INSIDE HIGHER ED

A Reckoning for 2U, and OPMs?

> After online program management company 2U talked openly about its challenges, the company's stock plummeted. Analysts say the company, and others like it, are down but not out.

By Lindsay McKenzie

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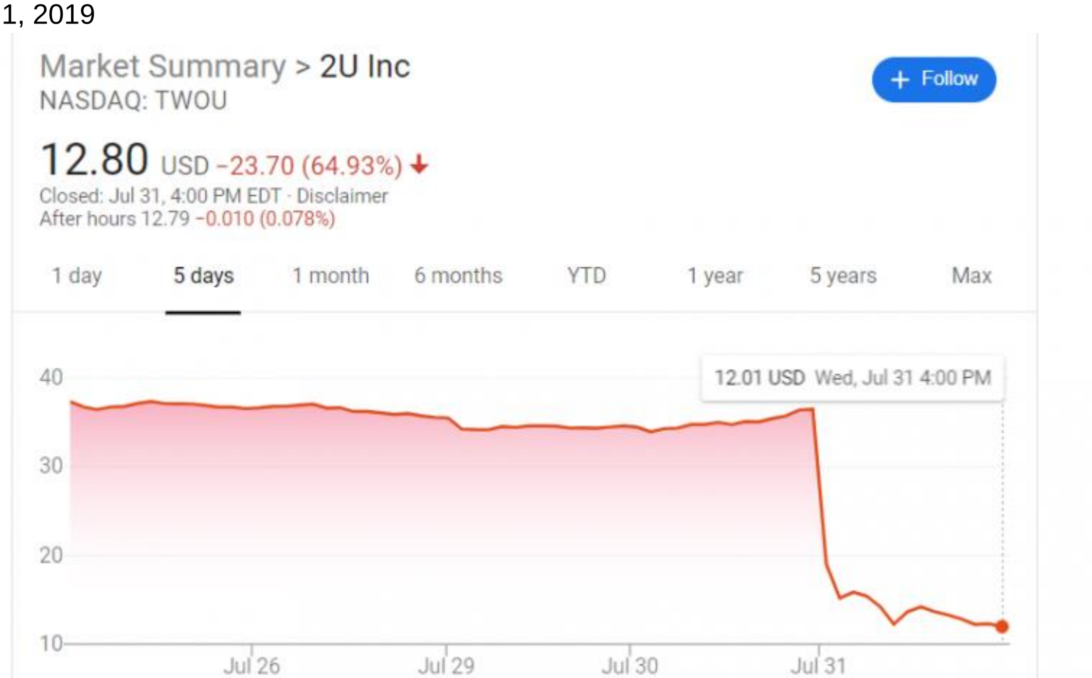

An hour before Chip Paucek, CEO and co-founder of 2U, held an investor call late Tuesday afternoon, the online program management company's stock was valued at $36.50. Over the next 24 hours, as investors responded to the news he delivered, its stock plunged to $12.80 -- a decrease of almost 65 percent.

In that investor call, Paucek delivered a set of messages that wouldn't have surprised many who watch the online education space closely. Online program management is a difficult business to be in. Online education is increasingly competitive, student acquisition and marketing costs are going up, and the regulatory landscape is becoming more complex.

The core business for 2U -- helping selective institutions such as the University of Southern California launch large online graduate programs -- isn't growing as hoped. With the "mainstreaming of online education," attracting large numbers of students to a particular online program is more challenging and more expensive than it was just a few years ago, said Paucek.

To adapt, the company is planning to significantly slow down the number of new graduate programs it launches, said Paucek. It also plans to make its online programs smaller than they were in the past. "By lowering enrollment expectations, we expect a more efficient marketing spend over the long term," he said.

Paucek did not share how many new programs 2U is planning to launch in the next few years, though he hinted it would be "substantially fewer than 21, probably less than half of that." More details would be shared at an investor event in November, he said.

The company, a market leader, is adapting to this changing environment in other ways, too. In the past, 2U has entered into revenue-sharing deals with institutions -- launching online programs in exchange for a large slice of tuition revenue without the need for a down payment. Now, 2U is planning to offer more flexibility, giving institutions the option to pay up front for services such as marketing, enrollment management, instructional design or advising.

Offering hybrid or fee-for-service options is something many OPM companies already do, but 2U has long been resistant to this change. It’s a significant shift in strategy, said Daniel Pianko, co-founder and managing director of University Ventures.

There has been long-running disagreement about whether fee for service or revenue sharing is the better option for institutions, said Pianko. “What’s really interesting is that 2U went from being the strongest proponent of the revenue share forever camp to effectively embracing the future of fee for service,” he said. “With the 2U move, we would expect a rapid move toward fee for service across the board.”

While investors may have been spooked by 2U’s revised, negative outlook. Pianko expects 2U to recover. “The most likely outcome is that in two years the stock will be much higher than it is today, but still below the peaks of last year, when the market was assuming perfect execution of a software-as-a-service company,” he said.

Like other OPMs such as Wiley, 2U has been busy acquiring companies that offer non-degree-level credentials. The acquisitions of short-course provider GetSmarter in 2018 and coding boot camp Trilogy earlier this year were early acknowledgments by 2U that its business model had to change, said Pianko. Howard Lurie, principal analyst for online and continuing education at Eduventures, agreed that the acquisitions were an acknowledgment by 2U that its core business was “going to run into some headwinds.”

“When we think about the OPM market in general, it's not surprising that 2U and others are having a hard time. Graduate enrollment is flat. The economy has been pretty good, and that means going to school is not as attractive as staying in a job,” said Lurie.

The health of the economy and the number of people enrolling in online programs are countercyclical, said Lurie. During the last recession in 2008, online providers did well. But there is no guarantee that future recessions will have the same impact, as there are many more ways in which learners can get credentials online now through alternative providers. This is why so many OPMs are investing in nondegree credentials, said Lurie.

"I think the OPM market will reward those companies that anticipate the challenges and adapt," said Lurie. "If they look at what adult learners want -- shorter, less expensive credentials -- they'll deliver that. If they hold on to what they think the market wants, they'll have a challenge."

2U is not the same company it was even a few years ago, wrote Phil Hill, publisher of the *PhilOnEdTech* blog, on Tuesday. He remarked that the company's growth assumptions "appear to be as much around boot camps and short courses as they are around traditional graduate degree programs." In his blog post, Hill described the 2U investor call as "the day the OPM market changed." It was an acknowledgment that the market is messy, chaotic and changing, he said.

But Nick Hammerschlag, president of the Entangled Group, said he felt Hill's assessment of the significance of this moment was "probably a little dramatic." More OPMs may offer fee-for-service deals over revenue-sharing deals, but the market is "still very healthy and vibrant," he said.

“There’s still a lot to like about 2U’s business,” said Hammerschlag. Universities will continue to seek assistance from third parties in launching programs, existing programs are still generating revenue and the nondegree market is “not only surviving but thriving,” he said.

2U embracing fee-for-service is likely a reflection of concern that the company would lose customers once their revenue-sharing deals came to an end, said Hammerschlag. Universities might lean on OPMs to launch their first few online programs, but many are building the capacity over time to bring these functions in-house. By giving universities à la carte service options, they are less likely to lose relationships with institutions completely when they look to renew, he said.

In the investor call, Paucek talked about the uncertainty created by recent Department of Education guidance that could prevent California students studying in programs from out-of-state nonprofit providers from receiving financial aid. But he failed to mention either the increasing political scrutinyof the OPM market or the impact of campaigns “pushing back against revenue-sharing models and OPMs in general,” wrote Hill.

Bad press surrounding the University of Southern California’s online master’s in social work, run by 2U, also went unmentioned. According to a recent article published in the *Los Angeles Times*, the push to enroll hundreds of additional students led to a lowering of admission standards, which faculty say has damaged the school of social work's reputation. The school is also facing a financial crisis because it seemingly underestimated the cost of hiring new staff and faculty to accommodate the extra students. Many cheaper alternatives to the online degree, which costs north of $100,000, have also been launched -- some by 2U.

"Given the earnings call, I suppose it's to be expected that there's so much focus on the company's market capitalization," said Jonathan Kaplan, a former Laureate Education executive who is currently advising ed-tech companies and private equity firms.

"But the most important issue for OPMs isn't market capitalization, it's market fundamentals. And over all, the fundamentals are sound: market demand for quality online education and the adult learner market is the fastest-growing segment of higher education."

"End of the day, there's a significant market need, and OPMs help many universities looking to address that need."

Read more by Lindsay McKenzie

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