Welcome to another edition of Career Education Report. I'm Jason Altmire, and today we have Trace Urdan as our guest. He's managing director at Tyton Partners and he spent much of his career in equity research, analyzing and covering the knowledge sector prior as a managing director at Credit Suisse. And during his career, Trace has followed a wide range of companies serving the education market. He's covered childhood K-12, higher education, and employment training, and he's widely cited as an expert on topics of for-profit education, education technology and education policy. And in fact, he's been cited by Career College Central Magazine as one of the 25 most influential people in the career college sector. And he's testified before the Spellings Commission and his writings and thought leadership is ubiquitous. You see it everywhere. I'm sure a lot of people have encountered him before and read his thinking and his writings. Trace, thank you so much for being with us.

Trace Urdan:
It's my pleasure, Jason. It's good to be here.

Tell us just to start a little bit about Tyton Partners. What kind of work do you do?

Sure. We're focused exclusively in the education market, so all those same areas that you mentioned I covered as an analyst are the same footprint that we have as an advisory firm. And we have two practices. One is a strategy consulting practice that looks like a Bain or a BCG or a Parthenon group where we help companies and institutions primarily with growth strategy. We also do all of our commercial diligence work out of that group. So, if somebody's looking to buy a company or an operation in the education market and they need some help understanding where that business fits into the overall landscape, our consulting practice will support that work. And then we have an M&A advisory practice, and that's where I spend most of my time. Probably about 85% of the work that we do is what's called sell side, where we help owners of companies sell their businesses, but we also get involved with buy-side work where we help companies that are looking to acquire businesses in the sector, ferret out those companies that fit their strategies. And then we do some miscellaneous advisory work on capital raising and so forth as well.

And I would say you have your ear to the ground maybe more than anyone else related to these issues and higher education policy generally. It's one of the reasons you're so widely cited on these issues. Just to start, it's such a momentous time with significant regulations pending congressional action on the horizon and just changes through technology and other things in the marketplace of higher education. What is your overall view of where things are headed with higher education generally?

You're exactly right. I think all of those issues are incredibly relevant. They were relevant when I was covering public companies for public market investors. And their every bit is relevant now when I'm helping private equity investors and strategic investors buy in and around the space and understand what's happening. It's funny, I think across the education market generally, there's always been this antipathy that folks have had to people making money in the sector. And it shows itself in a variety of
ways. I mean, back in the day, if anybody remembers Edison Schools Chris Whittle's project of having a large publicly traded charter school company faced tremendous amount of pressure because of what he was trying to do there. And of course we see it in the career college sector where there's just a general feeling that if there are individuals or if there are companies making money in this space, that must somehow be wrong.

(03:52):
And so, there's a very concerted effort to use the administrative state, use the regulatory apparatus to sort of press on enterprises that operate in the sector. And unfortunately, in the time I've spent covering the sector, I've gone from this being something that was fairly innocuous and there was really great bipartisan support to where we are today where I think the Democratic Party led by progressives are very intent on increasing the role of regulation in the career college sector and really in more broadly than that, and every kind of service business that's supporting higher education. Unfortunately, it just seems to be now part of the DNA of that group. And so, we are in this mode where depending on who's in charge of the Department of Education, there's very widely differing policies in this realm and it makes it difficult for investors who above all else, I mean they obviously love growth, but what they love more than anything else is predictability. And when you have this sort of very volatile regulatory agenda, it makes investment in the sector challenging.

Jason Altmire (05:07):
One of the criticisms that you hear from those folks that you were referencing, critics of the sector is that the role of private equity by itself leads to bad outcomes and decision-making not based upon student outcomes, but other factors. And I know you've had to answer that question a thousand times. What are the answers to that concern? Do you think there's validity to the concern?

Trace Urdan (05:33):
No, I really don't. I'm not sure that my arguments are ever that persuasive against the people that also see private equity as somehow nefarious. But the point I always try to make is that private equity investors are really interested in preserving and enhancing the value of whatever it is that they're owning. And if it's a school, what they want is for the value, the long-term value of that asset to appreciate. So, this idea that critics have that somehow they're interested in driving short-term gains, and at short-term cash flow really misunderstands how particularly private equity investing works, right? They're looking to build a business that has real value to customers and has real value to all of its constituent parties because that's how they're going to get the best return on their investment.

(06:30):
So, in the past when private equity shops have owned schools that have gotten into trouble, I think it's really been more a function of them not understanding what was really happening at those schools, more than it was some kind of a cabal to defraud students or defraud the government in some way. And so, by my way of thinking, having professional class of investors invested in schools is actually a way of enhancing the quality of those operations. This is what private equity firms are really good at. They're really good at building and enhancing infrastructure, so that institutions can grow and be more stable and better operating going forward. But that's not how they're generally viewed in the popular imagination. It's a tough case I have.

Jason Altmire (07:20):
Would you say that there is a difference in the thought process in managers and leaders of for-profit institutions versus private non-profit and public institutions? And I ask that question because I’ve served on the board of trustees at two different non-profit institutions, private non-profit colleges, and I can tell you from experience when the finance committee meet and they're talking about what needs to be done and decisions to be made, the bottom line is the primary factor in those discussions. And I always think twice when the critics say that, "Well, that's the problem with the for-profit sector." What is your experience related to public institutions and private non-profit institutions and how they look at their financial operations?

Trace Urdan (08:11):
Tyton works with both types of institutions, so we do quite a bit of work with non-profit institutions. We help them find merger partners on the M&A side, and we help them with strategy and understanding markets. And I certainly agree with you that decision makers in the administration are very focused on the sort of long-term viability of the operation, which just means that financial sustainability. It's not to say that there aren't other forces and that you have at non-profit institutions, you do have a consensus-based decision-making apparatus that sometimes can complicate that element. I do find that it's sometimes hard for non-profit institutions to make decisions, and I think one of the challenges that's facing that aspect of the higher education market right now, I mean it's facing everyone, but there is consolidation that's been happening.

(09:06):
It's coming particularly among traditional age students that the nonprofits tend to serve disproportionately. And there is a focus on the bottom line, but at the same time, there's also an institutional denial in some cases of the reality of their situations that unfortunately I just see, and this is something I've written about, I see closures that don't need to happen, but they end up happening because sometimes those types of institutions delay or they do engage in some wishful thinking sometimes that it causes them to get into trouble. Your point, and I do see it myself, there is a desire to obviously have revenues exceed expenses at those institutions the same way there is at a for-profit school.

Jason Altmire (09:56):
There has been an uptick in closures among nonprofit institutions. You see it in the morning newsletters that come out inside higher ed and the Chronicle and others, and I think that people have a focus on for-profit closures without thinking about how important it is to also consider closures that happen in other sectors, what are your thoughts about what the trend looks like in the future?

Trace Urdan (10:21):
There are challenges all over the place in higher education, right? So, among traditional age students, you have basically a contraction of just the raw numbers of traditional age students that are coming out of high school. You also have the reality that the demographic mix of those students is changing, such that there are fewer and fewer full pay affluent students. And more and more students in the mix for a variety of reasons are more challenged financially, and so they're not able to pay the same amount. So, there's a challenge to the revenue base in that traditional 18 to 22-year-old population, and what you want to see ideally is some kind of an orderly consolidation. But like I said, traditional institutions, especially if they're older and have been around for a long time, especially as I find sometimes nonprofit institutions tend to have very large boards. I think at some point that the smaller the school, the bigger
the board seems to be the operative case and it becomes very, very difficult for them to take the steps that are necessary to get in front of what is just a fundamental change in the market.

(11:30):
Like I said, I think in some cases you just see these terrible closures that really didn't need to happen, but because those institutions tend to wait too long, they wait until the liabilities are too great and they are not able to, by the time they get ready to merge with another institution, it's too late and their liabilities are too great for another institution to take on. I think in general, the issue, I am very sympathetic to the challenges around closures in general, and what you see criticized among the career college sector among the profit making, privately owned schools is that there have been cases where they've closed too abruptly. This is a hard thing no matter what you're doing when students are involved, getting real with what's happening in your business early enough, so that you can affect a transition that is optimal from the perspective of students and perspective of the government. I mean, this is incredibly difficult. It's the work that we try to do to help schools, but like I said, you could lead a horse to water, right?

(12:38):
It's a very hard conversation to have with schools that are in decline, and this is what I used to do as an equity analyst, right? I mean, what equity analysts do on Wall Street is that they make projections about where the revenues are going in the future, and we don't in the regulatory apparatus, there's no way for, not that I necessarily would trust the government to do this, but there's no way, there's no forward-looking measures in any of this, right? Everything is backward looking. And so, as a result of that, there's no formal way to see the writing on the wall early enough to affect some kind of regulatory intervention. It really just it's incumbent on the boards to deal with the reality and see when institutions are running into trouble to recognize that early enough, so that they have options. But it's a tough circumstance. It's a market driven circumstance and may not always be true, but it is sort of what the next few years look like for all kinds of schools.

Jason Altmire (13:41):
You've written and commented a lot about the administration's focus on debt forgiveness and income driven repayment, the loan forgiveness that was struck down by the Supreme Court. And a lot of political capital and time has been put forward by this administration pursuing those policies, but that's all driven by the fact that the increase in the cost of higher education is exponential. Over the past many years, as an analyst who studies this and works every day thinking about this just at the heart of it, why does college cost so much?

Trace Urdan (14:19):
That's a question that lots of people that are far smarter than me haven't been able to precisely put their finger on. There are a number of factors at work there. I think certainly the role that government lending plays, and it's a complicated role, and there's been studies that have shown both the direct impact and then no impact, and it can vary, but I think at some level when you subsidize something, you're going to create some padding for institutions to raise their prices. So, that's one of the conditions. It's certainly the case that there's been administrative bloat. This is a difference between a nonprofit institution and a for-profit institution. You don't have that same rigor necessarily. You've had the ability to raise prices. We've seen the creation of both the Grad PLUS Program at the graduate level, and the Parent PLUS Program at the undergraduate level has meant that there has effectively been no limit at all on the ability to raise prices, right?
So families and graduate students have gone into tremendous debt to fund degree programs with really no accountability in that area at all. It's probably more complicated than we have time to talk about today, but it's an issue. I'm not sure there's a simple solution to it, but the first step is just recognizing that it's a concern, and from my perspective, simply making it easier for loans that students have taken out to be erased doesn't really get at that cost question at all. It may make life easier for those students that have found themselves in tremendous debt. It makes life easier for the institutions who get to kind of sidestep the uncomfortable questions that come from having graduate populations that have enormous amounts of debt, but it doesn't do anything to get at how do we bring the cost down so that this kind of funding isn't required to fund education going forward.

Jason Altmire (16:19):
That's exactly where I was going to go with that is the inequity that exists and the difference in the thought process of canceling debt and the high cost of education. You don't solve the first problem by dealing with the second problem. And when you have an institution, for example, a public institution that derives huge funding sources from taxpayers state subsidies compared to a non-profit institution, whether it be a private non-profit or even a for-profit institution, what role do you think the taxpayer subsidy and the state subsidies that flow to public universities and colleges, what role does that play in the problem?

Trace Urdan (17:08):
That's a concern as well. These are challenges. You see the same debates in healthcare and in other areas where you have this combination of public and private dollars that work in the same equation and you can point to state subsidized programs that have been enormously successful, right? I think if you look at the University of California from its get-go, it's hard to make the argument that the state of California funding the University of California was not an overall positive for the state, for the students, et cetera. And yet lately, the performance of that system has begun to suffer, right? There's something that's gone on there where it's not working the way that it used to. I find this the case all the time in the community college system, which is you're not allowed to criticize community colleges at all ever without fire raining down on you. But the reality is, and especially because I live in California, and you see this example in California.

California has made the community college system so inexpensive through their subsidies, all with good intent, but it diminishes the value in the minds of the students. And so, you have students that spend some time there and don't complete. You have the proliferation of programs that are sort of dubious merit and quality. You have lots and lots of institutions that just don't accomplish what they were designed to accomplish. And that's not to take away from everybody will point you to very excellent community colleges, and there are some that perform really well. But overall, my feeling there is that you just have so little accountability. You have mission creep, you have really a student population that is ambivalent at best about what they're there to do.

It's an example where the direct subsidy doesn't necessarily result in the outcome that you want. The way we fund higher education in the U.S. is so complicated, and so the subsidies and the costs and they're so intertwined with each other, sort of unraveling it cleanly is extremely challenging proposition. I'm very sympathetic to the idea that there's not a simple fix, right? If you talk to the hardcore
libertarians, they just want to eliminate all student loans entirely, right? But that to me just seems enormously impractical. I can't see that happening tomorrow without enormous dislocations and problems taking place. So, I don't pretend to have the clear solution to it. I just try to fight the good fight at the margins on some of this stuff.

Jason Altmire (19:46):
Lastly, what I wanted to ask you was about online program management and the administration made what I think most people would agree, a huge misstep in the way they put forward the guidance on third party servicers more generally. And critics of the for-profit sector are more critics of for-profit involvement in higher education in any way more so even than just for-profit schools in and of themselves, and OPMs and the third party services are a part of that. How much do you think those types of management firms and what their involvement is in higher education plays into the critic of for-profit education?

Trace Urdan (20:33):
I think the critics of the for-profit sector moved on to OPMs because they were the next new thing and they were seeing growth and expansion at a time when for-profit colleges were seeing some contraction. And so, that it was a less amusing target and they moved on to OPMs. I think their criticism of OPMs don't really stand up at all. They want to put the OPM servicers in the same box that they place the for-profit colleges, but they don't really fit there nearly as well for a whole variety of reasons. One that you mentioned before, which is that there's this presumption that the universities themselves that partner with these groups are sort of unsophisticated rubes that are getting taken advantage of by the sophisticated for-profit companies. I don't think anything could be further from the truth that these institutions that are successfully partnering with OPMs are enormously sophisticated.

(21:30):
They're absolutely calling the shots in this contracting, and they are responsible for the enrollment decisions, good or bad, right? I think there's some criticism of USC growing its social work program too large for the market for the students to really benefit in the market for that program, given what the salaries look like there. That was completely a USC decision. And the worst you could say about their partner in that case was to you is that they maybe should have known better and walked away. But I think that's a tough line. So, the critics want to sort of make the for-profit companies out to be the bad guys, and that's not really how this is operating here, nor is it the case that somehow the fact that the for-profit OPMs are sharing revenue with these institutions means that they're incited to enroll students irresponsibly because it's really the institutions that are making the enrollment decisions there.

(22:26):
And fundamentally, the reason that that revenue sharing model, which is the core of what the critics have attacked, and what I think the regulations are attempting to put an end to is it's basically a low risk financing for the institutions, right? They want that. And so, what I continually hear is that even though there's all this noise made about how bad revenue sharing is, and even though all these new regulations have been proposed, the institutions themselves, they still want the revenue share model because in that revenue share model, the for-profit partner carries all of the upfront risk associated with building the program, launching the program, and running the risk that there may not be the kinds of students out in the market that they're anticipating for those programs. And the institutions are, especially nonprofit institutions, are very averse to risk. And so, that's part of why this model has worked and
really no one wants it to go away except the people standing on the outside just sort of objecting to the fact that there are large companies growing in the education services space.

Jason Altmire (23:35):
Our guest today has been Trace Urdan. He is a managing director at Tyton Partners Trace. Thank you for being with us.

Trace Urdan (23:42):
My pleasure, Jason. Thanks for having me.

Jason Altmire (23:45):
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