

ISSUER COMMENT

Virginia Dispute Highlights Governance Stress and Economic Threats Facing US Higher Education

Table of Contents:

SUMMARY	1
SHARED GOVERNANCE STILL POWERFUL AT LEADING UNIVERSITIES, EVEN AS SECTOR FACES REVENUE STAGNATION	1
PUBLIC UNIVERSITIES ADOPT PRIVATE UNIVERSITY BUSINESS MODEL, BUT NOT GOVERNANCE MODEL	2
DISRUPTIVE TECHNOLOGY OFFERS OPPORTUNITIES AND THREATS FOR ESTABLISHED UNIVERSITIES	3
MOODY'S RELATED RESEARCH	5

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Summary

The end of governance tumult at the Aaa-rated [University of Virginia](#) (UVA) is a positive credit development for the university, but also a symptom of broader stress in the higher education sector. While UVA's reputation temporarily suffered from these events, the final resolution affirms the stability of the university's faculty-centric governance model that will allow it to continue to effectively compete with the nation's leading universities for top students, faculty, research grants and philanthropic support. For the US higher education sector overall, we expect governance and leadership clashes to increase in coming years as the sector's ability to grow revenues dwindles, and its emphasis shifts to new operating efficiencies and cost containment. On-line learning technologies will play an increasing role in creating new efficiencies and lowering cost per student.

Shared Governance Still Powerful at Leading Universities, Even as Sector Faces Revenue Stagnation

On June 26, the governing board of UVA voted unanimously to reinstate Teresa Sullivan as president, just two weeks after board leadership orchestrated her forced resignation in a surprise to the broader university community. She had originally been elected as the 8th president of UVA in 2010. The university had a history of relatively long-serving presidents, with the average chief serving 15 years between 1904 and 2010. The reinstatement culminates an unprecedented cycle of events that included the resignation of the board's Vice Rector; a vote of no confidence in the board from the faculty; the resignation of a star professor, and a warning from Virginia Governor Robert McDonnell to the board to decide the president's status by June 26 or face removal.

Ironically, the clash between the president and some members of the University of Virginia board highlights the stabilizing effects of the counter-intuitive "shared governance" model still in place at leading US universities. Under this model, which is dramatically different from top-down corporate governance models as well as electorally-driven government models, the tenured faculty, and to a lesser extent the alumni, students and donors, have a powerful role to play in major university decision-making.

The UVA events showed that these stakeholders can effectively assert their implicit power, even to the extent of quickly blocking a strategic decision of the governing board. Comparable events involving major stakeholder involvement and presidential change have occurred in recent years at other major US universities, including [Harvard](#) (Aaa stable), the [University of Illinois](#) (Aa2 stable), [Boston University](#) (A2 positive) and [Case Western Reserve University](#) (A1 stable).

More university governance controversies are likely in coming years as the sector adapts to tougher economic realities. The faculty's implicit governing role remains especially strong at research universities, such as UVA, which are dependent on star "principal investigator" research faculty to attract grants and private gifts. However, the faculty's power is on the wane at the large majority of public and private US colleges and universities which operate with small endowments, weak selectivity, and high dependence on student tuition and/or state funding. Many universities are reducing the percentage of faculty that have tenure, a form of nearly guaranteed employment. This reduction erodes the implicit power of faculty and typically strengthens the hand of the board and president to deal with economic challenges quickly. Moody's 2012 outlook for the US higher education sector discusses these challenges in more depth. We maintain a negative sector outlook for the undiversified majority of institutions, but stable outlook for the minority of diversified market leading colleges and universities.¹

Public Universities Adopt Private University Business Model, but Not Governance Model

Conflicting trends face public universities as they are expected by state government to do more with much less public funding. Ironically, even as states have been unable to maintain funding of public universities, they also increasingly recognize the powerful role that universities can sometimes play in promoting economic development and labor force development in the state.

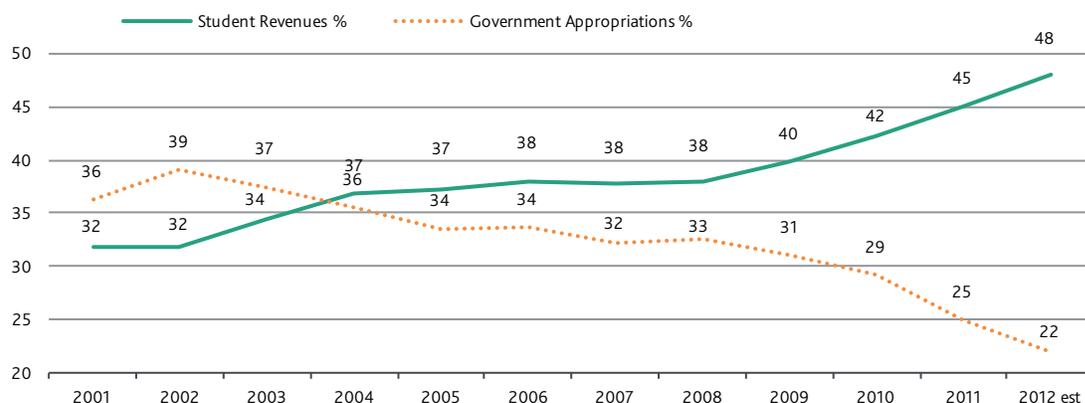
For public universities like UVA, the governance model has remained largely unchanged even as their underlying economics has shifted dramatically away from state funding. Compared to other public universities, UVA has very low dependence on state operating appropriations (7.7% of operating revenue in FY 2011, compared to the FY 2010 public university median of 29.1%). Students, and donors to a lesser extent, now provide the majority of revenues at most US public universities (Exhibit 1).

¹ [U.S. Higher Education Outlook Mixed in 2012](#), January 2012

EXHIBIT 1

Public University Funding Burden Shifts to Students

Median Share of Revenues by Source for US Public Universities (%)



Source: Moody's MFRA

This trend has generally been a positive credit development for public universities because it diversifies their revenue sources away from volatile state funding decisions and encourages professionalization of university management even as board governance has changed little.

The gubernatorial power to appoint board members remains in place at most public universities in the US, even as senior university managers have turned their focus more toward generating independent sources of revenues, following the long established business tactics of private not-for-profit universities. The two university types—public and private—now effectively operate under similar business models and compete intensely with each other. However, they still retain different governance models as private university boards are self-appointing and dominated by philanthropists, while public university board members are usually appointed by the state governor and rarely are major donors to the university, although in some cases have made material political campaign contributions.² The active role of the governor of Virginia in the UVA events highlights this continuing governance difference. As UVA gained additional operating autonomy under the State Higher Education Restructuring Act in 2005 the disparity of its increasing market orientation and governance model widened.

Disruptive Technology Offers Opportunities and Threats for Established Universities

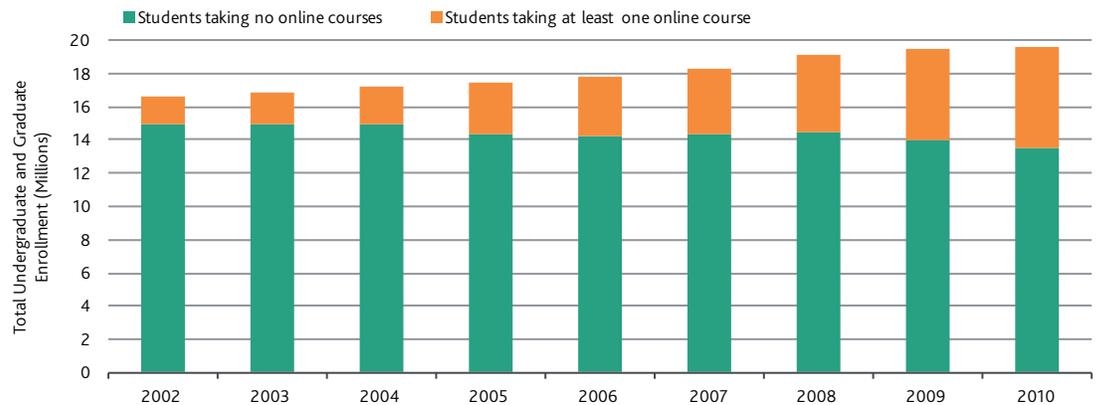
One aspect of the UVA governance struggle reportedly involved disagreement between the president and some board members about the pace of change in developing new on-line classes and degrees at the university. The explosive growth of on-line enrollments at for-profit and some not-for-profit universities³ has created increasing pressure on established universities to move toward a hybrid model combining face-to-face classroom instruction with on-line instruction.

² [Public University Governance Faces New Challenges as U.S. Public Higher Education Becomes Increasingly Market-Driven](#), February 2008; [Governance and Management: The Underpinning of University Credit Ratings](#), November 2010

³ See, for example, page 3 of [Liberty University, VA High Profile New Issue Report](#), January 2012

EXHIBIT 2

Online Education Continues to Blossom



Source: *Going the Distance: online education in US, 2011*; Babson Survey Research Group; Sloan Consortium

This emerging hybrid model is increasingly being offered by many traditional colleges and universities and creates the potential to deliver much more academic content at a lower cost per student, but also raises serious quality control challenges for leading universities that have long thrived on the campus experience model. Leading universities, such as [MIT](#) (Aaa stable) and [Stanford](#) (Aaa stable), are offering considerable on-line content free of charge to non-degree students globally in pursuit of their non-profit education mission. However, such leading universities also have considerable potential to leverage their brand name more aggressively to generate substantial new revenues if their boards and faculties decide to pursue the economic potential of on-line instructional technology. We expect virtually all traditional colleges and universities to develop hybrid learning models in coming years as a means of growing enrollment and lowering cost per student.

Moody's Related Research

Special Comments:

- » [Governance and Management: The Underpinning of University Credit Ratings, November 2010 \(128850\)](#)
- » [Public University Governance Faces New Challenges as U.S. Public Higher Education Becomes Increasingly Market-Driven, February 2008 \(105943\)](#)

Rating Methodology:

- » [U.S. Not-for-Profit Private and Public Higher Education, August 2011 \(134044\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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