

An aerial photograph of a university campus, likely the University of Maryland, showing various red brick buildings, green lawns, and a central quad. A large blue rectangular box with a dotted white border is centered over the image, containing white text. The background shows a dense urban area with many buildings and trees under a clear blue sky.

PREPARING FOR THE ACCELERATING DISRUPTION IN HIGHER EDUCATION

Michael Dymond

Assistant Vice President

Investment Banker

917.206.3665

michael.dymond@hilltopsecurities.com

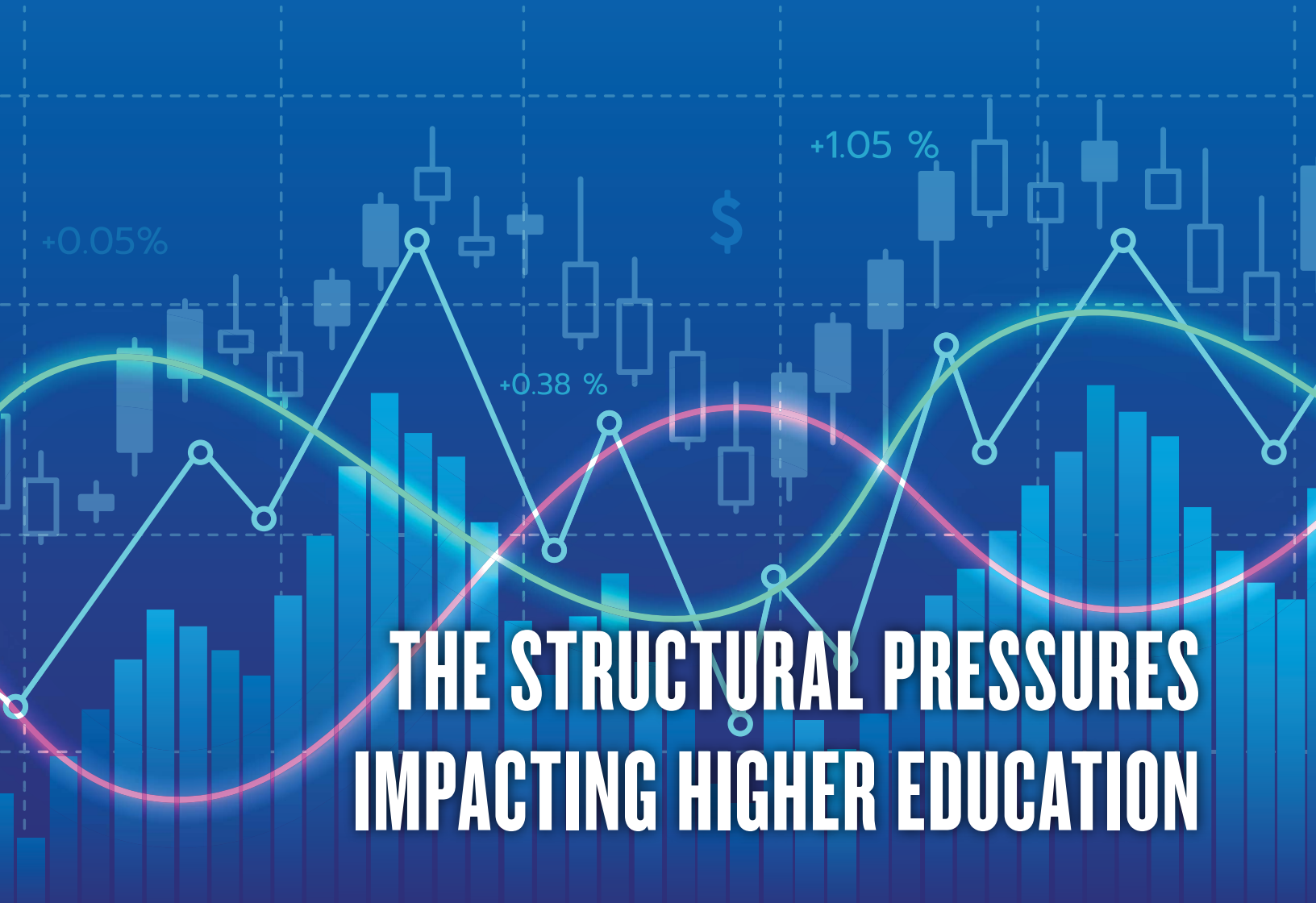
AJ Prager

Senior Vice President

Investment Banker

818.212.2075

aj.prager@hilltopsecurities.com

The background of the top section is a dark blue financial chart. It features a candlestick chart at the top, a line graph with white circles and a red trend line in the middle, and a bar chart at the bottom. Various percentage values like +0.05%, +0.38%, and +1.05% are scattered across the chart, along with a dollar sign (\$) and a green circular arrow.

THE STRUCTURAL PRESSURES IMPACTING HIGHER EDUCATION

The higher education sector faces looming structural pressures, chief among them an impending demographic cliff and widespread technological disruption. In addition to these forces, institutions have been confronted with tuition stagnation and high inflation, rising discount rates, muddled degree value proposition, and a largely fixed cost business model. [This confluence of factors has begun impacting enrollment at some institutions, leading to uneven operations.](#) While the approaching enrollment cliff will test higher education leaders in two years, even more pressing is the ongoing

disruption from technological innovation – lower cost structures of online institutions including different faculty governance and compensation models, new competition from online offerings, and student demand for anytime and anywhere learning – which has driven many administrators and Boards to assess their institutions’ strategic positions and plans. HilltopSecurities’ higher education group has worked with clients to develop what we term Strategic Transaction Frameworks as the sector encounters a period of greater change and volatility as a result of this disruption.

The Impact of Technological Disruption

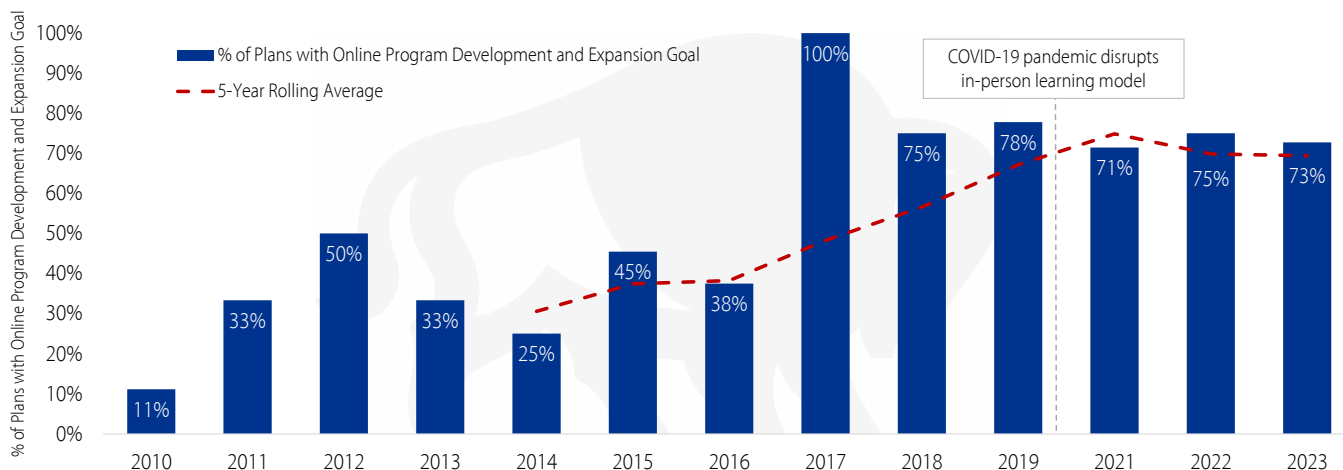
While technological innovation and the resulting disruption has been on the radar of higher education administrators for over a decade, the onset of the pandemic in March 2020 rapidly accelerated its impact and disruptive force. After institutions finished triaging their preliminary Covid-19 response, many then engaged in long-range planning that incorporated addressing the opportunity – and threat – presented by the new post-pandemic paradigm of technological innovation and disruption.

The extent of this response has been borne out in the strategic planning cycles of colleges and universities. Institutions build strategic plans to craft a vision and direction over a 5 – 10-year period. These plans are crafted by leadership and subsequently adopted by the Board, with input from a wide range of constituents. To assess the magnitude of the response to technological innovation and disruption, we prepared a novel analysis which demonstrates how strategic plans have over

time increasingly incorporated a goal or objective to develop, offer, and/or grow online academic programs. The foregoing analysis depicts the growth of these objectives within strategic plans since 2010.

Our results are based on a representative sample of 55 private, not-for-profit, baccalaureate and master's level institutions with between 1,000 and 10,000 students. The disruption from technological innovation impacts the whole sector, but smaller institutions are often more vulnerable due to their greater tuition-dependence and more limited resources. As such, we focused our analysis on the responses of institutions reflecting this type of profile. For each institution, we bifurcated strategic plans into two categories: (1) the most recent strategic plan (Board-approved plans after 2017); and (2) the immediately preceding plan (Board-approved plans between 2010 and 2017). Strategic plans in the preceding period included an objective of developing and growing online offerings 38% of the time. In contrast, 73% of institutions expressed a goal or objective, or grow online offerings in their most recent strategic plans.

Online Program Development and Expansion in Strategic Plans

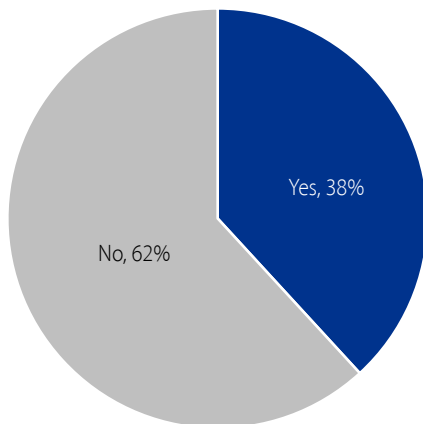


Note: Very few strategic plans were adopted by Boards in 2020 due to the immediate impacts of COVID-19. Most Boards at the time were almost exclusively focused on near-term operations. As such, 2020 is excluded from this analysis. Of the plans adopted in 2020, 50% included a goal to develop or grow online programs. See endnote 1.

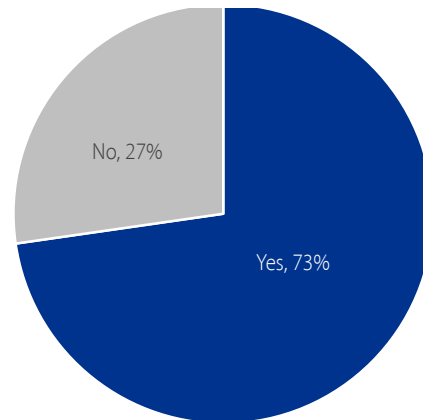
Source: HilltopSecurities.

Online Program Development & Expansion in Strategic Plans

Preceding Period (2010 - 2017)



Current Period (2017 - Present)

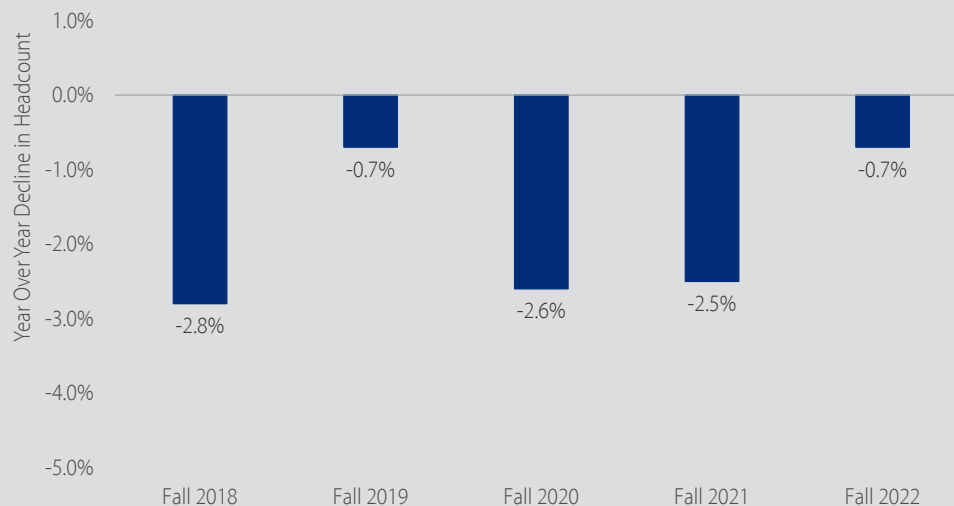


Source: HilltopSecurities.

While the extent to which institutions profess a goal to develop and/or grow online academic programs falls on a spectrum, the evolution in goals and objectives was clearly evident in our sample. For example, in 2011 one institution articulated its vision to be a residential, highly ranked, master's level college; however, a decade later, the same institution expressed a goal to grow online adult and continuing education programs.

Another institution stated in the middle of the last decade that it would enlarge capacity for online delivery but remain primarily campus-based. By 2021 the same institution highlighted its need for enrollment growth in light of contemporaneous and forthcoming economic and demographic conditions and articulated its goal to deliver academic programs in a range of modalities, including in-person, hybrid, and online formats.

National Decline in College and University Enrollment 2018 - 2022

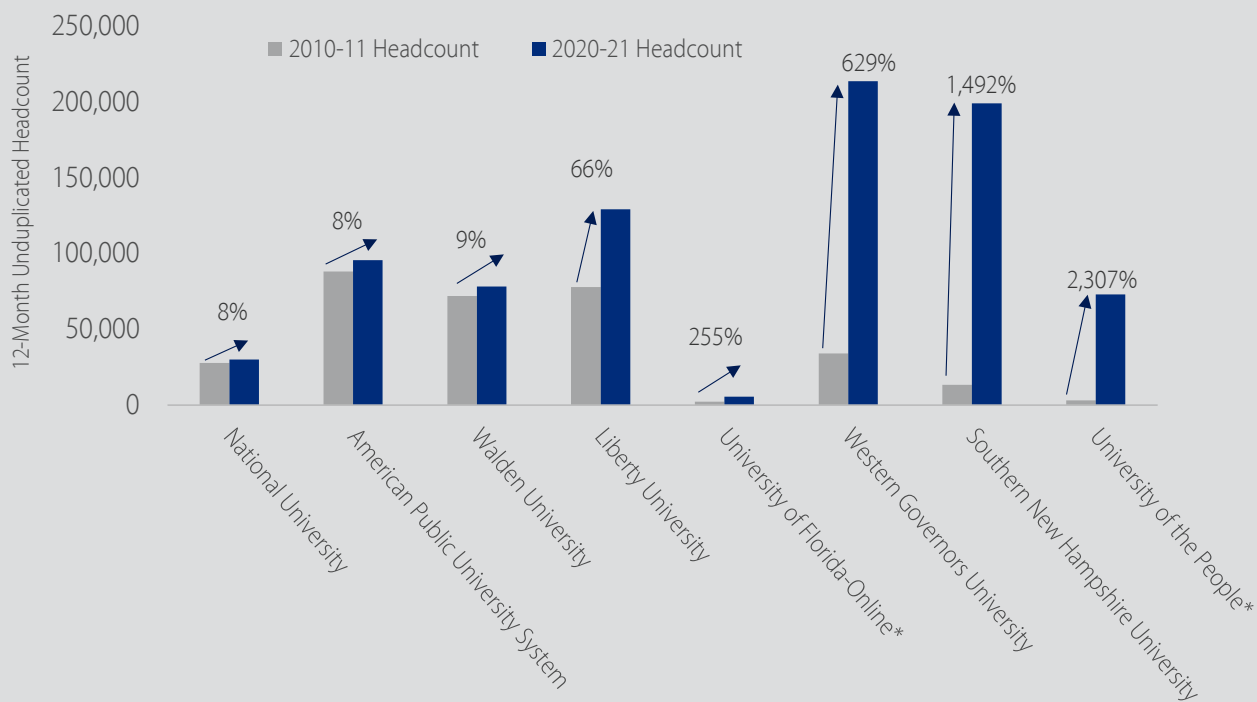


Source: National Student Clearinghouse.

The growing focus on online modalities is not in response to an idle or far-off threat. As noted, the enrollment cliff will begin testing institutions within a few years, but technological innovation has begun pressuring many institutions today. While national undergraduate and graduate headcount has experienced minor declines for several consecutive years, online universities, which often serve working adults and nontraditional students, have grown. Moreover, the online initiatives of public universities

have scaled rapidly, such as Purdue Global (~66,000 students), UMass Global (~16,000 students), and Arizona State's online offerings (~78,000 students), while interest in acquiring online universities continues such as with the University of Idaho's pending acquisition of the University of Phoenix. As many traditional 'brick and mortar' institutions face greater competition for a shrinking pool of students, the appeal of serving non-traditional students and working adults grows.

Headcount Growth at Selected Primarily Online Universities



Note: Data for University of Florida – Online and University of the People in the early period is for the 2015 – 2016 academic year (the time at which the University of Florida – Online was founded and the first year of available data in IPEDS for University of the People).

Source: IPEDS.

Addressing the Ongoing and Coming Disruption

Addressing the challenges facing the sector requires advance planning and alignment between Board, administration, and faculty. There is no one-size-fits-all solution, but every institution has an opportunity to bolster its defenses and address the threats presented by technological disruption and new challenges to come.

Some institutions may find that modest, internal adjustments are a sufficient response. However, other institutions may assess that the external pressures are too vast for incremental change and require a stronger, institution-wide response. Larger institutions may see an opportunity to grow and transform amid the structural challenges impacting the sector. For some of these institutions, the challenges may represent the right environment in which to acquire, merge, or partner. Partnerships can jump-start growth initiatives and scale enrollment and net assets at a fraction of the price and time of building them organically.

For any institution, regardless of profile, broad structural modifications are neither easy nor quick, nor are such transformations without risk. But with sufficient planning and strategic alignment, there are available platforms and tools to facilitate broad institutional change.

Hilltop Securities Strategic Transaction Frameworks

Institutions on stable financial footing are presented with a unique opportunity to jump-start mission-execution through strategic transactions during this period of transformational change in the sector. Moody's recently noted that "finding strategic alliances for a successful merger or takeover and overcoming barriers to execution remain[s] difficult, with [many] roadblocks" but that "universities will continue to pursue mergers or other combinations with financially stronger partners."

The institutional significance and inherent complexities of higher education mergers and acquisitions mean advance strategic planning on partnerships will be critical to identifying the right partner at the right time and successfully effecting a desired transaction. In the same way that a strategic plan serves as a vision and roadmap for an institution's identity and goals, a strategic plan to evaluate partnerships, what we term a Strategic Transaction Framework, allows an institution to define its goals and constraints, identify those which can be addressed via transactions, and assess available opportunities in the current environment.





A Strategic Transaction Framework is developed with an institution's President, Board leadership, and a small group of institutional leaders. Once adopted, a Strategic Transaction Framework allows management to quickly and efficiently move through a pre-approved decision tree to evaluate opportunities. The use of a framework allows institutions to:

- Have a disciplined rejection of low-potential overtures, saving management time (its most valuable resource);
- Proactively identify and invest time on high-potential opportunities; and
- Build internal due diligence capabilities

The underlying process leading to the adoption of a framework also confers benefits to an institution, including allowing it to:

- Align internal parties around institutional mission and goals;
- Clarify priorities; and
- Foster communication and provide a forum for key implementors to buy-into the planning process.

We have observed that prudent strategic transaction planning within the current environment can position institutions to confidently walk away from low-potential opportunities and pursue high-potential partnerships with early management and Board buy-in and alignment.

Conclusion

Higher education leaders and Boards will continue to face pressure as the sector encounters a period of greater change and volatility. Technological innovation and disruption have already driven institutions to alter their goals and the forthcoming enrollment cliff will soon strain the sector further. There is no one-size-fits-all solution to these challenges. However, for institutions on stable financial footing, advance strategic transaction planning can provide a platform for administrative teams to proactively initiate or efficiently respond to opportunities as they arise. The right strategic partner can transform an institution – and the wrong one can as well – which is why thoughtful and deliberate strategic planning is so critical.

1 The institutions are from IPEDS and reflect schools that meet the following criteria: (1) Degree-granting; (2) Not open admissions; and (3) Bureau of Economic Analysis regions of New England, Southeast, Mid-East, and Far-West. We exclude from the institution list any school for which we cannot access a current strategic plan and an immediately preceding strategic plan, yielding a final sample of 55 institutions. Our analysis focuses on private institutions due to the absence of a public funding backstop and the unique competitive pressures this sometimes creates.

The commentary expressed is for informational and educational purposes only and may change at any time. While we believe the information in this presentation is reliable, we cannot guarantee its accuracy. This material is not intended to be relied upon as investment advice or recommendations, does not reflect the views of HTS management, employees and/or affiliates nor does it constitute a solicitation to buy or sell securities and should not be considered specific legal, investment or tax advice.



717 N. HARWOOD STREET, SUITE 3400
DALLAS, TX 75201

833.4HILLTOP

HILLTOPSECURITIES.COM