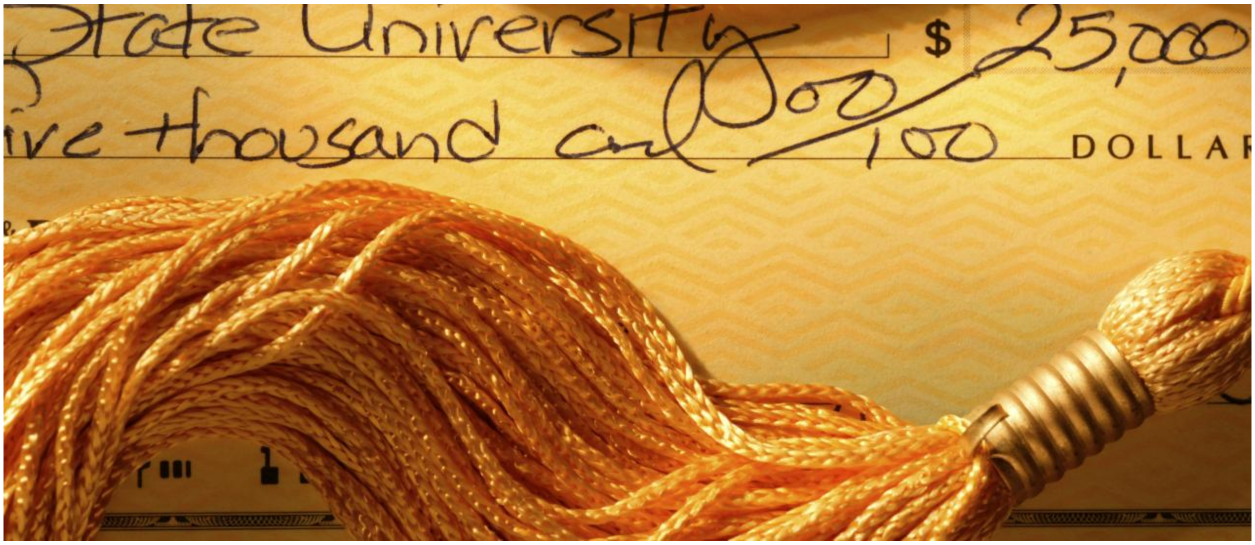
Rising Colleges Fees: a Reflection of Offerings or Aspirations



By Noah Askin , INSEAD Assistant Professor of Organisational Behaviour

Are rising tuition fees a sign of how much an individual college degree is worth, or how worthy the college wants to be?

With the price of higher education in the US surging **500 percent** since 1985 and the unemployment rate of recent college graduates hovering around **seven percent**, there is increasing debate around whether a four-year degree is really worth the cost. Are rising fees a response to market forces, do colleges need the increased revenue to improve offerings in order to compete? Or are the fees themselves being used as a signal intended to increase the perception of a school's status and its offerings?

Past research has shown that high status organisations command higher prices for their goods and services than low status organisations: Elite wineries **charge higher prices** for their wines than lower standing rivals; similarly, the status of a corporate law firm has a strong effect on the cost of its **legal services**; and biotech ventures with more prestigious affiliates enjoy **better initial valuations**.

What remains less clear is the impact that an organisation’s change in status has on its price-setting behaviour. Common thinking and **prevailing status theory** suggest that when an organisation slips in status, lower rates of innovation, higher costs, a fall in growth, and lower prices follow. But, while some companies passively accept their lower standing or ranking, and watch as prices fall, more dynamic organisations will take action to recover from this decline. This may include increasing their prices as an ‘‘adaptive device’’ to recover lost ground financially and/or send a signal to potential customers that their product is still one of high quality. This has been referred to as “the Chivas Regal strategy.”

According to marketing folklore, the Chivas Regal brand of scotch whisky was losing sales and struggling to gain market share when owners doubled its price—without changing the whisky—and found that not only did they make more money per bottle, they also doubled their unit sales. The idea being, higher prices can convince potential customers of the greater value of the product.

The attraction of price over quality

While there are certainly situations and markets where prices are primarily determined by buyers’ preferences and a relatively static status hierarchy, there are other goods—mostly luxury and experience goods such as fine whisky and wines, holidays, restaurants, and higher education—where the quality of the product or service being purchased is not necessarily obvious before it is consumed or experienced. When there’s lack of clarity around what is being paid for, and when status matters, there is a freedom for producers to set a higher price.

In a recent study, co-author **Matthew S. Bothner**, a professor and the first holder of the Deutsche Telekom Chair in Leadership and HR Development at ESMT, and I set out to examine whether this was occurring in the higher education system, and whether a fall in an institution’s status was, under certain conditions, triggering a rise in tuition prices.

The research, **Status Aspirational Pricing: The Chivas Regal” Strategy in US Higher Education 2006-2012**, analysed a panel of over 400 private, nationally focused universities and liberal arts colleges covered by the **US News and World Report** between 2005 and 2012, allowing us to focus our attention on organisations where status matters considerably and where ranked positions change meaningfully over time. Analysis of the sample revealed that in a substantial number of cases, a significant decline in status (resulting in the school falling below an aspirational range of ranks) was indeed associated with a higher than expected increase in future price. Schools almost universally increase their tuition annually, but the colleges experiencing these status losses were increasing their tuition levels *significantly more* than expected.

We tested for the possibility that these price increases had less to do with schools wanting to appear more prestigious, and more to do with their desire to recover their ranking by enhancing their offerings— for example, using the increased revenue to improve student-faculty ratios or boost grant dollars offered to students. However the results indicated the strategic raising of prices was done in the name of price-status perception: in other words, the price hike was being used as a “signal” to potential students that the school’s offerings were on par with those of other higher-ranking institutions. That the schools experiencing status losses did not appear to reach out to alumni for greater giving, supported the idea that raising funds was less of an aim than the school's desire to appear more prestigious.

The effect of outsized tuition increases was more likely to be found among schools with more disparate groups of applicants and those whose peer schools were already charging higher prices. Interestingly, the effect was largely concentrated among institutions in the middle band of the top tier (those ranked below 50 yet still reasonably well within the top tier of ranked schools), where competition for rankings is most intense and where schools faced the threat of falling further down the ranks, or even dropping out of this high status group.

Does it work?

But when it comes to recovering status, does hiking up the price of a product work? In the case of higher education, increasing prices did appear to provide a modest boost toward regaining a couple of ranks in the short term. However, the data did not provide enough information to indicate whether this would be effective over the long run. It stands to reason that, if colleges don’t back up the higher prices with improved offerings, it probably won’t. And if a school is revealed to be using a “Chivas Regal” strategy, the tactic is likely to be rendered even less effective.

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