KaufmanHall

Financial Outlook: 2018 Report for Higher Education

Based on 2017 survey data

KaufmanHall

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Introduction

Higher education, like many other industries, is experiencing new levels of disruption. Despite enduring, cherished reputations, colleges and universities are business ventures that are vulnerable to supply and demand rules, nontraditional competition, the eccentricities of the financial markets, and demographic shifts.

The following forces and others are presenting significant challenges for higher education institutions:

- **Funding and endowments.** Flat or reduced state and federal support for public institutions, endowments still reeling from the 2008-2009 financial crisis, and uncertainty in current financial debt and investment markets are forcing college and university executive teams to make hard funding choices. Many institutions are looking at a future that is quite different, including reduced program choices, fewer tenured faculty members, sale of underused assets, and delayed facility investments.
- **Competition.** A continued focus on national rankings and evaluations is changing how institutions manage admissions, faculty compensation, campus facilities, and athletics. A costly arms race is underway in many regions to garner national and international attention and draw faculty and students with top salaries, reduced tuition, and exceptional facilities. In addition, technology is enabling new entrants that can scale quickly to compete with traditional institutions, often with much lower tuition costs. Meanwhile, an increasing number of high school seniors are examining options outside of post-secondary degrees.
- **Tuition dependency.** For some schools, particularly small private colleges and some public institutions, a shortage of students willing or able to pay full tuition rates is leading to greater-than-anticipated tuition discounting, which in turn strains operating budgets that depend on tuition as their main source of funding. Some colleges and universities now receive in aggregate only slightly more than half of their published tuition. The National Association of College and University Business Officers (NACUBO) has reported year upon year of unprecedented tuition discounting. Even if elusive enrollment targets are achieved, some institutions may not be able to overcome tuition revenue shortfalls.[1]

While some large research universities and private colleges with diverse funding sources, robust endowments, and brand strength may be unscathed by these developments, most higher education institutions are feeling the impacts of shrinking enrollment, decreasing net tuition, declining debt capacity, limited liquid assets, and aging facilities.

The 2017 *Inside Higher Education* Survey of College and University Business Officers shows that 71 percent of chief business officers (CBOs) agree that media reports saying higher education is in the midst of a financial crisis are accurate, up from 63 percent in 2016 and 56 percent in 2015. The survey also noted that only 56 percent of CBOs agree or strongly agree that their institutions will be financially stable over the next five years, down from 64 percent in 2016.[2]

As these forces reshape higher education in small and dramatic ways, an advanced level of financial leadership and acumen is required, along with a willingness and commitment to bring increased rigor to financial planning and budgeting.

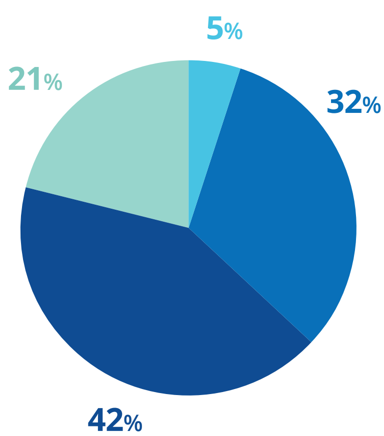
Based on Kaufman Hall's 2017 Higher Education Survey results, this report examines the current challenges facing higher education finance professionals, and evaluates actions and practices that are influencing financial planning and budgeting. It concludes with recommended strategies to position colleges and universities for the future.

About This Report

Kaufman Hall developed the 2017 survey of senior finance professionals in the nation's colleges and universities to gauge where participants stand with respect to the current business environment, what planning and analytic processes and tools they are using, and the extent to which specific planning and reporting challenges are affecting individual institutions. The survey also assesses practices that may be contributing to financial stability or struggles.

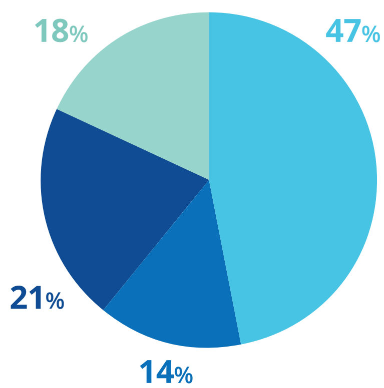
The online survey was completed in August and September 2017 by 183 respondents from a range of institutions, including four-year, two-year, public, private, non-profit, and for-profit colleges and universities. The survey respondents are comprised of a greater percentage of institutions with larger enrollments and endowments than is representative of the market.

Profile of Survey Respondents



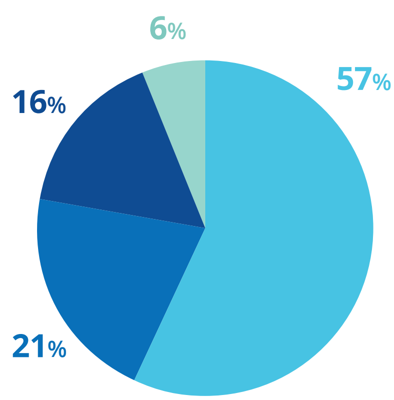
Institution Type

- For-profit college or university
- Four-year non-profit private college
- Four-year public college or university
- Two-year non-profit college (community college)



Enrollment

- Less than 5,000
- 5,000-10,000
- 10,000-20,000
- Greater than 20,000



Endowment

- Less than $100M
- $100M-$500M
- $500M-$1B
- Greater than $1B

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Survey Findings

As Change Puts the Status Quo at Risk, Increasing Revenue and Reducing Expenses Are Top Institutional Goals

Nearly half of finance professionals responding to the survey express concern about the long-term viability of their business model given the financial and demographic pressures on colleges and universities.

47% believe their current business model is not sustainable for the next 5-10 years

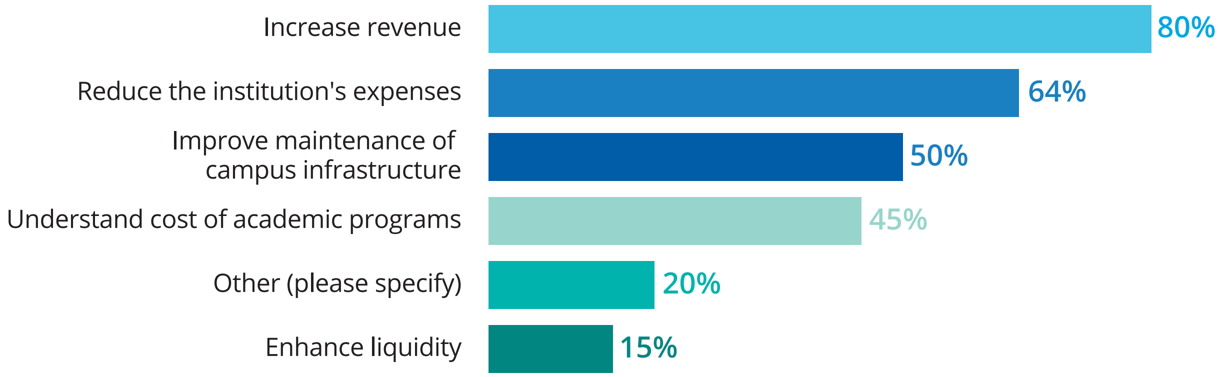
When asked about goals for the 2017-2018 academic year, financial improvement was top of mind, with increasing revenue ranking first at 80 percent and reducing expenses coming in second at 64 percent.

Despite aging facilities nationwide, only 50 percent of respondents reported that they will be improving campus infrastructure. Many institutions experience the additional challenge of funding deferred maintenance projects as a component of improving campus infrastructure.

Almost 45 percent of respondents noted that understanding the cost of academic programs was a goal for the 2017-2018 academic year. To succeed with program development, funds allocation, and expense reduction, institutions need a rich set of accurate data that gives leaders insights into current program performance and costs, and promotes informed decision making.

Increasing revenue in higher education primarily requires growing the enrollment of students with the ability to pay full or slightly discounted tuition. Population data point to the challenges

Figure 1. Select the goals your institution plans to achieve in the coming academic year.*



** A "check all that apply" option was available* of this approach. There are not enough graduating high school students for every college and university to increase enrollment.[3] Competition for college-bound students will intensify, along with pressure to retain students for their complete program. A *University Business* survey asked presidents, provosts, and chancellors to choose from 20 issues that could harm their institutions' names or stability. Seventy percent of respondents cited enrollment declines as their biggest concern for 2017.[4]

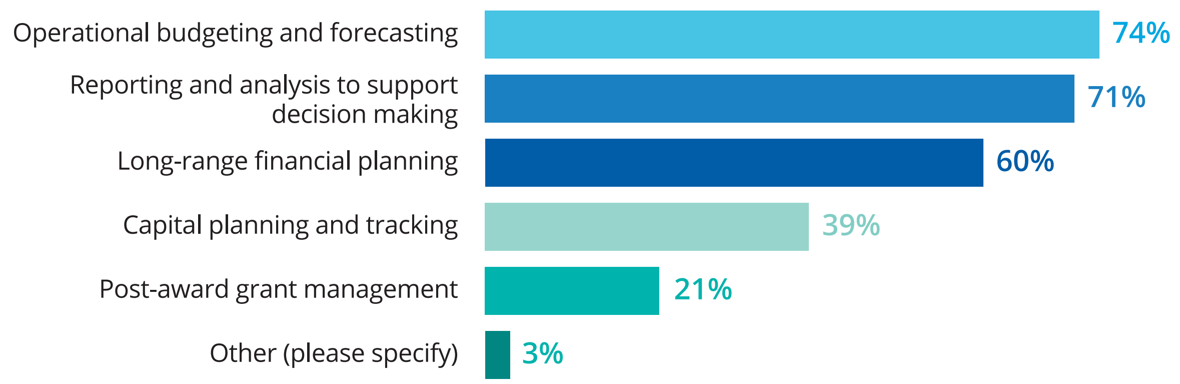
Operational budgeting and forecasting (74 percent) and reporting and analysis to support decision making (71 percent) were the top-cited financial planning and analysis activities being pursued by survey respondents for the 2017-2018 academic year.

Budgeting has long been viewed as a high-priority finance activity for higher education institutions. While its short-term view of an institution's financial health is important, budgeting must be coupled with long-range financial planning to create a complete picture and identify the financial means that will support execution of an institution's strategies. The fact that 40 percent of respondents did *not* identify long-range financial planning as an area of emphasis is of concern. Given the number and magnitude of external pressures in higher education, the need for robust long-range financial planning in tandem with rigorous budgeting processes is more critical than ever.

In addition, college and university trustees are increasingly asking for improved visibility into the longer-term financial trajectory of their institutions. With a strong strategic financial plan in place, higher education leaders can make decisions that are in the institutions' best financial interests, with clear and connected strategic-financial vision.

Also of note is that only 39 percent of finance professionals reported that they are focusing on capital planning and tracking in the 2017-2018 academic year. In the current dynamic environment, long-term success depends even more highly on today's capital investment decisions. Capital allocation and management is an important component of an integrated financial planning process that can strengthen the overall financial health of colleges and universities.

Figure 2. Which of the following financial planning and analysis initiatives is your institution looking to improve in the coming academic year?*



A "check all that apply" option was available

Modern Practices and Tools Enhance Agility in a Changing Environment

Like other industries, colleges and universities must keep pace with contemporary business and financial processes and tools as they contend with disrupted environments. The majority of survey respondents (64 percent) recognize that higher education institutions lag behind other industries in this regard. Only 20 percent of respondents think that higher education is ahead of, or on par with, other industries.

64% acknowledge higher education is behind most other industries in terms of adopting modern financial planning practices and tools

66% say they are not prepared to respond quickly to change, or were unsure if they could using existing tools and processes to do so

Two-thirds of survey respondents think the existing tools and processes at their colleges or universities have *not* prepared them to respond promptly to changing circumstances, or are unsure of their level of preparation.

Given the depth and breadth of challenges facing higher education institutions, college and university leadership should look to the corporate finance principles used by the country's high-performing organizations in other industries to manage strategic and financial risk. Healthcare organizations did so in the 1990s to early 2000s when the industry faced vast financial challenges including declining profitability and liquidity, pent-up capital demand, staff shortages that contributed to wage inflation, and lower reimbursement trends. In response, healthcare organizations moved from a public operating model to a corporate finance model. This change required transitioning away from a narrow concentration on spending and budgets, and instead focusing on assessing organizational performance using financial measures, processes, and tools in place in thriving corporations in other sectors.

Rolling forecasts are an additional corporate finance practice that has been adopted by industry leaders outside of higher education to replace or enhance the budgeting process. Rolling forecasts allow for more frequent updates to financial plans, and thus, are more responsive to changing conditions than traditional budgeting processes.

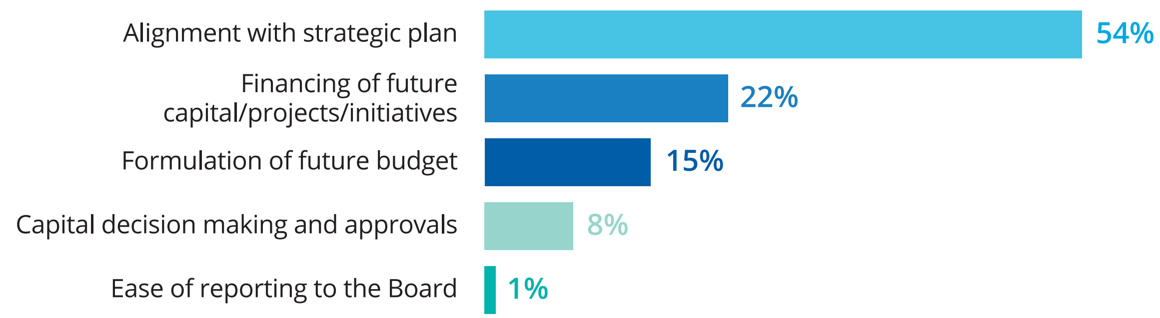
As higher education finance professionals pursue activities to strengthen their institutions' financial positions, they should consider adopting corporate planning approaches and tools.

Planning Must Be a Disciplined, Integrated, and Institution-Wide Activity

Survey responses point to weakness in long-range planning and capital planning processes at higher education institutions, and the need to align plans with strategy. Fourteen percent of finance professionals indicated their college or university does not conduct long-range financial planning. Among those that do, only 54 percent of respondents identified alignment of their strategic plan with their long-range plan as a primary goal.

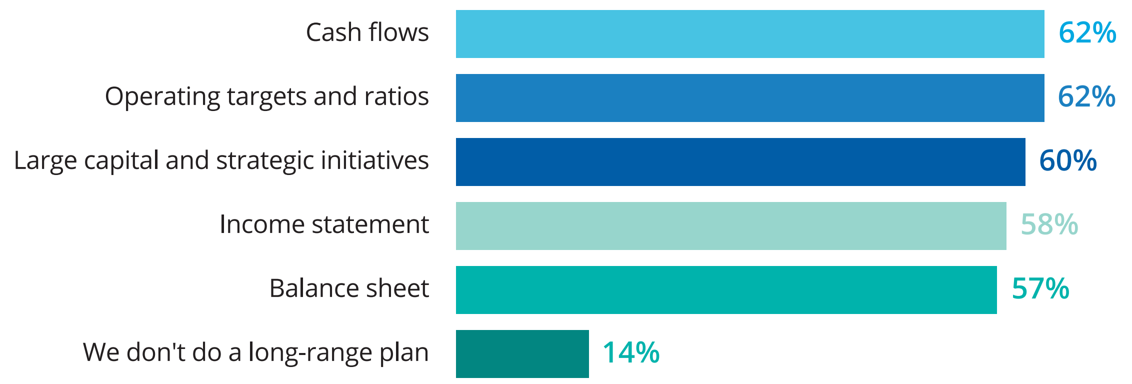
An integrated strategic, capital, and financial plan sets the stage for quantifying future financial risk, considering alternative scenarios, and specifying sensible reactions to expected or potential changes. Modern planning tools allow executives to operate quickly and flexibly in a dynamic and complex marketplace, with improved oversight and control.

Figure 3. Which of the following is your institution's primary goal of its long-range plan?



Despite more than half of respondents acknowledging the crucial link between their long-range financial plan and strategic plan, 40 percent report that their long-range plan does not include large capital and strategic initiatives. Other components and targets, such as income statements, balance sheets, cash flow, and operating targets and ratios, also are noticeably absent in roughly 40 percent of respondents' long-range plans, as shown in Figure 4 on the following page.

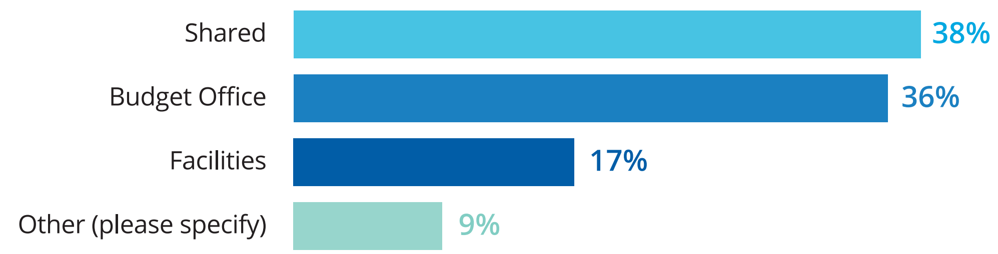
Figure 4. Which of the following are included in your institution's long-range plan?*



* *A "check all that apply" option was available*

A likely contributor to the absence of large capital and strategic initiatives in long-range plans is that capital planning may be the sole responsibility of facilities (17 percent) or the budget office (36 percent). Only approximately 38 percent of survey respondents indicated that capital planning is shared. A siloed approach to capital decision making is unlikely to result in the best deployment of capital resources, and many institutions may not be using a disciplined capital planning process. Without such a defined process, capital initiatives cannot be incorporated into long-range financial plans.

Figure 5. Which department is primarily responsible for the capital planning process at your institution?



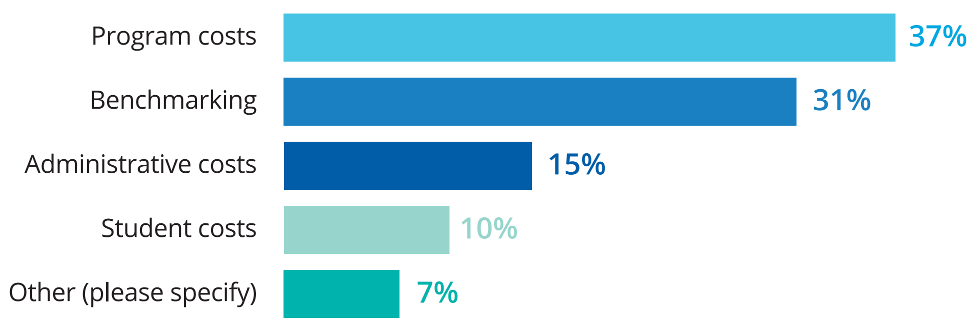
Better Data Drive Better Decision Making

Seventy-one percent of survey respondents said they are pursuing better reporting and analysis to support decision making. An associated challenge is access to high-quality data. Most respondents (87 percent) want better data and analytic-based insights about their institutions' performance.

87% say that more insightful data into their institution's performance would result in better financial decisions

When asked what type of data would drive better decision making, 37 percent of respondents were seeking data on program costs, while 31 percent wanted benchmarking data. Program-specific cost information drives critical decisions related to growth, cost reduction, and other institutional imperatives.

Figure 6. What type of data would help drive better decision making?



The absence of agreed-upon key performance indicators (KPIs) to measure and communicate financial health at 42 percent of the surveyed institutions confirms Kaufman Hall's observations that financial KPIs are a known challenge within higher education. The lack of industry-specific revenue and productivity data from which to benchmark has generated confusion about what indicators to look at for a particular purpose. In response, some colleges and universities have created their own organization-specific benchmarks.

42% do not currently have agreed-upon KPIs to measure and communicate financial health

71% are using administrative or academic cost benchmarks, and revenue or productivity benchmarks

38% are using federal financial responsibility test scores

35% are using credit rating agency benchmarks

More Timely Budgets Are Needed to Support Institutional Planning

Higher education is struggling to use budgeting as a platform from which to make decisions. Instead, budgeting often is viewed as a required academic exercise, but not a strategic one. In addition, if long-range planning is not aligned with budgeting and conducted as a linked exercise, miscalculations may occur, narrow decisions may be made, and a lack of understanding about how data flow through the plans emerges.

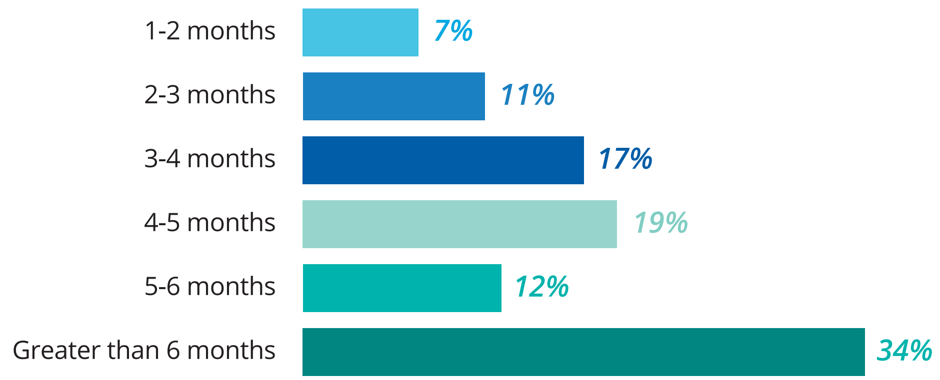
Higher education is entering a new era for budgeting. Colleges and universities must seek alternative revenue sources, and reallocate existing expenses to fund new spending needs. This presents a strategic budgeting imperative for senior finance leaders.

Survey results indicate budgeting challenges at many institutions. Approximately 43 percent of respondents said the length of their budgeting cycle is limiting their ability to make well-informed planning decisions and react to changing circumstances.

When drilling down to a granular level, approximately 83 percent of survey respondents report that their budgeting cycle requires more than three months to complete. Of these, a worrisome 34 percent cite a cycle of six months or more. A prolonged development and/or approval process, and inefficient or inadequate tools may be key factors in long budgeting cycles. Silos of financial responsibility often exist across functions, making planning, decision making about resource allocations, and budgeting more challenging and time consuming.

Figure 7. Is the current length of your budgeting cycle limiting your ability to make informed decisions and react to changing circumstances?

Figure 8. From initial roll-out to board presentation, how long is your budget cycle?



Strategies for the Future

The need for more strategic and disciplined planning in higher education is the key takeaway from this survey. It is the call to action for senior finance professionals to ensure that their institutions continue to be successful in an increasingly complex and demanding environment.

Skilled planners can identify strategic and financial stressors, and recommend alternative approaches to addressing those challenges. To accomplish this, the overall direction of the institution must be clearly articulated and its strategic requirements integrated within long-term capital and financial plans and annual budgets. The strategic plan must drive financial planning and budgeting.

> *"(W)hen the world changes around you and when it changes against you—what used to be a tail wind is now a head wind—you have to lean into that and figure out what to do because complaining isn't a strategy."*
>
> — JEFF BEZOS

At a tactical level, what does this look like? Consider these imperatives.

Create a Multiyear Financial Plan A multiyear financial plan should be developed before an operating budget is created. The financial planning process quantifies the resources required for priority strategies and then connects those strategies to the institution's long-term financial picture. To accomplish this, an accurate understanding of available financial resources, and the financial outcomes and consequences of the strategic plan's goals and objectives, must be reached.

The financial plan solidifies an understanding of what capital must be generated by a particular date, and what portfolio of strategies will be pursued now and in future years. The financial plan also identifies capital constraints, and helps define operating budgets and necessary project returns or cash flows.

Ensure Access to Relevant and Timely Data Without access to accurate and timely data, disciplined approaches to financial planning are not feasible. Finance professionals need data to assess strategic opportunities and financial performance related to pursuit of those opportunities. Investments in systems and tools that provide access to program, student, and administrative cost data ultimately reduce guesswork and encourage accountability in financial planning.

Assume a Strategic Leadership Role In this complex business environment, senior finance professionals are on the front line and will need to add a strategic role to existing operating relationships. The demands will be great as they are expected to shift from a focus on revenue planning toward an emphasis on expenditures, cost modeling, and benchmarking. They must be advocates for finding resources to support the institution's strategic plan while ensuring ongoing dialogue about financial implications and realities. They also must continue to be involved with the strategic plan at the institutional and program level, helping faculty and staff assess the ongoing feasibility of budget requests.

Conduct Disciplined Capital Planning Investment decisions should be the result of institution-wide planning to ensure that capital projects are funded because they fit the institution's long-term strategy, not because they are on someone's wish list. As part of strategic planning processes or updates, existing and new capital projects should be reviewed along with their funding sources to ensure that debt, gifts, unrestricted investments, proceeds from the sale of assets, and other capital sources are still in place.

Capital allocation processes that demonstrate this level of discipline will help support the institution's long-term goals and objectives, while communicating to stakeholders within the institution about how, why, and when capital projects are funded. Unexpected capital needs that strain tuition revenue can also be minimized when more discipline is injected into capital planning.

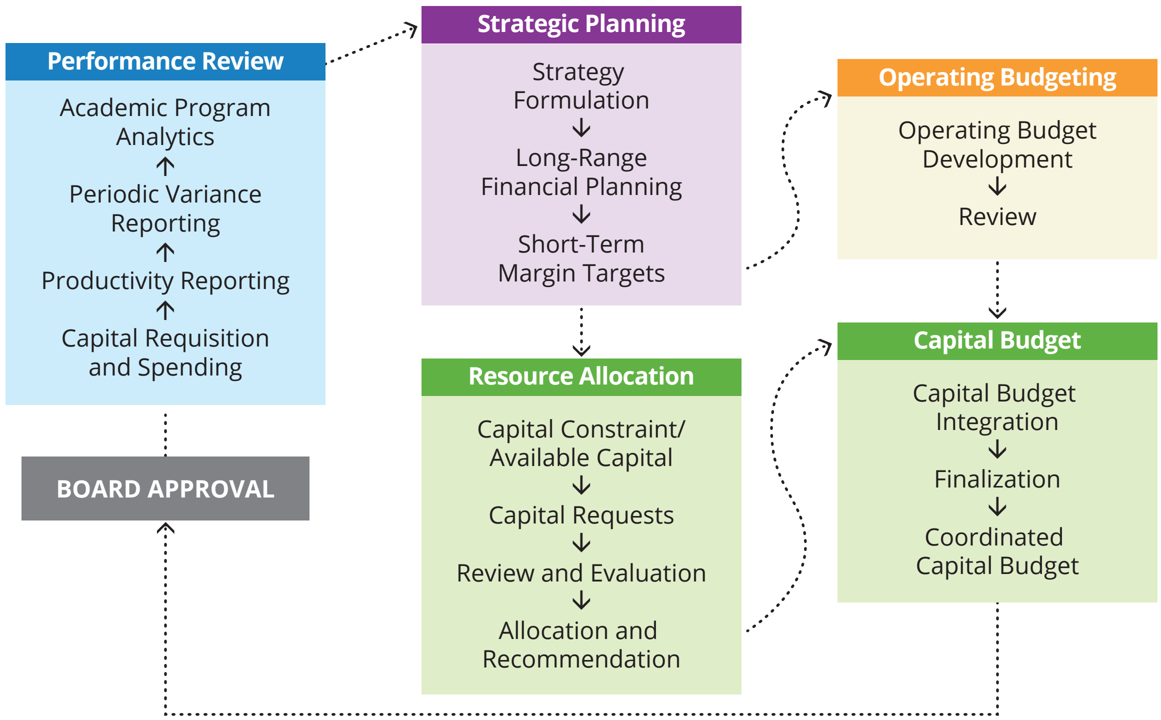
Achieve Faster and More Strategic Budgeting When operating in higher education's dynamic environment, finance professionals will need to transition from the "we budget because we have to" mindset to viewing budgeting as a strategic exercise that creates the platform from which to drive decision making. They must commit to shorter, well-defined, process-focused budgeting cycles that incorporate shared decision making for major investment decisions. Strategic plan-driven budgets enable institutions to allocate resources according to academic and operational goals instead of allowing budgets to determine institutional initiatives.

Planning for an Uncertain Future

The challenges and uncertainty facing higher education institutions will not be resolved soon; however, uncertainty should not lead to business as normal or a pause in planning. Instead, more rigorous and strategically aligned financial planning must move to the forefront of institutional priorities. Mapping out financial resources and matching those resources to strategic priorities, as illustrated in Figure 9, ensure informed strategic and operational decision making at a time when there is little cushion for error.

Figure 9. Adapt an Integrated Planning Process to Support Better Decision Making

An integrated planning process deserves increased attention in colleges and universities. This process brings together strategic planning, financial planning, capital budgeting, operational budgeting, and the forecasting and analytics required to measure, monitor, report, and improve results.



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2. Lederman, D. Seltzer, R.: “The Rose-Colored Glasses Come Off: A Survey of Business Officers” July 28, 2017. https://www.insidehighered.com/news/2016/05/16/discount-rates-rise-yet-again-private-colleges-and-universities

3. Lederman and Seltzer.

4. “Higher Ed Enrollment Concerns and Strategies” *University Business*. December 20, 2016. https://www.universitybusiness.com/article/enrollment-concerns-and-strategies

For more information,
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Kaufman Hall provides management consulting and software to help universities and colleges realize sustained success amid changing market conditions. Since 1985, Kaufman Hall has been a trusted advisor to boards and executive management teams, helping them incorporate proven methods into their strategic planning and financial management processes, and quantify the financial impact of their plans and strategic decisions to consistently achieve their goals.

Kaufman Hall uses a rigorous, disciplined, and structured approach that is based on the principles of corporate finance. The breadth and integration of Kaufman Hall advisory services are unparalleled, encompassing strategy; financial and capital planning; treasury and capital markets management; and mergers, acquisitions, partnerships, and joint ventures.

Kaufman Hall's Axiom Higher Education Suite provides sophisticated, flexible performance management solutions that empower university leaders to analyze results, model the future, and optimize decision making. Configured for higher education, solutions for strategic financial planning, reporting and analytics, as well as budgeting and forecasting are delivered on an integrated software platform, managed in the cloud.

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