

Fees - Stretched to Breaking Point ?

Pricing Policy Discussion

Jean-Marc Hodgkin

Bursar - Dame Alice Harpur School

The 4 “P”s

Since 1960s, *Borden* of *Harvard Business School* identified the 4 “P”s of Business:

- Product
- Pricing
- Placement
- Promotion

These four elements are often referred to as the Marketing Mix, which are used to craft a Marketing Plan.

Marketing Mix in Schools

- **Product** - usually very well understood by schools
- **Promotion** - far more professionally done over the last decade or so
- **Placement** - usually requires external market research to optimise
- **Pricing** - still poorly approached by most schools

Pricing Strategy

Pricing is an important strategic issue because it is related to product positioning and affects other marketing mix elements such as product features and promotion.

7 Pricing Elements

1. **Define “Marketing Mix” decisions** - perform market, segmentation and positioning analysis. Define the product and promotional tactics.
2. **Calculate cost** - include fixed and variable costs associated with the product.
3. **Set pricing objectives** - for example, surplus maximisation, revenue maximisation, or price stabilisation (status quo for set demand).
4. **Understand environmental factors** - evaluate likely competitor actions, understand legal constraints, future political actions etc.
5. **Understand Perceived User Value** - understand how customers perceive value in the product and consider premium pricing
6. **Estimate the demand curve** - understand how demand varies with price.
7. **Determine pricing** - using all the information collected in the above steps, select a pricing method, develop the pricing structure.

Aspirational Demand

How many of you would like to own a Ferrari ?



How many can afford to buy a Ferrari ?

(Clue: £135,865 to £212,613)

(Reality Check: Average ISC Termly Fees - £3,933 in 2008/09. 7 years x 3 terms = £82,593 per child ignoring extras. There are 365,000 households that buy independent education in UK, sending on average of 1.7 children = £140,408 or a new Ferrari !!!

Aspirational Demand in Education

- Independent School Product: 50-60% aspirational demand
- “Schools that can seriously...keep fees to a minimum will open the sector up to more customers” (*Chris Woodhead, Cognita*)
- *Sunny Varkey, Chairman of GEMS Education*, believes that there is a potential UK market of 1.7 million pupils for **affordable** private education

(Note: The UK independent sector as a whole educates around 628,000 children in around 2,600 schools. The independent sector educates around 6.5% of the total number of schoolchildren in the UK)

Perceived User Value

- Why do parents pay 365,000 households pay £140k+ on educating their children when there is a free alternative ?
- Understanding the dimensions of Perceived User Value is key to marketing your Schools.
- What core things matter to parents and pupils and what is peripheral
- How do they pay for it ?
- What is the Price Elasticity of Demand ?

Price Elasticity of Demand

Using elasticities to understand the market:

- How does demand for independent schooling respond to changes in fees ?

- Price Elasticity of Demand =
$$\frac{\% \text{ Change in Demand}}{\% \text{ Change in Price}}$$

ISC Research Boarding 2008

- An increase in fees leads to a fall in demand
- BUT, demand is inelastic
- Elasticities vary significantly by Association

	Elasticity
HMC	-0.2
GSA	-0.5
IAPS	-0.6

ISC Research Day 2008

- An increase in fees does not lead to a fall in demand (YET?)
- BUT, demand is inelastic
- Again, elasticities vary by Association

	Elasticity
HMC	-0.2
GSA	-0.1
IAPS	-0.3

So will it remain Inelastic ?

There is an old maxim in Financial Services that goes something like this:

“Past performance is not a guide to future performance. The value of the investment can go down as well as up and can't be guaranteed. You may get back less than you invested.”

School Fees vs. Average Income

Year	Av. Growth in School Fees	RPI /CPI (from 2003)	House Price Inflation	Salary Earnings Growth
2008	5.5%	4.0% (CPI 3.6%)	-14.7%	3.2%
2007	5.8%	3.1% (CPI 2.1%)	6.9%	3.8%
2006	5.9%	4.4% (CPI 3.0%)	9.3%	4.0%
2005	6.0%	2.2% (CPI 1.9%)	3.2%	3.8%
2004	9.7%	3.5% (CPI 1.6%)	13.9%	4.3%
2003	7.4%	2.8% (CPI 1.3%)	15.4%	3.4%
2002	7.9%	2.9%	25.3%	3.6%
2001	7.3%	0.7%	13.3%	3.3%
2000	6.4%	2.9%	9.3%	4.7%
1999	5.3%	1.8%	12.5%	4.9%

This means that school fees have doubled in 10 years but wages have only gone up by 50% in the last 10 years.

School Fee Inflation Justifications ?

- Comparing fee inflation with CPI inflation is disingenuous
- Its weight in the CPI basket is only 2.1%
- Independent School fees increased by an average of 5.90% in 2009.
- This compares with a rise of 8.60% in the CPI education component in the year to January 09 (Has been 14% in 2007)
- This includes ALL paid for education - independent school fees account for less than a third of this total

Single Earner Affordability

Hypothesis: Let's assume that you need the national average wage to run an average household before you can consider independent education paid for out of salary.

Question: What professions could afford independent education in 1999 compared to 2009 ?

1999

Average Gross Wage: £21,300 per annum

Average School Fees: £6,100 (paid post taxation)

Average Fees per household: 1.7x

Gross income required for average household
PLUS independent education: £37,500 pa

2009

Average Gross Wage: £31,800 per annum

Average School Fees: £11,800 (paid post taxation)

Average Fees per household: 1.7x

Gross income required for average household

PLUS independent education: £65,000 pa

1999 – Professions > £37.5k

- Directors and chief executives of major organisations - £152k
- Financial managers and chartered secretaries - £64k
- Aircraft pilots and flight engineers - £63k
- Brokers - £55k
- Medical practitioners - £51k
- Barristers and advocates - £51k
- Managers in mining and energy - £50k
- Management consultants, business analysts - £47k
- Police officers (inspector and above) - £42k
- Dental practitioners - £40k
- Marketing and sales managers - £40k
- Purchasing managers - £39k
- Advertising and public relations managers - £39k
- Computer systems and data processing managers - £38k
- Taxation experts – £38k
- Chartered and certified accountants £38k
- Solicitors - £37.5k
- Actuaries, economists and statisticians - £37.5k

No. of Full time roles in these professions in 1999 = 1.1m jobs

2009 – Professions > £65k

- Directors and chief executives of major organisations - £193k
- Brokers - £117k
- Financial managers and chartered secretaries - £89k
- Medical practitioners - £84k
- Senior officials in national government - £69k
- Managers in mining and energy - £69k

No. of Full time roles in these professions in 2009 = 0.4m jobs

This means we have shrunk our available market by some 60%.

The Question of Affordability

BIG QUESTION: So, if in 2008, the ISC research showed relative price inelasticity for school fees - for how long can that continue ??

2019 – Professions > £120k

If we extrapolate unchecked and allow fees to double in the next decade whilst wages only rise by 50%, then it is not inconceivable that we will only be able to be afforded by the top 4 professions from earned income.

- Directors and chief executives of major organisations ~ £270k
- Brokers ~ £175k
- Financial managers and chartered secretaries ~ £120k
- Medical practitioners ~ £120k

BUT in order for dual income families to provide the solution, **BOTH** parents will need to part of the 20 or so higher paid professional classes noted on the 1999 slide rather than one professional high paid earner and one administrative/vocational role.

Alternative Fee Funding Sources

If we have 365,000 households purchasing independent education and have a Single Earner total market of only 400,000, the vast majority must come from other sources:

- Trend to dual income households - must account for the majority of households
- Bonuses - Financial Services Bubble is Burst
- Savings / Investments - not worth what they used to be !
- Sacrificing - Bognor not Barbados - limited scope
- Re-mortgaging - banks not lending, less asset equity
- Gifts/Grandparents - Only ever accounted for around 10% of households.
- Inheritances - greater longevity, less asset equity, poor annuity rates.

Brave New World

- Industrial Production has seen its biggest decline since 1981:
 - manufacturing output fell by 6.2% in Q1 2009
- The housing market has come to a near halt:
 - average house prices have fallen by well over 20% so far
 - are we near the bottom? Maybe Green shoots ?
 - how long will it take to recover to some sense of “normality”?
- The Bank of England has cut interest rates to 0.5%:
 - the lowest level since the Bank was founded in 1694
 - but banks are reluctant to lend in the face of rising risks and capital inadequacy although there are signs of some renewed lending in recent months

National Debt

- The gross national debt will rise from 46% of GDP in 2008 to almost 80% of GDP in 2009 and will not peak until 2015/16 despite the planned squeeze on public sector spending
- Over the next 5 years, the government is set to borrow an additional £700 billion!
- It could be 30 to 40 years before the debt-to-GDP ratio is back below 40% (as in 2007)!

Darling's Response

- 50% income tax band for those over £150k
- Removal of tax free bands for those over £100k
- 42.5% dividend tax on profits over £150k
- Higher rate tax relief on pensions abolished

What's the Answer

For most schools, fee increases can no longer be allowed to exceed wages inflation.

- Niche Positioning
- Cost Cutting
- Federating

Niche Positioning

Back to the 4 Ps:

Likely to involve very high standard of excellent
in whatever area chosen (boarding, academic)

Careful definition of Educational Market

Exactly “what” is the educational Product

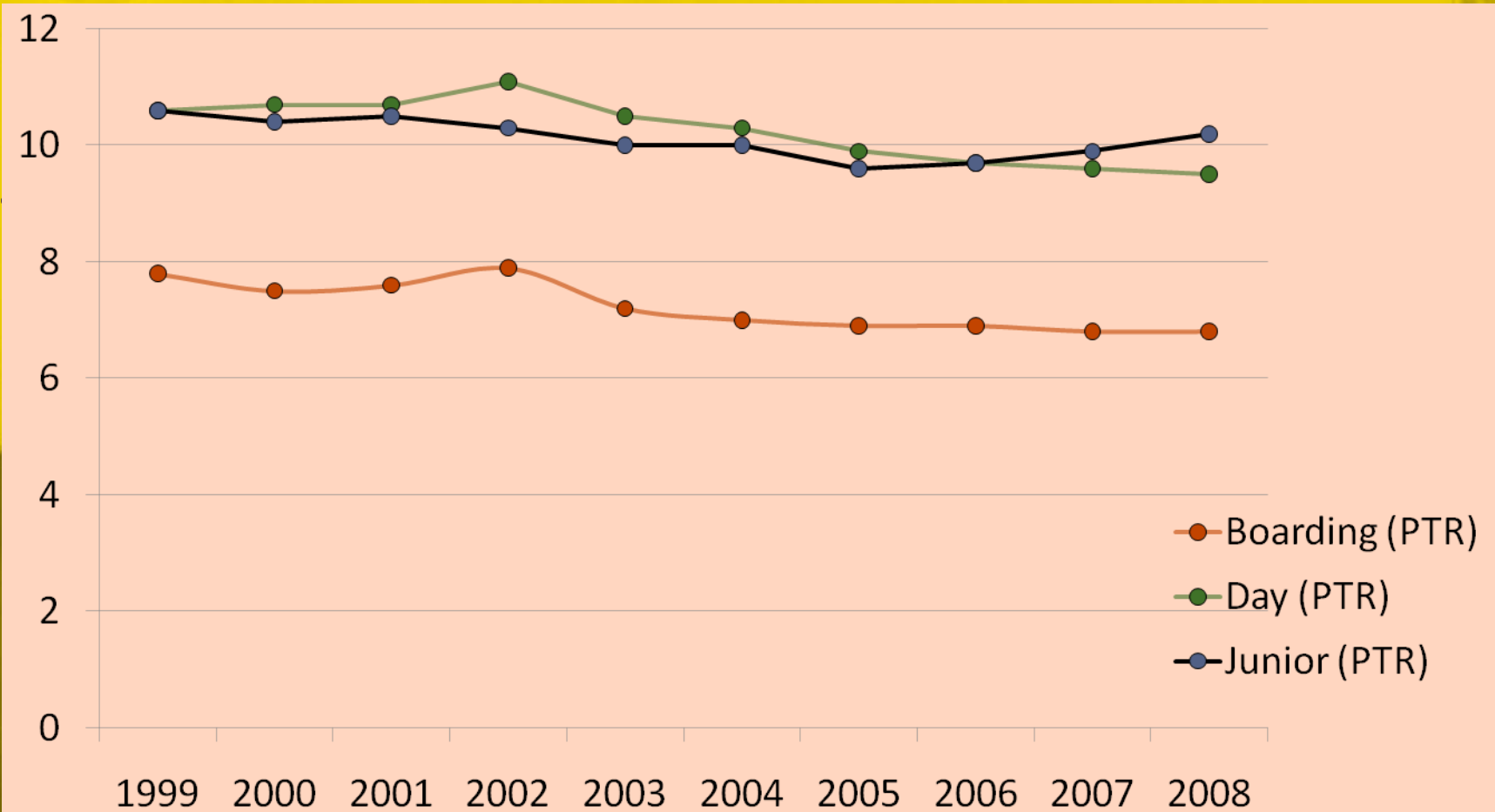
Exactly “who” will be the typical buyer

Establish “how” the school will sell and deliver

Cost Cutting

- Capital Projects
- Invest in strategically important assets only
- Tight control of overhead costs
- Stop Loss on numbers
- Analyse the trends and meet reality head on
- Reduce costs systematically

Pupil Teacher Ratio



Federating

- Leverage Economies of Scale - management, support structure, professional services etc
- May be possible for smaller groups of schools - strategic alliances / shared services

Scenario Conclusions

Forecasts...		Affordability declining	Harsher political climate	State schools more attractive
Likelihood...		Almost certain on current trends	An even chance	Unlikely nationally, but some will be
Scenarios...	Cost-cutting	✓✓✓	✓✓	✓
	Federating	✓✓	✓	✓
	Niche positioning	✓		✓