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A New Approach to Scholarship Aid Deserves Foundation Attention

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Since British students first went to study at Oxford and Cambridge, scholarships have been a favorite tool of patrons eager to support promising students who might otherwise lack the economic means to pursue higher education.

But while scholarships are magnanimous, they are not sustainable. Scholarships, as we know them, offer one-time benefits that rely on a continuous stream of charitable individuals and entities. Bolstered with iconic campaigns, they are powerful in effect — but, perhaps, the philanthropic equivalent of a slot machine that constantly needs feeding.

The aim of endowed scholarships is to exist in perpetuity. Yet even prestigious programs like the Rhodes Scholarships live in fear of economic headwinds. And smaller funds face inherent trade-offs that limit their charitable purpose and impact at a time when the cost of college can put a degree beyond reach of even middle-income Americans.

An emerging approach, buoyed by nascent technologies, may soon upend these struggles. A growing number of universities are experimenting with so-called income-share agreements, which allow students to trade a percentage of future earnings for tuition fees. Purdue University's "Back a Boiler" program, perhaps the best-known example, has enabled the Purdue Research Foundation to distribute more than $2 million to about 160 juniors and seniors in 79 majors this year.

The success of programs like Purdue's opens the door to scholarship funds that are self-sustaining, taking advantage of initial investments to establish an endowment that maximizes scale and grows over time.

Graduates Pay It Forward

Income-share agreements owe their intellectual beginnings to a 1950s proposal by libertarian economist Milton Friedman. Yale and Princeton experimented with the idea in 1970s, as did a handful of tech start-ups in the early 2000s. Today, the advent of big data and predictive analytics enables start-ups like Vemo Education — an organization that undergirds Purdue's program, and one in which my company, University Ventures, invests — to deal with many of the historical flaws that stymied earlier efforts.

So, what would happen if major American foundations, rather than granting billions for scholarships, asked recipients to sign income-share agreements? Awards could still focus on the areas of greatest need — for instance, supporting low-income students or minorities. But aspiring graduates would agree that if their subsequent earnings exceed $50,000 per year, they would pay 10 percent of their income back to fund future students like themselves.

Currently, if a foundation gives away $1 billion in scholarships, there is no self-sustaining mechanism to continue that level of giving. What if a foundation gave $1 million in scholarships with an income-share component? In less than a decade, such a program would be able to sustain itself without additional donations from the endowment.

More important than economic sustainability, however, would be the creation of a social contract between today's recipients and subsequent generations of beneficiaries who gain from their predecessors' academic and professional success.

For example, scholarship recipients could be offered economic benefits, like owing a smaller percentage of their income, in return for mentoring a future recipient or creating a certain number of entry-level jobs for grantees. Or they could be allowed to tailor their payback to personal or professional interests — for instance, a grantee working on Wall Street could direct her income share to aid a student from her alma mater who also wants to work in finance.

There is something inherently positive about scholarship recipients "paying it forward." Already many alumni who received financial aid feel a deep sense that once they succeed, they need to give to their institutions to help those who come later. Income-share agreements codify that relationship.

Not Like Loans

Today's income-sharing programs take care to ensure that paying for college will not become burdensome for students. There are no penalties for failure to pay if income drops below a certain level. The thresholds at which a student must begin paying are relatively high, and the programs are typically capped by both length of time and amount of payment.

Perhaps the greatest risk in the income-share approach is the potential of these agreements to create disincentives to attend college. Research suggests that loan recipients have higher dropout rates than those who receive grants, and it is possible income-sharing deals would also play out that way.

But the ways in which student loans can be problematic do not entirely apply to income shares. If a college graduate doesn't repay a loan, she will get a bad credit rating that can cause long-term problems, no matter whether the initial difficulty was caused by job loss, medical emergency, or another crisis. With an income-share agreement, there are no consequences when her income goes down, either for the graduate or the program; the agreements themselves can predict future income streams, as actuarial tables do for life expectancy, and account for this possibility.

We can project, with a high degree of accuracy, future income for specific pools of students if we know their major, school, and other key facts. This projection, in turn, underlies the pricing model of income-share agreements like those at Purdue. Nonetheless, because this idea is so new, additional research is critical to ensure that the benefits of the income-share idea are not offset by unintended consequences.

When Harvard College was founded in 1643, it offered the first known endowed scholarships, financed with a gift from Lady Anne Mowlson. The Rhodes Scholarships were created in 1902. But throughout the 20th century, major scholarship innovations dwindled in the face of economic uncertainty. At a time when the cost of higher education keeps rising, it may be time for philanthropy to add momentum to an idea that puts college in reach of people from low-income and middle-class families.

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