

SECTOR COMMENT

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Higher Education - US

Coronavirus will accelerate business model transformation with varied credit effects

Many universities will hasten their efforts to bolster online learning and expand certain nondegree/certificate programs with the coronavirus accelerating a transformation in higher education business models. Some universities previously resistant to change will have to take more expansive steps to adapt to the transformation. While highly disruptive over the next one to two years, with varied credit effects on individual universities, the initiatives will ultimately be credit positive for the sector as a whole, driving innovation and growth.

Not all universities, however, have the resources or culture to move quickly and the coronavirus will expedite existential threats for some. Universities having made extensive investments in digital capabilities and with more entrepreneurial and flexible decision-making will be better positioned to adjust. Prior to the pandemic, the sector was gradually adapting to shifts in student preferences, with a more tech-savvy “digital” generation in the wings and employers seeking a workforce adaptable to more rapid shifts in the workplace.

Recent arrangements indicate that public universities, in particular, will continue to expand their digital learning footprint long after the pandemic abates. For example, on August 3, the [University of Arizona](#) (Aa2 stable) announced an agreement with fully online, for-profit Ashford University, which has about 35,000 students, aiming to significantly grow its presence in the online education market. Similarly, in a move to expand its online capabilities, the [University of Massachusetts](#) (Aa2 stable) announced its intent in June to enter into a strategic partnership with Brandman University, a nonprofit online provider that is a component of the private [Chapman University](#) (A2 stable) in California.

The agreements come as many colleges are moving to all online learning or hybrid models for the fall, accelerating shifts in the sector. Post-coronavirus, universities without strong brand names and consistently strong student demand will face greater urgency to adapt than universities among the top tier. As with any industry where change is rapid and fundamental, some universities will emerge stronger with growth in enrollment and associated revenue, while others will struggle and potentially fail. Those that can pivot and invest most efficiently in the technology and infrastructure needed to meet changing demand will prevail.

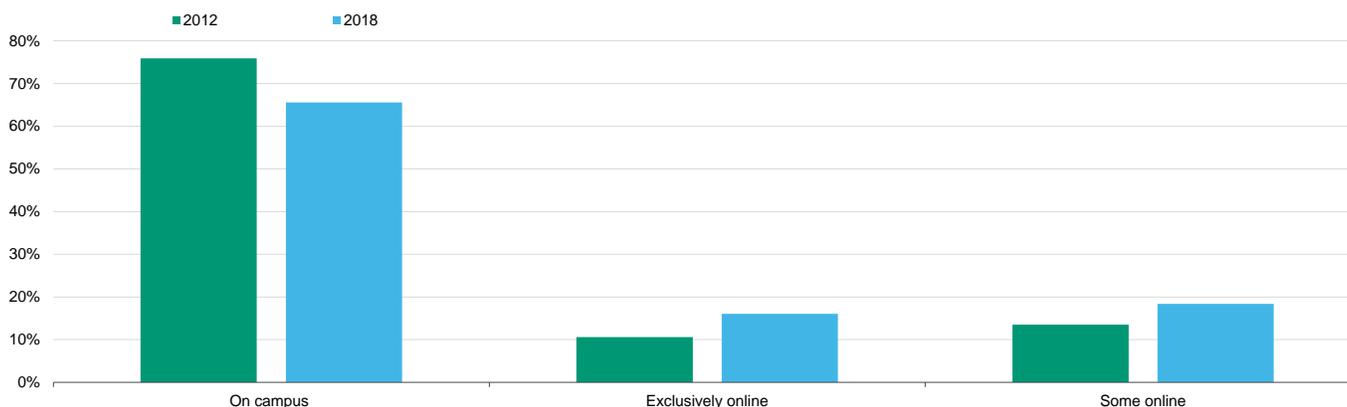
Besides increasing online learning capabilities, many universities will also continue to add nondegree/certificate programs, including for adult learners, to boost enrollment. Programs include opportunities to build career skills via stackable credentials that can ultimately add up to a degree. These credentials have gained popularity in recent years as workers, parents and those wishing to return to school after not following a traditional degree-earning path have shown an interest.

Online learning will continue to expand, forcing many universities to adapt

The move toward online and hybrid education (a combination of online and on-campus) will accelerate (see Exhibit 1) with the pandemic forcing many previously reluctant universities to launch or expand digital capabilities. A robust digital infrastructure and expertise in offering online classes will be crucial for many universities to maintain/gain market share post-pandemic.

Exhibit 1

Online enrollment accounts for a small but rapidly growing share of total enrollment



Sources: Integrated Postsecondary Education Data System (IPEDS) Data Center - National Center for Education Statistics, and Moody's Investors Service

Yet even as the coronavirus drives growth in online learning, the conventional on-campus experience will remain attractive for many traditional-age students. The maturation process from socializing with peers and faculty and exploring cultural, athletic and academic interests in a college setting is difficult to replicate. In addition, some academic pursuits require hands-on learning, such as lab work or clinical interaction. Recent lawsuits by students opposed to paying on-campus tuition for online education during the pandemic highlight that students feel they are paying for the overall campus experience rather than just credentials.

Online enrollment growth will benefit from social distancing practices — even if classes resume on some campuses in fall 2020, hybrid and flipped learning will likely grow with lectures offered online with smaller group discussion sessions. Growth in online education will also be facilitated by the Department of Education's [announcement](#) of its final rule on distance learning. This rule, effective July 1, 2021, will allow for more asynchronous online delivery of courses, or portions of courses, in traditional "clock-hour" hands-on programs. This will benefit colleges and universities offering distance education, competency-based education (CBE), and other types of educational programs. There will be greater emphasis on demonstration of learning rather than seat time when measuring student outcomes. This rule will also clarify "regular and substantive interaction" required between the instructor and students for the online programs to qualify for federal financial aid.

The move to online learning is also costly because universities need to invest in building out their infrastructure while maintaining and investing in traditional on-campus education. Additionally, the move can increase exposure to cyber risks. Further, growth in online education will introduce potentially greater enrollment volatility as universities increasingly compete across geographic boundaries on price, customer service, and the most user-friendly digital interface. New nontraditional providers could emerge, further sharpening competition, although their ultimate success will depend both on the quality of their products as well as employer acceptance of their credentials.

Not all universities will be successful at developing high-quality offerings with favorable student outcomes and some will invest what could be considerable funds without ever generating a positive return. Differentiated program offerings, scale and financial flexibility were important before the pandemic and will be even more critical over the next few years of this transition. Instructional design for online and hybrid programs will increasingly become a point of strategic differentiation and while some will outsource portions of that function, the most successful will increase investment in design and production as a core competency.

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The University of Arizona and University of Massachusetts arrangements follow the [Purdue University](#)-Kaplan transaction in 2018 that created Purdue University Global (Purdue acquired the for-profit Kaplan). In each of these cases, the universities made the decision that the arrangements would enable them to expand their digital footprints more rapidly than building out their own infrastructure. The agreements essentially allow the universities to acquire technological and delivery capabilities and a marketing presence rather than building the functions. At the same time, the universities are entering into long-term contractual agreements that carry costs, [partner performance risk](#), and reputational risks.

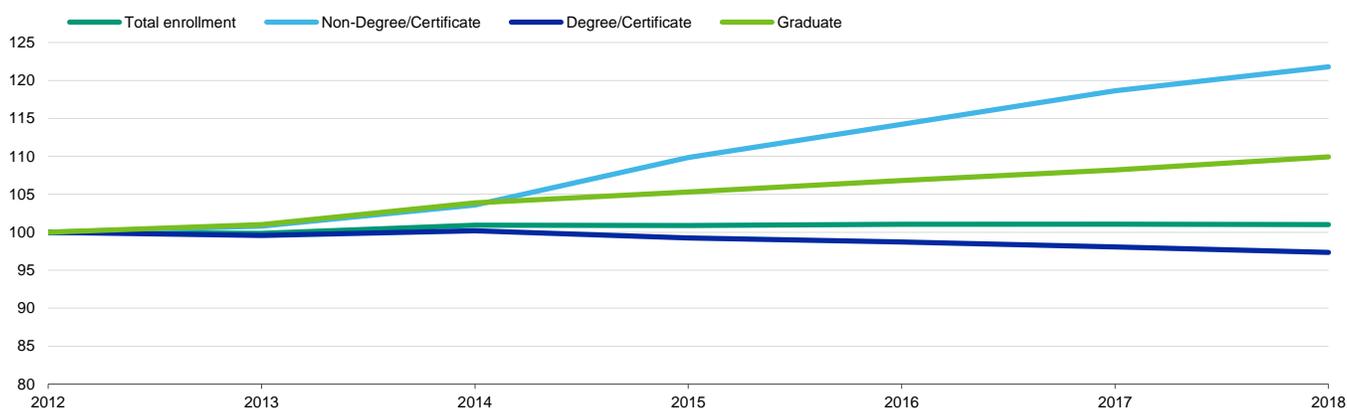
The Purdue transaction highlights some of these challenges. While demand for Purdue Global will contribute to net tuition revenue growth for [Purdue University](#) (Aaa stable), competition among online education providers has accelerated, as shown by the Arizona and Massachusetts transactions. Operating revenue for Purdue Global approached \$400 million in fiscal year 2019 (ended June 30, 2019), close to 15% of total revenue for the university. However, during its first full year, Purdue Global generated an operating loss of about \$40 million, including \$28.5 million of one-time brand advertising expenditures. Over time, Purdue Global offers the prospect of boosting Purdue's already-strong credit profile if executed successfully. However, the risk is higher over the next one to two years as the university integrates and manages the disparate brands, programs and reputations of its online and traditional programs. The University of Massachusetts arrangement differs from the other two transactions in that its partner is a well-established nonprofit with generally stronger historical student outcomes, which reduces some of the reputational and mission alignment risks.

Expanded programs targeting nontraditional students offer growth opportunity

The coronavirus will also accelerate growth of nontraditional programs such as undergraduate nondegree/certificate programs, where career-advancement courses can be completed discretely and bundled into a degree. While accounting for only 10% of total enrollment (fall 2018) in the sector, undergraduate nondegree/certificate programs are growing at a rapid pace (see Exhibit 2) that will likely continue post-pandemic. Corporate partnerships with institutions for short-term curriculum design will also likely grow as universities increase focus on their value proposition and making their graduates attractive to potential employers.

Exhibit 2

While still a small share, undergraduate nondegree/certificate programs will likely remain a fast-growing market segment Index 2012 = 100



Source: Integrated Postsecondary Education Data System (IPEDS) Data Center - National Center for Education Statistics

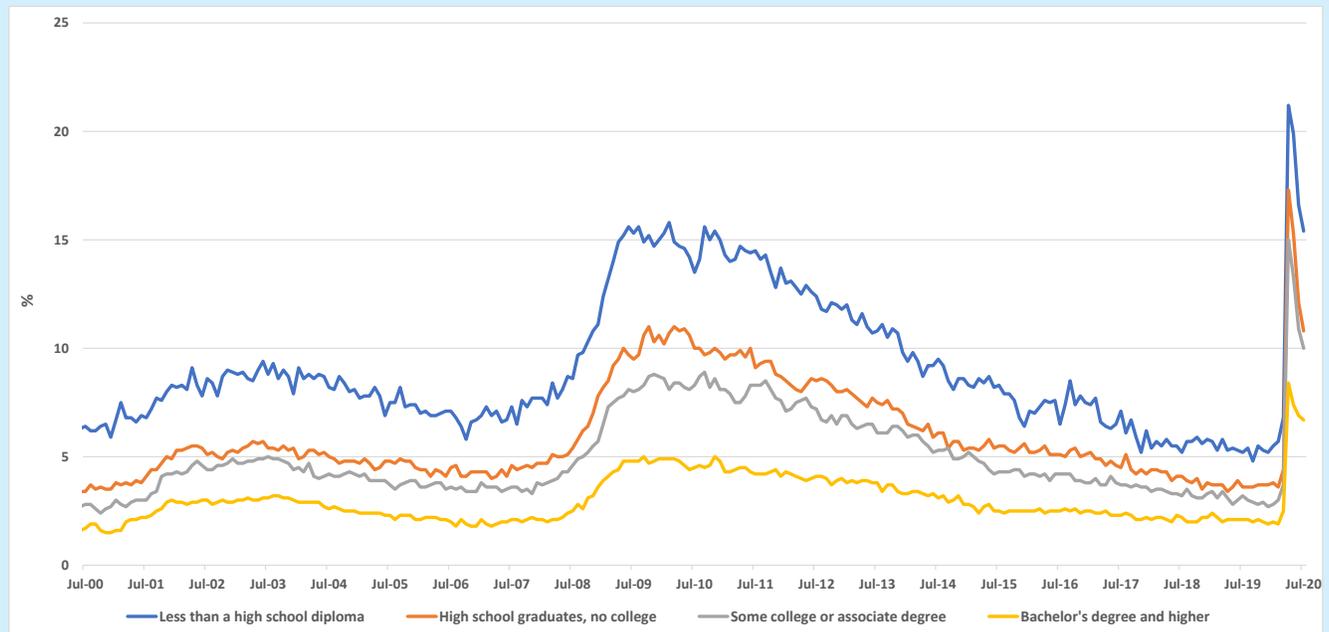
Consistently high wage premium and lower unemployment rates will continue to bolster demand for higher education

Despite rising scrutiny surrounding the return on investment, a college degree retains strong economic value, which will drive continued demand for higher education for years to come. College degrees boost earnings and allow graduates to better adapt to economic shocks, as evidenced by the current pandemic, with 6.7% of individuals with a bachelor's degree or higher unemployed as of July 2020 compared to 10.8% unemployment for those with a just a high school diploma (see Exhibit 3).

Exhibit 3

College education is a good predictor of employability with a lower unemployment rate correlating with higher education attainment

Unemployment rate for people aged 25 and older by educational attainment



Source: Bureau of Labor Statistics

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Outlook

- » [Outlook shifts to negative as coronavirus outbreak increases downside risks](#), March 18, 2020

Sector In-Depth

- » [Continued growth in online education will intensify competition, shifting market share](#), April 8, 2019

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