HURON

HIGHER EDUCATION NEEDS TO GET CREATIVE TO ENSURE A FINANCIALLY VIABLE FUTURE

By Laura Marcero

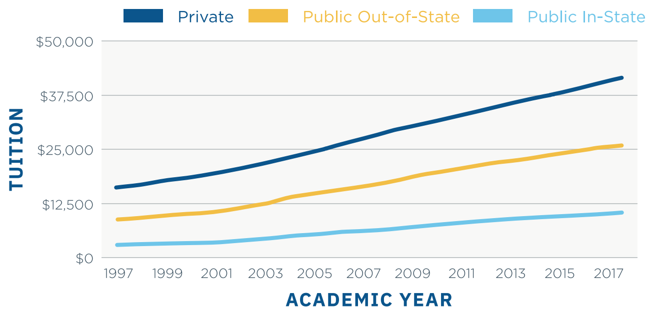
Dramatic swings in consumer behavior, challenging economic realities, emerging technology and regulatory constraints. The same forces that industries from retail and oil and gas to healthcare, automotive and technology have reckoned with for years are swiftly impacting the higher education sector. But while the trends challenging the future of postsecondary education may seem familiar, nuances in the leadership and legal obligations of these institutions mean that the available solutions are far from it.

As declining enrollment and escalating cost structures threaten the financial viability of mid-tier institutions nationwide, higher education leaders have a unique opportunity to transform. By making proactive, strategic choices today, boards, C-level executives and faculty can sustain their institutions for years to come.

Higher Education Disruptors 101

Most colleges and universities serve students and communities, not shareholders. However, they're not immune to the economic pressures their Fortune 1000 counterparts have wrestled with for years. Consider the major trends forcing financial and operational transformation throughout higher education:

- **Declining enrollment and graduation rates:** The fall of 2017 marked the sixth consecutive year of shrinking university enrollment, according to the National Student Clearinghouse Research Center. While overall enrollment was down one percent from 2016, enrollment of first-time college students dipped more than two percent. Concurrently, the six-year graduation rate for first-time undergraduate students at four-year institutions stands below 60 percent. Faltering degree demand has been a leading contributor to closures in certain parts of the industry. Between the 2012-2013 and 2016-2017 school years, the number of U.S. public and private nonprofit colleges shrank from 3,900 to 3,861.
- **Diminished return on investment:** Debates over the ROI of a postsecondary degree are not new. But slipping enrollment is a sign that more prospective students can't justify the costs of higher education. The average tuition and fees at private national universities jumped 157 percent over the last 20 years. The change has been more dramatic at public institutions, for which out-of-state tuition and fees rose 194 percent, and in-state by 237 percent. Today, Americans owe upward of $1 trillion in student loan debt and, despite a currently healthy job market, more than 43 percent of recent graduates are underemployed.
- **A fractured capital structure:** Total expenditures at public and private nonprofit institutions have increased each year over the last two decades, despite funding turmoil. 2017 state funding for



public colleges was almost $9 billion below 2008 levels; on a per-student basis, the average state spent 16 percent less. While state appropriations for colleges rose 1.6 percent from FY2017 to FY2018, the increase was the smallest in five years.

Government funding isn't the only source in question. Ten-year average endowment returns are down (as many institutions increase their endowment spend), and individual giving has dropped off for both alumni and non-alumni. At the same time, institutional debt has inched upward. Taken together, these shifts signal impending instability, prompting Moody's Investors Service to downgrade the sector's 2018 outlook from "stable" to "negative."

Some institutions are already grappling with the effects of these trends; others may still be months or years away from feeling a real impact. Either way, the time to act is now.

Roadblocks to Traditional Restructuring

Despite similarities between the elements disrupting higher education and other industries, education-specific internal dynamics and regulatory standards complicate institutions' transformation journey.

In almost any private sector organization, the C-suite has tremendous decision-making authority, particularly when it comes to financial optimization. Chief executive, financial and operating officers hold the power to pull necessary levers or launch strategic initiatives to mitigate (or prevent) cash constraints. In higher education, C-level officers share a significant portion of that power with tenured faculty and boards of trustees.

With power distributed across multiple parties, it can be difficult to reach consensus on key issues. Furthermore, many of those involved in institutional planning and strategy may not have the expertise to address critical financial challenges. Boards of trustees often encompass political appointees, major donors or community luminaries who, while successful in their own right, may not have the breadth of experience necessary to deal with this level of industry disruption and required transformation. Left unchecked, this imbalance can lead institutions to delay action altogether until a bigger issue arises, such as an inability to pay employees or vendors.

Leadership structure isn't the only wrinkle in the higher education sector's ability to proactively pursue financial optimization. Regulatory, labor and endowment hurdles also muddle the process:

- **Limited restructuring tools:** Filing for bankruptcy, one of the private sector's most prominent options for corporate restructuring, is all but off-limits for U.S. colleges and universities. Under revisions to the Higher Education Act of 1992, institutions that files for bankruptcy risk being stripped of Title IV funding and their accreditation.
- **Labor complexities:** Due to the level of clout faculty have over institutional decision making, labor negotiations are a sensitive part of higher education turnarounds. Tenured and non-tenured faculty, as well as associated unions, all have vested interest in these initiatives, necessitating close collaboration and communication.
- **Endowment and real estate rules of engagement:** A significant portion of institutions' cash lies in endowments, but specific criteria dictate how those funds can be used (largely for student aid, research and community programs). Colleges and universities can't rely on endowment dollars as a safety net to cover operating shortfalls. Real estate

assets are another main source of cash, albeit one that's difficult to monetize. Recent projects at The Ohio State University and Purdue University provide examples of how institutions can partner with real estate firms on revenue-generating developments. But the length of time required for these initiatives to bear fruit is prohibitive to institutions in need of a more immediate turnaround.

In the case of a distressed manufacturing organization or retailer, company leadership can negotiate an agreement with its creditors and move on. Higher education institutions are held to a number of standards that add multiples of time to the same process, underscoring the sector's demand for creative solutions.

A New Spin on Higher Education Turnarounds

Liquidation is a last resort for most institutions, not to mention one that involves careful, extensive coordination. And mergers and acquisitions—another staple of the private sector—have yet to gain traction in higher education, with many colleges and universities focused on preserving their distinct missions.

With a handful of common financial turnaround options off the table, higher education institutions need to think differently about how to eliminate excess spend, increase efficiency and grow revenue. Two strategies leadership teams should start considering more closely are joint ventures and formal shared services agreements.

- **Joint ventures:** Historically, U.S. colleges and universities have tapped into joint ventures to expand their international footprints, creating satellite campuses such as NYU Shanghai and Duke Kunshan University. These formal partnerships can also be a smart way for institutions to spin off under-performing academic programs, collaborate on research initiatives and minimize expenses. Under a joint venture arrangement, institutions may keep their brand and mission intact while benefiting from a partner's resources and economies of scale. Going forward, institutions have an opportunity to create value by forging these alliances domestically and regionally.
- **Shared services agreements:** Plenty of institutions have created shared service centers internally to eliminate resource redundancies and streamline human resources, accounting or research administration. The same model can be applied across institutions to reduce administrative costs by 5 to 10 percent. Around one-third of college and university business officers think their institutions are likely to share back-office functions with another in the next few years, and a comparable amount envision combining academic programs, according to a 2017 survey. For example, three Philadelphia-area liberal arts institutions (Bryn Mawr College, Haverford College and Swarthmore College) have a formal relationship that lets students take classes and join extracurricular activities across the schools. In some scenarios, these agreements could help institutions shed underused real estates and trim spending on everything from IT and procurement to admissions.

The right time to invest in a higher education institution's financial future is sooner rather than later. The earlier leaders kick off any of these strategic processes, the more alternatives will be available—and the more time you'll have to identify the best partners.

Colleges and universities have always been hubs for innovation, creativity and critical thinking. Now more than ever, institutions need to harness those qualities internally to generate stability and growth in the years to come.

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