executive is alleged to have said. "It will always be about the numbers. But we need to show the Department of Education what they want to see."

Apollo has denied the allegations, and the federal government opted not to join the lawsuit. Phoenix has filed a motion to dismiss the case. A federal judge in Sacramento, Calif., is expected to rule on the motion any day.

Mr. Nelson says money is the motivation for the lawsuit. Under a *qui tam* action, whistleblowers normally earn 15 percent to 25 percent of whatever money the government recovers to compensate them for their efforts and risks.

Ms. Hendow and Ms. Albertson declined to comment because they still work for the university. But Daniel Bartley, one of their lawyers, said in a release: "Hendow and Albertson did not file this lawsuit because of the monetary recovery. This lawsuit was never about the money for them. ... They filed because the University of Phoenix was requiring them to break the law to do their job."

Mr. Bartley says the Department of Education is conducting an investigation into Phoenix's compensation practices. The department will only say that it is conducting a program review, an evaluation it performs on institutions that receive federal higher education funds. Mr. Nelson confirmed the program review but says there is no investigation.

Phoenix's reliance on government financial aid programs has also led to criticism that it and other for-profit schools are gobbling up a growing share of this aid with little public accountability. Phoenix dismisses this accusation.

"There shouldn't be a distinction between for-profit and non-profit education," says Mr. Nelson, citing Phoenix's high graduation rate and low default rate on student loans.

But Phoenix isn't run like a traditional nonprofit school. The amount of pay and other compensation that Apollo's top executives take home depends on whether they meet earnings goals set at the beginning of each fiscal year.

Phoenix's success has led to enormous rewards for Mr. Nelson, who received a bonus of nearly \$4 million on top of his \$500,000 salary last year. In comparison, Harvard president Lawrence Summers earned about \$450,110 in 2002.

To boost revenues, the university is taking aim at new markets.

It wants to expand its reach beyond major metropolitan areas with a product called FlexNet. Students in Wichita, Kan., Boise, Idaho, and other cities too small to support a campus can take

the first and last weeks of a course in a classroom and do the rest online.

FlexNet has attracted 7,000 students even as it reduces the amount of classroom space the university needs to lease.

And now Apollo is gearing up Axia College for Generation Y. More than a year's worth of educational research went into the making of this school, which will be a part of Apollo-owned Western International University in Phoenix.

Although most of Phoenix's students are between the ages of 26 and 45, Axia is geared toward working adults ages 18 to 23. Phoenix came up with the concept after receiving thousands of calls from people too young to enroll in its classes, Mr. Nelson says.

If it succeeds, watch for the school to spread across the country just like the University of Phoenix has. But for now, Apollo is taking a wait-and-see approach.

"If by the end of the year we have 90 or 100 students, I'll be surprised," Mr. Nelson says. "If it goes well and there's a demand for it, then obviously in later years it will grow to be larger."

Lobbying strength

Apollo has the resources to see that Axia succeeds.

Its army of lobbyists monitor state legislation for proposed laws that could have a negative effect on Phoenix, says Laura Palmer Noone, the university's president. And they've proved adept at altering Department of Education rules for the university's benefit.

Thanks to their efforts, a Phoenix course no longer needs to provide 12 hours of instruction a week for its students to receive federal financial aid. One day of instruction or examination per week will do, but under the new rule a "day" isn't clearly defined.

Yet for all its political prowess, Phoenix stirs up plenty of debate. Student opinions of the school run the gamut from delight to disgust.

"It definitely helped me refine my skills," says Jake Rich, who graduated from Phoenix Online with a bachelor's degree in 2003. "I'm happy I went there."

But the 28-year-old network administrator in Murrieta, Calif., says he wouldn't recommend the school to others because there are less expensive online courses available at public universities.

"University of Phoenix is very expensive," he says.

Others are less enchanted.

In Dallas, Richard Quiroga, 39, dropped out of his fifth Phoenix class last year after he couldn't

find a study group needed for his communication skills course.

So far, the school has called Mr. Quiroga only to get him to pay his bill for the course he dropped. The stay-at-home father has yet to hear from any counselors who could help him find a way to get the bachelor's degree he wants.

"They don't really care," he says.

Phoenix insists it doesn't cut corners to make a profit. Academic budgets are created from the ground up, not dictated from the top down, Mr. Nelson says. And the academic and business sides have an equal voice in running the school, Ms. Noone adds.

But what happens when academic and business interests clash? Academics win, Mr. Nelson says.

"Our interest is the long-term financial and academic health of this company," he says. "And how do you do that? You do that by not shortchanging what needs to be done out at the campuses."

E-mail kyung@dallasnews.com