Identifying Risks and Responses for Higher Education Institutions in Transition

Strategic Changes for the Future

Higher Education institutions are facing the pressure of finding their way in a changing market. The question is no longer, “Should we adapt?” but is now, “What is the best way to adapt?” For many, the most important first step in adapting is to understand institutional risks and to develop strategies to combat those risks.

Following the onset of the Great Recession in 2008, 30 percent of institutions did just that, adopting some form of short-term cost-reduction (i.e. hiring freezes, salary freezes, and downsizing).

It became clear that those efforts would not suffice. Comprehensive, systemic approaches were needed to keep institutions viable. Those approaches require that institutional leaders evaluate risk factors, including institution size, operational expenses, tuition discounting, and tuition dependence to project whether or not their institutions are sustainable.

But changes within each institution are only part of the equation. The entire higher education sector is evolving. The Great Recession hit families, greatly reducing college savings and making college unaffordable for many individuals.

For too many, the increased cost burden has changed their view of college: They once assumed it was a next step, now they believe colleges need to prove their long-term benefits before they are willing to commit to them.

On top of these financial pressures, demographics have changed; the number of potential traditional-age students has actually decreased. The bottom line as fewer potential students with less ability to pay means that price sensitivity is greater than ever. And that means institutions must compete more fiercely.

These trends have led many colleges and universities to revisit their strategic plans and to question if they are effectively allocating their limited resources to the most important areas. As part of these efforts, institutional leaders now must focus on:

- Changing the nature of decision making
- Developing deeper understanding of their markets
- Embracing the concept of “academic auxiliaries”
- Relentlessly pursuing an efficient bureaucracy

The reactive fixes that were first implemented following the Great Recession must be replaced by intentional, sustainable re-structuring. Perhaps the best result from the recession is the impetus for all institutions to look at the big picture and chart a strategic course toward their future.

Understanding the Changing Market

In both the recession and the recovery there has been no shortage of bleak and dire predictions for the future of higher education. Harvard business professor Clayton M. Christensen has long emphasized the
The negative economic and political pressure of the recession that began in 2008 proved to be a considerable catalyst for change, significantly increasing the number of institutions embarking on performance improvement initiatives.

During this period, dozens of university presidents (including those of Harvard University, Dartmouth College, Massachusetts Institute of Technology, and University of Chicago) wrote open letters to their campuses announcing revenue enhancement and cost-reduction initiatives. But those fixes proved only temporary. As financial challenges lingered, colleges and universities moved from temporary changes designed to get them through the rough patch to comprehensive, system-wide reviews, analysis, and reorganizations. A number of colleges are now teetering on the brink — the Department of Education in a 2013 report found 149 private colleges and universities that did not pass its measurements for “financial responsibility.”

Colleges must realize that long-term change is not just a good idea, it is essential to continue to function in this rapidly changing industry.

Students

While colleges and universities have been rapidly increasing tuition to pay for operations, they are pricing prospective students out of the market. The shifting of the burden of costs to students has been tremendous: they have been made responsible for paying double the percentage of the total cost of education, compared to 1985 totals.

Increasing Price Sensitivity

The dramatic shift in financial status of incoming students has not only removed the assumption that attending a traditional four-year college or university was the next step after high school, but it shifted the onus of responsibility to prove value to higher education institutions. Students are still being wooed by specific colleges, but those students are demanding that those colleges prove they are worth the financial
Tuition Discounting and Operating Losses

Funding Gap
Colleges and universities are being forced into a position where they must increase their grants and scholarships to bridge the funding gap. Over the three years from 2010 to 2013, institutional grants and scholarships increased by 30 percent. Essentially, institutions are forced to fund their own mini “bailouts” each year to make the numbers work.

risk. However, some families may choose not to attend college at all and those willing are seeking institutions with the least impact to their personal bottom-line.

Decreasing Market Population
After years of increasing numbers of potential college students aged 18-25, the numbers have reached a turning point. The number of high school graduates has declined and the population of potential students is expected to fall to levels not seen since 2006 (Source: U.S. Census Bureau).

In other words, there is less demand, which means that either the supply must decrease (closing institutions), the cost must decrease (cheaper tuition), or a paradigm shift is needed to re-invent the market.

Students by the Numbers
Average decrease in family savings per student from 2009 to 2013. $7,000
Inflation adjusted increase in median student debt since 1993. 116%
Increase in Stafford loan recipients from 2004 to 2014. 52%
Increase in number of low-income students receiving Pell grants in 2014 compared to 2004. 125%

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Institutions by the Numbers
Number of Private Not-for-Profit Colleges and Universities with annual expenditures less than $75 million. 80%
Number of institutions reporting cost-reducing initiatives in 2010. 37%
Number of college and university closures since 2005. 57

References:
4 Collegeboard.org, data compounded
5 Inside Higher Ed Survey of College and University Business Officers 2014
6 TICURA.org - Learning from Closed Institutions: Indicators of Risk for Small Private Colleges and Universities: July 2013
7 Sallie Mae: How America Saves for College 2014
8 TICURA.org - The Changing Profile of Student Borrowers - October 6, 2014
9 CollegeBoard: Trends in Student Aid 2014
10 CollegeBoard: Trends in Student Aid 2014
Tuition Discounting
In 2013, the average discount rate for freshman students reached 46.4% at private not-for-profit colleges and universities.11 So, while tuition rates are continually climbing higher, the discounts are climbing as well.

Tuition discounting is a short-term remedy, as it helps get students in the door but it does not address financial challenges by adding net tuition revenue. Excessive discounting may also undermine the sense of value and desirability of an institution. And at some point, the large grant or scholarship cannot be offered, leading to student dissatisfaction and disillusionment.

Tuition Dependence
Given the increased competition and reduced ability to pay, institutions with higher tuition dependence are more vulnerable to the changes in higher education. Tuition dependence among Private not-for-profit institutions varies by level of expenditures.

Mid- and low-tier institutions (those with less than $300 million in annual expenditures) are more dependent than ever on tuition for revenue. This increase in tuition dependence is particularly concerning in light of declining enrollment trends.

Growing Financial Pressures
The net result of the financial and demographic trends is increased competition among colleges for a smaller population of students, who on average have a reduced ability to pay.

That reality raises legitimate concerns about the long-term sustainability of a number of institutions. Perhaps most startling, median public university operating margins fell from 4.0% in FY2011 to 2.2% in FY2013.12

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Public regional universities demonstrated particularly high levels of distress, with over one-third running operating deficits in FY2013. It has become clear that, for many institutions, change is essential to remain viable but with each opportunity for change there are great risks.

Ultimately, these mounting challenges are forcing colleges and universities to rethink strategies, markets, and operations to ensure they can achieve their missions in sustainable ways.

While specialized programs or services may be helpful, they will not be the right approach for every institution. Financial pressures compel many colleges and universities to look for a straightforward and simple-to-implement approach, but in reality, each institution needs an approach tailored to its specific strengths and needs.

Average Tuition Dependence in
Low-Tier Private Not-for-Profit Institutions
55% Tuition dependence in schools with fewer than 2,000 students
93% Tuition dependence in schools with more than 10,000 students

Average tuition Dependence in
Mid-Tier Private Not-for-Profit Institutions
37% Tuition dependence in schools with fewer than 2,000 students
89% Tuition dependence in schools with more than 10,000 students

Average Tuition Dependence in
High-Tier Private Not-for-Profit Institutions
3% Tuition dependence in schools with fewer than 5,000 students
45% Tuition dependence in schools with more than 15,000 students

Risk Indicators for Higher Education Institutions
1. Tuition discounting > 35%
2. Tuition dependency > 85%
3. Debt service > 10% of annual operating budget
4. Tuition increase has been > 8% for five years
5. Conversion yield is 20% lower than primary competitors

11 NACUBO 2013 Tuition Discounting Study
12 Moody’s Investor Services FY2013 Public University Medians, July 11, 2014 and Moody’s Investor Services United States Higher Education — Public Universities Sector Comment, October 16, 2014
Charting Course: 4 Best Practices for Evaluation and Adaptation

Key Aspects of Successful Adaptation
In a time of rapid change, every higher education institution is forced to evaluate its methodology and determine the best course of action. For this reason, many institutions are conducting assessments that can act as a map, helping them chart their best course of action.

The following areas need to not only be evaluated, but a tailored action plan must be implemented to get out of crisis management mode and set an institution up for long-term success:

Best Practice 1: Changing the Nature of Decision Making
Traditionally, institutional decision making is a complicated and lengthy process that ensures options are thoroughly vetted and approved by all invested parties before action is taken. The institutional bureaucracy is effective in preventing many bad decisions, but by its very nature, many levels of approval are change-limiting and risk-averse.

The nature of decision-making for colleges and universities, therefore, needs to be streamlined wherever possible to allow for more direct leadership that can review current data, evaluate market changes, and act swiftly.

Best Practice 2: Develop a Deeper Understanding of Markets
With the decreasing demand for traditional higher education options, colleges and universities must become more market-savvy than ever before. Institutions should understand the increased competition for students, faculty, and funding, and be ready to commit to approaching those markets in new ways.

Intentional market-driven differentiation will be a key aspect of long term success. How well a college or university understands its target markets and demonstrates the ability to respond to their needs unlike anyone else will also be a key factor in making gains in this competitive market.

Best Practice 3: Embrace the Concept of “Academic Auxiliaries”
Historically the concept of “auxiliaries” in higher education has been confined to transportation, bookstores, residence halls, dining halls, and the like. However, the economics of higher education require that some programs are “profitable” such that other programs can be subsidized. Until recently, institutions have not actively managed academics as a portfolio, and profitable programs have been an unspoken secret in higher education.

As business models evolve, institutional leaders must get better at understanding costs, and they must get comfortable knowing that they must balance cost-intensive, mission-driven activities with activities that provide net operating revenues — taking a portfolio approach.

While pursuing profit is sacrilege for most educational institutions, particularly not-for-profit colleges and universities, it is important to recognize revenue-generating streams as an essential part of sustainability plans. Reliable sources of income keep the entire institution viable.

Best Practice 4: Relentlessly Pursue an Efficient Bureaucracy
University leaders need to ensure resources are spent on mission critical activities. Effective management requires the relentless pursuit of more efficient business and administrative operations so quality investments can be made in academic operations.

While any cuts are painful, they may be necessary to free up money and give breathing room so leaders can focus on going deeper with the most important programs and services offered by the college or university.

The more income institutions are able to generate and save, the more resources they will have to pour back into providing the highest caliber of education possible.
Moving Beyond Assessment Into Action

Institutions are more at risk of failing than ever before. This need to adapt cannot be exploited by single-focus fixes so many institutions are undergoing enterprise-wide assessments to grow revenues and decrease costs. This is a good start, but true sustainability requires a complex analysis of costs, benefits, and risks as they apply to each unique institution.

An initial assessment serves as a guide and is helpful to determine the best course of action.

For this reason, many institutions are choosing to work with a team that can not only tell them the best way to go, but act as a navigator.

To learn how Huron can be your guide, please contact:

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