

The State of Higher Education in 2016

Fifth annual report



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Introduction

It continues to be an exciting and challenging time to be part of the higher education sector. On one hand, the challenges of the past few years have only intensified. More than a few institutions struggle to achieve enrollment and net tuition targets, make effective use of physical assets, and respond to competition from both traditional and nontraditional education channels. Even as the general economy continues to improve, higher education is seeing only modest growth at best. On the other hand, leaders at colleges and universities have new opportunities and tools to move their institutions forward toward ever greater success — whether it be attracting students from new demographics, applying new levels of analytics to optimize financial performance, tapping into new revenue sources, or using technology in new ways to support learning, researching and assessing performance (both students' and the institution's). The possibilities are wide open for engaging a diverse constituency, collaborating with other institutions and expanding internationally. It's a time of great potential for either forward movement or stagnation and failure.

In this, our fifth *State of Higher Education* report, our intent is to point the way to decision-making that will sustain your institution, positioning it for long-term success. While we will continue throughout the course of this year to provide you with webcasts, training and articles of interest to leaders in higher education, the editorial purpose of this publication is to focus on key trending topics for this sector and to offer experience-based viewpoints, approaches and solutions. As a leader in the higher education sector, I believe it is our responsibility to give back to this community we serve by providing these valuable insights.

Within these pages, you will find our thoughts on key industry developments and challenges facing higher education leadership, including those in setting and measuring key performance indicators, adopting social responsibility and sustainability, adjusting benefit plans, using data analytics, engaging faculty to improve financial performance, determining cost-benefit in research projects, establishing a presence in China, and creating transparency in communications with stakeholders.

The articles in this report stem from knowledge gained through our professionals' direct interactions with their clients. Rather than theoretical pieces, they are the result of practical, hands-on experience gained by more than 400 Grant Thornton LLP professionals serving over 200 higher education clients. These insights are intended to be used by you — board members, executives, management and other leaders in higher education.

Our Not-for-Profit and Higher Education practices are committed to helping “organizations that do good” achieve their missions. We understand that protecting your reputation and operating sustainably are essential to your institution's ability to achieve its mission and further its cause. Our higher education experience is deep, and we offer it to assist you with the challenges addressed in this report.

On behalf of the partners and professionals of Grant Thornton's Not-for-Profit and Higher Education practices, I am pleased to present *The State of Higher Education in 2016*. We hope that you find this to be a valuable resource. As always, we welcome your feedback and are available to assist management teams and boards in addressing the challenges discussed in this report, or any other issues your institution may be facing.

Sincerely,

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Maturing from adolescence into adulthood: Major factors shaping the sector in 2016

Larry Ladd, Director, National Industry Specialist, Not-for-Profit and Higher Education Practices

Higher education is leaving its adolescence and entering adulthood. The post-World War II growth spurt is over. Sheer physical expansion — in tuition, enrollment, faculty and staff numbers, buildings, and everything else — is fast becoming a thing of the past. Simply following the traditional trajectory isn't a choice at all, for any institution.

In this new level of maturity, there is no longer a rising tide to lift all boats. Colleges and universities will need to find new currents and ride them. Institutions will have to carefully pick initiatives, making clear choices about what to do and, most significantly, what not to do. We will be experiencing a shakeout in the industry.

Start with where we are now

Revenue challenges

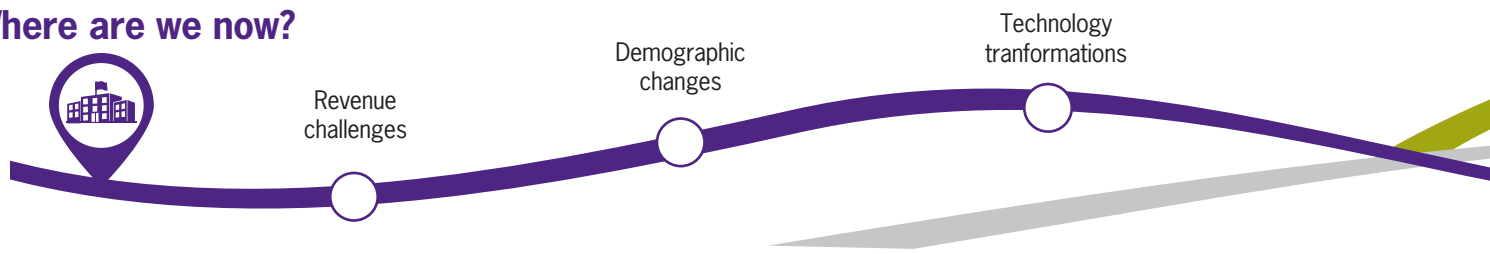
First, as confirmed by Moody's most recent outlook report, most of higher education is experiencing, and can expect to continue to experience, extremely modest revenue and asset growth (no more than 3%) in 2016.¹ Counter to the rapid revenue growth for most of the past three decades, higher education now faces a zero-sum game in which additions must be accompanied by subtractions. And while modest revenue growth represents an average, there will be many institutions beset with actual declines in revenue that are unlikely to be temporary.

Think long term — see articles in this report for insights you can use to focus on academic quality; invite faculty to become your partners in change; consider mergers or affiliations with other institutions and re-evaluate investments; measure outcomes; step up communications, promoting efforts and results to stakeholders; and target demographic segments in recruitment and program planning (see Fact No. 2, pg. 3).

Demographic changes

Second, seismic shifts in our national demographics mean that historical numbers of students aren't available from traditional sources.² Recruiting new populations is essential to survival. Institutions will need to shape programs that specifically attract new clientele, or find new clientele that will be attracted to current programs.

Where are we now?



¹ Thomason, Andy. "Moody's Upgrades Higher Ed's Outlook From 'Negative' to 'Stable,'" *The Chronicle of Higher Education*, July 20, 2015.

² Williams, Joseph P. "College of Tomorrow: The Changing Demographics of the Student Body," *U.S. News & World Report*, Sept. 22, 2014.

Technology transformations

Third, the digital revolution continues its inexorable march forward, in spite of skepticism and occasional failures. The digital revolution is transforming how institutions operate and, more significantly, how they provide their educational programs. Electronic classrooms in many forms will continue to revamp pedagogy and the underlying economics of our institutions. While this new technology presents opportunities, it also poses threats. Students can now take high-quality online courses elsewhere and then transfer credits into your institution, thereby reducing your tuition revenue. Colleges and universities will need to mitigate the challenge of this new technology while also leveraging the potential it affords by finding alternative sources of revenue and reducing their own instructional costs substantially, as well as developing their own online and hybrid courses.

Next, look at where we are going

As the industry enters adulthood, three hard facts in particular will shape our thinking and behavior:

Fact No. 1: Your institution is on its own.

You have to take decisive action. Too often, boards, presidents and faculty feel entitled to success because the college or university is serving an important purpose or has a great reputation. It's pointless to assign blame — to students for not arriving in sufficient numbers, to donors or alumni for insufficient giving, to accreditors for scrutiny of the financial condition, or to faculty for resistance to change — just as it is pointless to passively watch for deserved appreciation to emerge.

Fact No. 2: Opportunity abounds.

There are external factors that represent huge opportunities. Two prime examples:

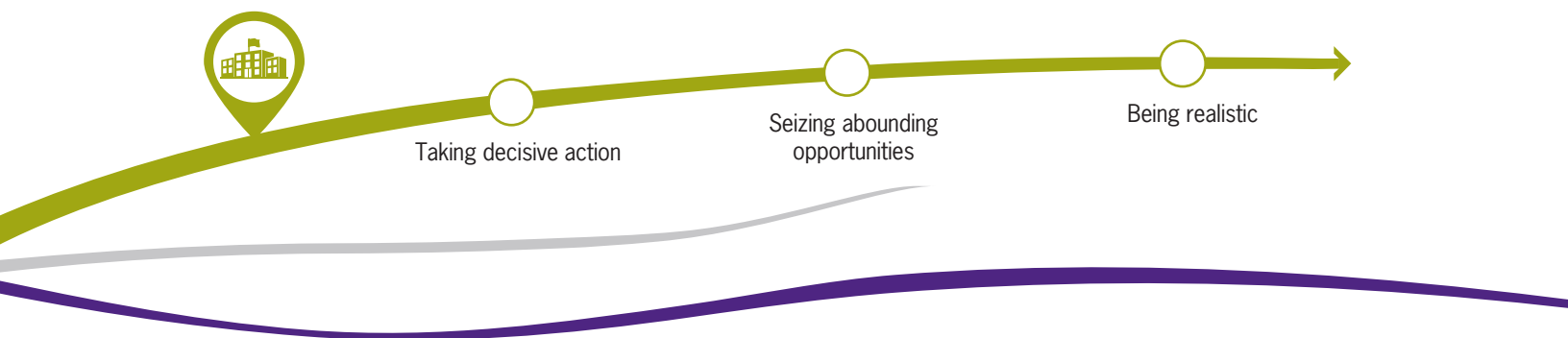
- Potential students from growing demographic groups such as Hispanic and Latino — and students who live in the West and South
- Potential students who are outside your geographic reach and could access your programs only through online or hybrid delivery systems

To take advantage of opportunities, your institution needs to be unique. What could truly distinguish your institution from the competition? Create or promote offerings that lead a student to choose your institution over others that now look and sound the same, e.g., curriculums or programs with effective branding that attracts students, such as programs that link liberal arts and vocational objectives in clever ways.

You also need to focus on only a few things and do them very well. Many institutions have added programs to attract students without reducing or eliminating less attractive programs, thereby building too much cost and complexity into the system.

Chances are good that the recession of 2008 resulted in budget reductions at your institution. Those reductions, while painful, probably reduced some low-priority expenses that should have been cut previously. But as revenue slowly grows, resist the pressure to restore those cuts; instead use the incremental revenue to fund new initiatives that will embrace the future (e.g., attract new students and improve retention) rather than just returning to past practices.

Where are we going?



Fact No. 3: This is the year of the distressed college, and it may start the decade of the distressed college.

Right now, many colleges and universities are leading a secret life. That's right. They know they are in trouble, but they aren't talking about it. Or they are in both deep trouble and denial, even to themselves. We know about Sweet Briar College and several others, and we know the warnings from Moody's about the financial risks for smaller tuition-dependent colleges. It's a good possibility that there are as many as 100 Sweet Briars in the making, and they likely have some or all of the following symptoms:

- The numbers (applications, yield, enrollment, faculty utilization, financial assets) are all trending downward, with no end in sight.
- The board and president don't have credible answers or solutions to the challenges facing the institution.
- Lenders and accreditors are worried.
- Cash is either an issue or likely to become an issue soon.
- Faculty, students and alumni are either clueless about the precariousness of the institution or resisting any significant change.

To separate your institution from the distressed-college fold, begin with a realistic view of your situation. Your biggest challenge will be to get real, and face your situation without illusion. Consult with all key stakeholders who have on-the-ground information, both to learn and to gain their support. Determine a projection based on your current course, which usually leads to the conclusion that your current course is not sustainable. Then think boldly about new paths that are consistent with your mission, but that take the institution in a sharply different direction. Denison University offers an example of an institution maintaining much of its current practices while designing an academic program that breaks with the norm.³

Colleges and universities must deal directly, as adults, with the facts and pursue opportunities aggressively, with strong leadership showing courage in the face of potential opposition and with vision to lead the institution toward a successful future.

To separate your institution from the distressed-college fold, begin with a realistic view of your situation.

³ Weinberg, Adam. "Beyond Business: Global Commerce and the Liberal Arts," *The Huffington Post*, Jan. 14, 2014.

Enhancing stakeholder communications, transparency

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Establishing and maintaining strong lines of communication with stakeholders is of critical importance for today's higher education institutions. Constituents are developing an increasingly voracious appetite for timely, relevant and specific information, and are voting with their feet and dollars for institutions that meet those needs. While certain financial and nonfinancial reports are compulsory, higher education leaders are taking deliberate measures to go above and beyond by proactively disclosing fiscal and operational performance to demonstrate transparency and a commitment to the relationships between the institution and its stakeholders.

An institution's constituency tends to be quite diverse, with each segment possessing its own unique set of needs. Whether addressing internal stakeholders (boards, students, alumni, faculty, administration, etc.) or external constituencies (parents, prospective students, regulators, corporate partners, credit rating agencies, the media, the broader community, etc.), institutions are deploying enhanced communication techniques to build awareness, increase engagement, earn trust and demonstrate goodwill. After all, an institution's reputation and stakeholders' perception are largely shaped by the number and types of touches brought to the attention of these constituencies.

Enrollment, funding, alumni relations and internal project support are on the line

In an era of increased scrutiny, college and university leaders are under ever-greater pressure to differentiate from competitors, demonstrate the value of a degree, and assure prospective students that their future employment and/or graduate school aspirations are attainable. Compelling engagement with prospective students can significantly affect the level of interest generated, total number of applications received, selectivity metrics and overall student quality. Improving communications and relationships with current students leads to improved responses from ranking institutions' student surveys and begins the lifelong alumni relationship on the right foot.

From a fundraising perspective, an institution's ability to engage alumni, share relevant information and establish a tradition of giving has tremendous impact on financial position. There are staggering differences in results between institutions that engage alumni with effective messaging, and those that lack a formal alumni relations and development strategy. Overall revenue diversity and financing of future growth hang in the balance.

Since the definition of institutional success may vary from one constituency to the next, maintaining open lines of communication is key to generating dialogue and fostering mutual understanding. For instance, many institutions are in the midst of formulating or implementing transformation initiatives; it is critical to be proactive in providing information to those who will be affected by change, and in answering questions to build trust, demonstrate transparency and alleviate anxiety. Clearly articulating anticipated changes, expected benefits and implementation timelines enables leaders to set expectations for faculty, staff and other key stakeholders.

Institutions have found that communications and transparency work

Institutions are taking the cue that stakeholders expect more communications than in the past.

- **Relationships with current students:** Observing a spike in student loan defaults, Indiana University decided to increase transparency about student loans. The university provided current students with a report of what their postgraduation loan payments and total debt would be. Students heeded the message; according to *Bloomberg Business*, federal undergraduate Stafford loan disbursements dropped by \$31 million (11%) in nine months.¹
- **Alumni relations:** Clemson University is recognized by The Princeton Review as No. 1 in the country in its list of top 10 colleges with the best alumni network.² Beyond traditional means of interacting with alumni — such as direct mail, email and social media — Clemson’s exceptional alumni engagement can be largely attributed to the university’s vast network of Clemson clubs and special-interest groups, and the university’s focus on delivering a consistent message through that network regarding what it means to be an alumnus in

terms of obligations and privilege. Such an infrastructure helps facilitate the institution’s ability to share information about recent activities on campus, articulate how alumni can help their alma mater on a national and local level, and build cohesive engagement. Viewing its 75-plus Clemson clubs across the country as a communications channel, volunteer leaders, along with young alumni councils and a robust alumni relations staff, help foster a lifelong connection between the institution and its alumni. Clemson’s alumni relations and constituent engagement strategy is one part of what enables the university to achieve its No. 1 ranking in The Princeton Review’s best career services.³

- **Institutional transformation:** Communicating via a less traditional medium, the University of Michigan maintains a YouTube page with over 11,000 subscribers and approximately 3.7 million views.⁴ Posts include an inside look at a nurse’s job in the university health system, TED-like talks and student perspectives about campus. An April 2015 post is a 19-minute discussion of the budgeting process; eight months after posting, it had been viewed almost 900 times.⁵ The discussion traces the progress of cost-cutting measures; addresses criticism and describes changes in the sources of funding; delineates budget allocations, models and processes; and articulates the beneficial outcomes of the new approach to budgeting. Additionally, the university’s website reports on financial positioning and ongoing budgeting efforts. This level of information sharing about rationales for decision-making enables an open dialogue with the internal and external community.

¹ Lorin, Janet. “How Indiana University Cut Student Debt,” *Bloomberg Business*, July 17, 2014.

² The Princeton Review. “Top 10 Schools With Awesome Alumni Networks,” Feb. 17, 2015.

³ The Princeton Review. “Best Career Services,” August 2015.

⁴ See the University of Michigan’s YouTube page for additional information.

⁵ University of Michigan, “Budgeting at the University of Michigan,” April 13, 2015.

What does good look like?

Higher education institutions are improving transparency and sharing information in many ways. A few best practices stand out.

- **Timeliness:** Provide data consistently and quickly after it is available or collected.
- **Appropriate level of information:** Communicate the right level of quantity and complexity, based on each constituency's degree of interest. When burdened with too much unexplained data, the message gets lost. When information is meager, stakeholders have more questions and less trust.
- **Full disclosure:** To build trust, share the bad with the good. Be forthcoming about challenges, crises and other less-than-optimal situations. Accompany these reports with a description of remedial actions or plans.
- **Open conversations:** Keep the conversation a two-way street; develop channels of communication so that constituents can speak to you. Listen and respond.
- **Metrics that matter:** Align metrics to a broader vision and strategy, and demonstrate how the institution is executing its key mission and values. However, understand that data alone doesn't explain anything. Provide analysis and accompany it with interpretation, and explain what the institution intends to do in response.

Partnering with your constituents is part of the foundation for your institution's success. As in any partnership, trust is earned through honesty and transparency. Earn your partners' trust by maintaining meaningful, ongoing communication to tell the story of what has been done, what is being done and what comes next.

Setting aside uncertainty in strategic planning

Brian Page, Partner, Audit Services, Not-for-Profit and Higher Education Practices

Uncertainty. It describes not only the economic reality that higher education institutions are facing, but also an emotion generated by that reality — one that often prompts leaders to resort to short-term plans instead of minding important long-term strategies.

Those leaders who do take a longer-term perspective and seek to truly plan often ponder questions such as these: What impact will current economic and demographic changes have on the next few years' enrollment? What will the business climate be like in three years, and how can we begin now to position our fundraising efforts? In formulating a successful strategic plan, leaders must also realize that an analysis of external factors is just one component. At least as valuable are comprehensive internal and competitive assessments, perspectives on potential outcomes, and the ability to adapt to change.

All of these components require flexibility and a keen eye on trends. Until recently, boards and executive management did well to rely on long-standing strategic planning techniques, but in a dynamic environment giving rise to serious revenue challenges, these techniques need to evolve.

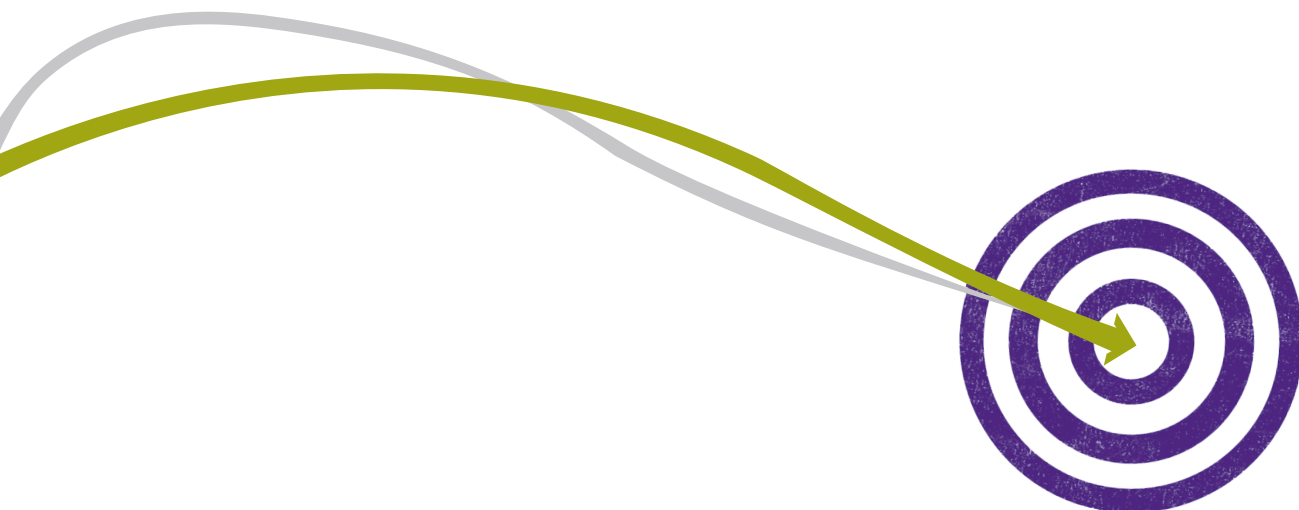
Consider these emerging approaches during the design, implementation and execution of your institution's strategic plan:

1. Holistically assess the state of the internal and external environment.

Institutions of all kinds have a tendency to focus on immediate operational challenges, primarily during the assessment phase of a strategic plan. In recent times, this has led to prioritization of enrollment management or other factors that can affect revenue generation. These factors certainly should not be ignored and do carry significant weight, but they can also encourage a short-term focus. It is critical to take into account other important aspects, including leadership competencies, competition for personnel, cost structures, program development, technology capabilities, risk profile, mission and culture.

2. Contemplate potential changes to the initial assessment.

The higher education sector no longer operates in a static environment. By the time an institution understands and documents the current state, the environment most likely has changed. It is difficult to prognosticate, but a thorough process needs to postulate a variety of outcomes or scenarios to stay nimble during the implementation phase. Often, bringing external perspectives from peer institutions or outside experts is helpful in providing a well-rounded viewpoint of the future of the sector.



3. Be wary of consensus during strategy formulation.

Human nature is such that it is easy to adopt insular thinking. When individuals share similar experiences within the organization, discussions and decision-making can become groupthink, resulting in a more-of-the-same view of the appropriate way to progress. This can lead to a narrowly focused strategic plan and a limited ability to identify when course corrections are needed. To avoid this, welcome into the planning committee a variety of individuals with differing functional responsibilities and perspectives. Make sure to have the input of opinions contrary to the norm.

4. Link your strategic plan to your operational and tactical plans.

An institution has plans that are much less encompassing than the strategic plan. They include annual academic, enrollment, campus master, budget, IT and institutional advancement plans, to name a few. Often, day-to-day activities in support of these annual operating plans take place independently of strategic priorities. Either these activities are in accord as contemplated with early strategic planning formulation, but as time goes on, they drifted from the original intent, or they are reactively executed in response to nonstrategic priorities. To ensure that resources are expended on strategic imperatives, periodically evaluate operational plans to ensure that they are fully aligned with the strategic plan.

5. Keep in mind that executing the plan is not linear.

Agility in execution and monitoring is as important as the actual plan. Development of a strategic plan is time-consuming — one of the main sources of failure is the “collective sigh of relief” that sometimes occurs after the initial plan is developed. Too often the plan is developed, put on a shelf and not revisited for the duration of its time horizon. Periodic monitoring of the environment (and your plan) helps to determine when changes to strategic priorities and goals need to take place. In light of the current dynamic environment in which colleges and universities now operate, this monitoring is critical as significant changes in the level or use of resources or changes in strategic/programmatic direction may be needed in the strategic plan. Consider forming a strategy analysis response team to both monitor the strategy and lead the charge for identifying when modifications need to be addressed.

Strategic planning has always been a vital component to the long-term institutional success. Given the broader context of change in the higher education competitive landscape, a realistic, flexibly designed, closely monitored strategic plan has become fundamental to ensuring financial sustainability and success.

Keeping strategic goals in focus through KPIs, scorecards

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Since the beginning of the post-recession period, higher education institutions have been challenged to demonstrate that they are operating effectively and efficiently, and producing acceptable outcomes. These challenges have prompted institutions to develop metrics to demonstrate progress toward broad goals. It's still a new business discipline for most universities, and results are varied.

Up until now, institutions have measured performance across a broad spectrum. Measurements are frequently developed from credible, system-based internal reports and offer insights into a department's or function's progress in meeting a stated goal (most often an output goal — more on that later). However, this approach doesn't usually include a process in which important institution-wide performance indicators are defined, measured and reported in a way that enables the board and senior leadership to assess operational efficiency in achieving strategic and mission goals. A more holistic perspective comes from defining key performance indicators (KPIs) that are critical to achieving the institution's strategic goals, tracking and evaluating them, and creating a scorecard summary.

Expansion of methods, mindset produces a bigger picture

The traditional KPI and scorecard concept has not changed. KPIs are used to measure outcomes — often achievement of an operational goal (e.g., zero compliance defects, high satisfaction ratings and students' application yield rates) or a strategic goal (e.g., the percentage of major donors giving more than \$1 million, and the percentage of students admitted with SAT scores higher than 1,500). Since KPIs can measure success or failure in many different functions, they need to be summarized to give the complete picture. A summary scorecard becomes a performance improvement measurement tool.

The concept of output vs. outcomes is an essential one. Too often, measures are chosen that are activity-based, because they tend to be ones that can be easily related to day-to-day work activities. However, these metrics frequently reflect the means to an end rather than the end itself, and they do not reflect why resources are being expended (e.g., a critical measure in student services is not the number of employers brought to campus for on-campus interviews; it is the number of well-paid, timely job offers extended).

It is clear that instead of incremental activity-based achievements by departments, performance of the entire institution toward mission achievement must be measured. It's a much bigger job, but it can be done through judicious selection of KPIs and prudent development of a scorecard.

KPIs are still the starting point

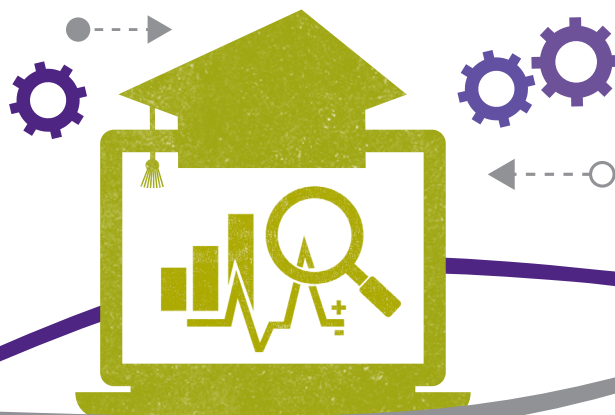
Departmental KPIs have often been misinterpreted as the building blocks of institutional performance, with success at the departmental level projected as institutional success. The appropriate use of KPIs is turning the process around to choose indicators that align departmental achievement with the strategic goals of the institution. When selecting KPIs, you must start by determining what is important to your institution (i.e., the strategic plan, an assessment of the current financial and market position of the university, and the outcomes of key institutional drivers).

The definition and shaping of KPIs must be well-coordinated and structured, involving individuals across many functional disciplines and departments. It is useful to explain to participants that KPIs are tools used to understand and measure success toward achieving goals; they are not goals unto themselves. Similarly, KPIs are not risk measurements, but they can reveal potential risks. They are intended to be easily understood and directly connected to strategic goals.

Business activities that support these goals will help determine the KPIs, and most activities will have more than one KPI (e.g., a cost indicator and an outcome indicator). Accordingly, a strategic goal may be to increase the institution's standing in sponsored research awards. This could simply be measured by showing the increase in the number and dollar value of sponsored research awards received. From a strictly departmental view, increasing these amounts could define success. However, the amount of unreimbursed indirect costs may have increased by a rate greater than the increase in awards, and this would have to be factored into the KPI. Or the increase may be due to awards following a newly hired professor who has brought his staff with him and requires significant investments in lab facilities. Or course-load release times were increased to focus on award competition, with an impact on the KPI because of the incremental costs of adjuncts to cover courses. If KPIs are purely cost metrics, service and effectiveness outcomes are ignored. If cost metrics are ignored, the institution could be doing well in satiating demands but be overspending. KPIs are meant to measure both efficiency and effectiveness.

Input from professionals throughout the institution should be welcomed. Finance officers can contribute KPIs such as Moody's and Standard & Poor's financial ratios; investment benchmarks for portfolio performance; deferred maintenance ratings by Sightlines; and on-time, on-budget completion rates for capital projects. Risk officers and enterprise risk management committees can offer KPIs to identify activities that require closer monitoring or mitigation, such as crime statistics, on-campus student injuries, cybersecurity breaches, and noncompliance with regulatory or institutional policies, including whistleblower and ethics violation reports.

Each of these departmental or operational indicators is important to the managers responsible for ensuring strong operational performance in their respective areas. But these indicators can create blind spots if they are not accompanied by indicators that measure risk and activity outcomes that are core to the success of the institution as a whole. Commonly, these departmental indicators have not been linked across institutional silos to measure joint performance. What is important to the admissions staff in measuring enrollment yield may not have the same importance to the finance officer measuring the trend in discount rates and the average net tuition paid, or to the provost managing departmental faculty shortages and capacity. In all cases, the value of KPIs is in the aggregate. In this case, in order to create an institutional KPI, the outcomes of departmental branding and enrollment need to be measured along with enrollment application yield rates, tuition discount rates, student SAT and academic profiles, and achievement of demographic targets established in the institution's strategic plan. The separate measures should be presented together and weighted to create an institutional measure of enrollment outcome.



Scorecards bring context to KPI collection

Scorecards synthesize the information provided by KPIs, linking related KPIs to produce a progress score for a strategic goal.

Consider the U.S. Department of Education's new College Scorecard site. This enhanced consumer tool designed to compare college costs and outcomes is an example of selected KPIs that do not reflect the comprehensive outcomes of an institution. Student inputs (e.g., Pell grant status, first generation and race/ethnicity), cost of attendance (e.g., net tuition and fee price, percentage of need met and student loan burden) and student outcomes (e.g., retention and transfer rates, graduation rates, loan repayment rates and post-graduation earnings) are presented in one place as a means of helping consumers learn about the affordability and effectiveness of particular institutions. However, this scorecard provides only a partial view of an institution based on a selective consumer perspective. It does not measure the institution's success in achieving its strategic goals, the educational value and high-impact academic experiences a student receives, or the effectiveness of academic-readiness programs for science, technology, engineering and math fields. Other KPIs of interest to a prospective student or family include campus safety ratings, graduate or medical school acceptance rates, international academic opportunities, number of months until employment following graduation and internship programs, etc. These factors contribute to a unique or enriched academic environment that may be as important as the financial consumer indicators. Scorecards can and should summarize a variety of performance indicators for different user groups.

Typically, performance indicators that depict strengthening or weakening financial performance have been viewed as a goal in and of themselves. However, financial KPIs should be part of a scorecard that also weighs nonfinancial indicators such as marketplace performance, academic reputation and performance measures, facilities and service excellence ratings, and risk exposure.

For example, financial KPIs should measure operational performance, balance sheet strength and long-term viability as one score. Improvement in the financial score is one performance indicator on a scorecard that captures the performance indicators for (1) progress made in attracting a certain cohort of students and in other market position goals, (2) the increase in academic reputation and instructional performance, (3) risk exposure, (4) facilities excellence and program effectiveness, and (5) excellence in student and research services and support.

Other performance indicators linked to strategic goals can be developed from underlying departmental and interfunctional indicators and summarized on a balanced scorecard to reflect institution-wide KPIs. An essential component of this effort is building bridges between the academic and corporate silos of an institution to assess business and academic activities through different lenses. This is best achieved if the information is supplied through institutional systems and not ad hoc or shadow systems.

Match KPI and scorecard development to goal and business model evolution

Defining and measuring new institution-wide performance indicators may take a few years, and scorecards will reflect updated KPIs as institutions determine how to measure goals and define success. This evolving approach allows for flexibility as goals and business models change over time. It also provides an institution-wide assessment of achievement and targeted areas for continuous improvement.

Institutions tend to manage what they measure, and in the absence of clear performance reporting responsibilities and well-defined metrics, managers measure what they interpret success to be. For appropriate measurement of your institution's performance, identify individuals with the skills and ability to work effectively with multiple university functions and personnel, and provide them with the well-defined indicators to be measured so that performance can be monitored and scorecard ratings developed. These individuals must be able to socialize measurements and ratings among departments and functions. They will be responsible for ensuring the accuracy of the data supporting the KPIs, knowing that questionable data can undermine the entire effort, or worse, lead to erroneous judgments and decisions.

Continuous refinement of KPIs and objective analysis of the direction in which the data point are essential for an institution to sustain the benefits of measuring and reporting performance. KPIs and scorecards must become integral to every institution's operating and governing model, guiding the institution toward its goals.

Taking budgeting to the next level: Integrating the strategic plan

Larry Ladd, Director, National Industry Specialist, Not-for-Profit and Higher Education Practices

Budgeting for colleges and universities is getting more and more challenging, especially for those institutions facing the most acute financial stress — namely, smaller regional private and public colleges and universities. Many have improved their budgeting practices, but many more must step up to not only survive but also to become more successful.

While there are many permutations, just about every college and university uses incremental budgeting. Even for those institutions that take a performance or responsibility-center budgeting approach, incrementalism is the core of their process. Incremental budgeting involves deciding about relatively modest increases or decreases in revenue and expense lines to produce a balanced budget. Performance budgeting involves using metrics in deciding how much to increase or decrease, but it's still incremental. Responsibility-center budgeting involves decentralizing by turning budgetary decisions over to deans, but those deans are themselves using incrementalism. Some institutions say they are using zero-based budgeting, but in reality they can't effectively judge each program freshly every year because it would take too much time and effort.

Why is incremental budgeting the common practice? It is safe and requires less effort. It creates very little change and causes the least disruption. It is highly conservative — students and faculty like the college the way it is, and alumni want to remember the college as it was. The budget simply enshrines the current state of affairs, with modest changes responsive to the latest perceived internal needs and constituency pressures. Strategy plays no part, nor does long-term planning based on real-life market positioning.

Move from the old to the new and better

There is a better way. Consider these key elements of budgeting to either adopt as new, or refine existing processes:

First and foremost, budgeting must be the short-term quantitative embodiment of the institution's strategic plan. In the past, strategic plans were a set of lofty goals indicating how new resources (from tuition increases, debt and fundraising) would be used. They rarely challenged the existing expense base in a material way. Those days are over. Now, strategic plans are expected to represent notable departures from the status quo — to define ventures not previously conceived or significant redeployments of physical, financial and human resources. Effective strategic plans incorporate meaningful change in response to critical environmental changes. They require trade-offs and, potentially, risks. To make that kind of change, do not begin with the existing budget. Base your budget planning on your strategic plan. The first rough sketch of the budget should be a mirror of that plan.

Second, your budgeting approach must be budgeting by substitution, in which every new program or initiative is funded by reducing or eliminating existing programs, rather than by finding a new source of funding. Incremental budgeting shaves a little from existing programs, adds a little to existing programs, and funds new programs with new revenue. Budgeting by substitution funds new programs by deleting old programs and takes a much harder look at existing programs as a result. There are fewer small reductions in existing programs (which often reduce quality). Further, a powerful incentive is introduced to force the examination of existing programs and make hard decisions.

Lastly, use zero-based budgeting as a phased discipline. Every year, select a set of programs to intensively evaluate and reconsider. Concentrate efforts on how consistent those programs are with the strategic plan and the institution's mission, compared with other programs. This form of zero-based budgeting provides the funding for the new initiatives likely to be essential to institutional viability and success.

Ideally, an organization uses multiyear budgeting to plan several years ahead. That's an ideal hardly ever realized. Next year's budget is frequently perceived by participants as the "real" one, and that's the one they focus on. The second and third years are usually an afterthought — prepared by staff at the last minute after the real one is put to bed — with the elegance of compound interest (e.g., revenue grows by 3%, expenses by 2.8%) as the fallback.

A good way to create realistic multiyear budgets is to start with the third year and work backward. Create a budget that represents an ideal but incorporates clear-eyed trade-offs, since the budget must be balanced. Then move backward through years two and one. Strategy and planning then take the forefront, with the top question being "How do we get to our ideal?" which generally isn't the way budgets are now approached. It creates an incentive for decision-makers to remember that their ideal takes priority over their current state. It makes budgeting by substitution emotionally easier.

Follow overall best practices

- Maintain a strong commitment from the top for integration of planning and budgeting. There will be many temptations to compromise to satisfy constituencies that don't want change.
- Rank the priorities as high or low, rather than the typical list of unranked priorities that inhibits decision-making. Make priorities clear and actionable. Have very few at the top of the list, and make sure the budget reflects those priorities.
- Show courage in setting clear priorities. Leadership in these times requires courage in the face of opposition.
- Identify all the resources required to achieve and implement the strategic plan — money, people, facilities, IT, etc. — so they can be translated into the final budget. Any plan must include all of the components needed for success. For instance, you can't create a financial budget for a new program without identifying the space and IT resources that are required.
- Use a budget projection as a component of the strategic plan; it can serve as the basis for the actual budget.
- Ensure continuous conversation between the president and deans/vice presidents about plans and future budgets, so managers know what is likely to be approved or cut. This will speed the budget process.
- Keep it simple — complex processes are a distraction from the actual work.

Budgeting approaches

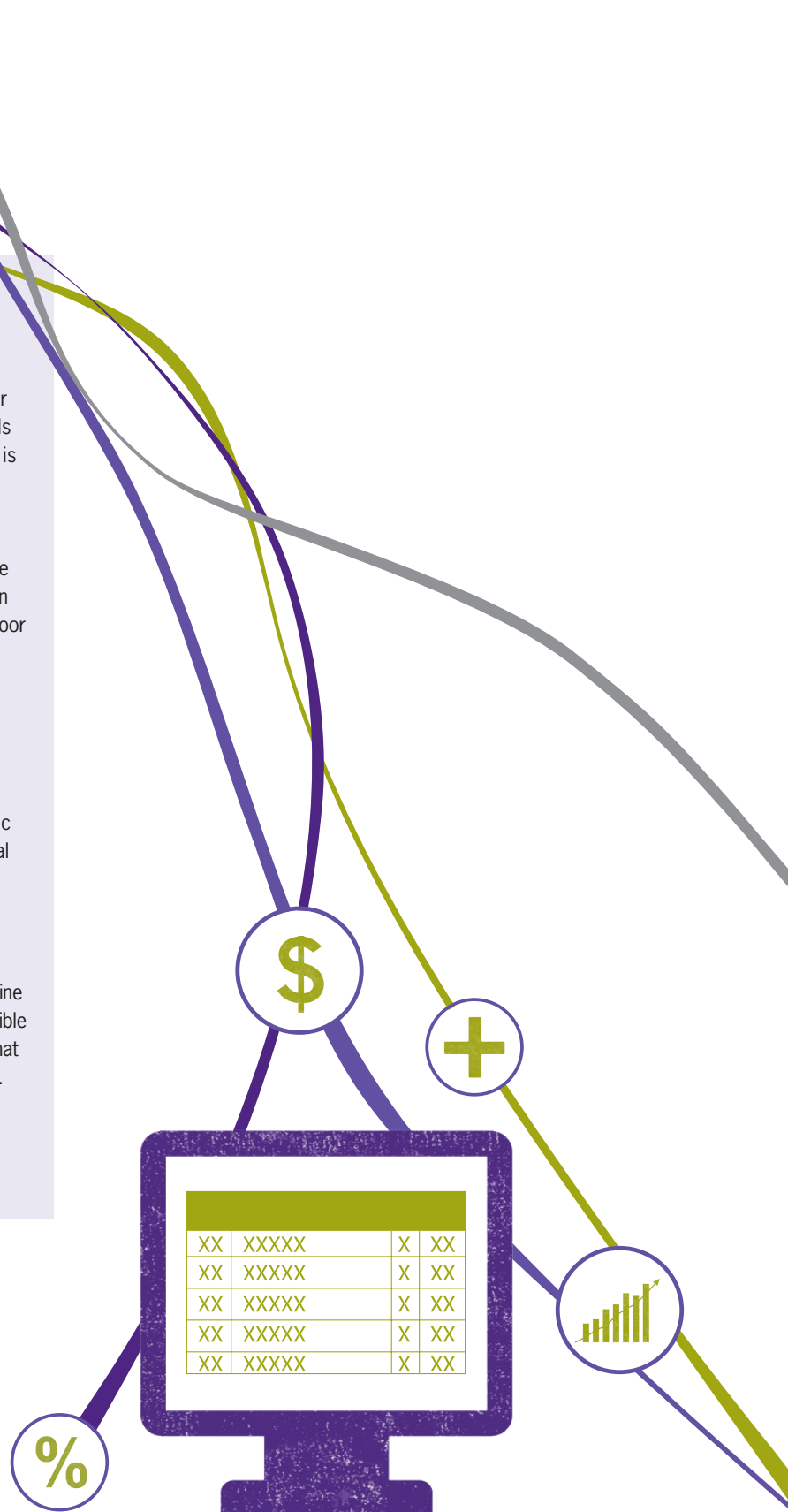
The overarching principle of budget planning is to start with the strategic plan, not the existing budget.

Incremental: Changes are made at the margins as pluses to or minuses from the existing budget. What is being done now tends to take precedence over what might be done in the future. This is the most popular approach because it is the easiest and most conservative.

Performance: Metrics (assessing performance) are usually at the core of this approach. Areas that can demonstrate improvement in their metrics are rewarded with new funding. Where metrics are poor or deteriorated, that part of the budget incurs funding reductions. This is nice in theory but hard to practice in reality.

Budgeting by substitution: Revenue is identified, as are key new expense items, based on the strategic plan. Inevitably, the projected budget will be in deficit at that point. To balance it, items of low priority (for the most part, those not in the strategic plan) are deleted until the budget is balanced. This is the optimal approach — basing decisions on the strategic plan — but it doesn't preclude incorporating the best of zero-based and performance approaches, as well.

Zero-based: Putting all existing programs on the table to determine if they should continue to be funded is great in theory, but impossible in reality. A workable approach is a "rolling" zero-based process that puts some portion of the budget under the microscope each year.



Achieving, measuring social responsibility, sustainability

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Colleges and universities across the United States are turning into reality the ideal of preparing students to work toward a just and sustainable society. They're doing so by modeling environmental and social responsibility, and training students in responsible attitudes and actions. As much as any other sector, higher education is addressing such imperatives as climate science and diversity. As their efforts expand and deepen, individual institutions are measuring their work to assure long-term positive effects.

Determining a stance, modeling and teaching action steps

Increasingly, institutions are realizing that an essential element of their character must be a clearly defined sense of responsibility to community — locally and globally — and the environment — socially and ecologically. Colleges and universities need to maintain a heightened sense of institutional conscience by voluntarily minimizing their impact on the environment and otherwise promoting the common good, going beyond compliance with laws and regulations. This new sense of commitment needs to be embraced alongside the primary educational mission. Institutions can refine their character based on these considerations:

- **Physical impact:** How we positively affect the environments where our institution is located and where our faculty, staff and students reside; how we increase the diversity of our campus community and vendors; and how we help individuals boost their health and well-being
- **Perceptions:** How we are viewed by our faculty and staff; if we are the employer of choice for prospective candidates; how our students view us; and if we are a preferred provider of higher education in our market space

An early leader in social responsibility and sustainability is Arizona State University in Tempe. In 2006, the university established its School of Sustainability within the Global Institute of Sustainability, which is the center of the university's sustainability initiatives. Students are working toward the goal of mitigating 100% of the university's greenhouse gas emissions related to building energy, refrigerant and waste by 2025, and are trying to eliminate 100% of transportation greenhouse gas emissions by 2035.

Many institutions are committing to sustainable purchasing, showing fiscal stewardship as well as environmental care. For instance, Yale University buys event items in bulk to save money and to reduce waste in support of its philosophy — "Yale University Procurement supports the research, teaching and practice missions of the university by leveraging the overall purchasing power of the institution, reducing the overall cost of goods and services, facilitating the acquisition of all necessary goods and services."¹

¹ Yale University Office of Sustainability. "Yale Sustainability."

Other institutions are stepping up to model sustainability across operations and community relations. Breathtaking examples range from building a rainwater harvesting system, purchasing dining hall food from local producers and increasing transactions with minority- and women-owned vendors to increasing faculty diversity and promoting on-campus wellness through pedestrian- and walker-friendly initiatives.²

Going public about intents and purposes

In 2015, 218 colleges and universities, representing millions of students, announced their intent to act responsibly and sustainably when they signed the American Campuses Act on Climate Pledge.³ The pledge reads, in part:

“We recognize the urgent need to act now to avoid irreversible costs to our global community’s economic prosperity and public health and are optimistic that world leaders will reach an agreement to secure a transition to a low-carbon future. Today our school pledges to accelerate the transition to low-carbon energy while enhancing sustainable and resilient practices across our campus.”

Making purposes and actions known can bring both external and internal benefits. Institutions publicize their commitment through direct communications with stakeholders, social media and press releases, website postings and materials for potential students. Since the issue is important to the general population, an institution can boost its reputation by making social responsibility and sustainability part of its public image, encouraging more loyalty among alumni and community members considering contributions to the institution, as well as attracting like-minded students to enroll. In the increasingly competitive environment of higher education, these external advantages could be key to an institution’s success. Internally, social responsibility and sustainability tend to foster higher employee satisfaction and loyalty, which have been shown to improve job effectiveness and result in employee retention, reducing attrition-related expenses.⁴

Using data to gauge effectiveness, substantiate work

Cost savings and avoidance are real results of many social responsibility and sustainability initiatives. Goshen College reduced its electric consumption by 25% and gas consumption by 23% between 2007 and 2014.⁵ Energy-efficient features at the school include a computerized building temperature regulation system, motion sensors for indoor and outdoor lighting, a solar hot water collection system, and open loop ground-source heat pumps.

At Arizona State University, the institution reports an 18% reduction of emissions, despite having 25% more people (staff and students) on campus and almost 25% more building space.

Beyond direct cost elimination, other important results can include reductions in food waste and recyclable materials sent to landfills and greater on-campus health and diversity, in addition to improved employee motivation and institutional pride.

When considering how to gauge success, some questions arise: What is the long-term purpose of this initiative and how can it be measured? How will the success of individual efforts be measured? Can results be tied to hard empirical data that can be audited or substantiated?

For instance, an institution encourages carpooling and observes fewer cars parked throughout campus. To demonstrate actual results, it would need to track the progress employees are making in reducing the number of single car trips and how that converts into avoiding consumption of tons of carbon emissions. Tracking and measuring can be complex and labor-intensive, but they must be done to show noteworthy outcomes to stakeholders.

Sustainability reports on institutions’ efforts are increasingly being issued in conjunction with financial reports. They should be verified by a third party such as an independent CPA or an environmental consulting or engineering firm. This independent assurance of sustainability metrics and analysis can provide confidence about the credibility of not only the report, but also of the efforts themselves.

A sustainability report can be the proof that students and the community are looking for as they evaluate your institution and its commitment to the common good.

² Association for the Advancement of Sustainability in Higher Education. 2015 *Sustainable Campus Index*, Oct. 13, 2015.

³ The White House Office of the Press Secretary. “Fact Sheet: Ahead of the Conference on Climate Change, More than 200 Colleges and Universities Sign the American Campus Act on Climate Pledge to Demonstrate Support for Strong International Climate Action” (press release), Nov. 19, 2015.

⁴ Bauman, Christopher W., and Skitka, Linda J. “Corporate social responsibility as a source of employee satisfaction,” *Research in Organizational Behavior*, pp. 63–86, Volume 32, 2012.

⁵ Association for the Advancement of Sustainability in Higher Education. *STARS Annual Review 2014: Campus sustainability ratings, innovations & best practices*, Sept. 24, 2014.

Utilizing data analytics to improve performance

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Despite higher education's current focus on operational performance, efficiency and effectiveness, many institutions rely on techniques that provide little to no quantifiable insights into performance improvement. To generate measureable results that also support mission achievement, colleges and universities are turning to data analytics.

Data analytics yields meaningful patterns in data — financial and nonfinancial — that can describe performance, and predict and guide improvements. Analytics is a multidimensional discipline that simultaneously applies statistics, computer programming and operations research to quantify performance and provide a clearer picture of what is working and where improvement is needed. Analytics can help you validate trends, pinpoint root causes of existing issues and take a comprehensive analytical overview of institutional performance as a whole — both within academic programs and underlying business operations. More importantly, analytics can be predictive as well as real-time, illustrating future possibilities to enable decisions about transforming performance.

Data analytics is a continuous, iterative exploration and investigation of past business performance to gain insight and drive business planning for the future. The results of data analytics can be used to streamline operations; increase cost efficiency; determine and optimize financial margin by department/student type; model and forecast performance (e.g., student trends, resource needs and revenue expectations); improve the budgeting process; and enhance overall mission effectiveness. With a true understanding of business performance based on data, statistical methods and predictive modeling, data analytics allows management to concentrate on the fundamental objectives of the institution and find ways to enhance mission achievement.

Results can be financial, academic and sustainable

As an example of how data analytics can be used to enhance a university's operations, contrast how classroom space planning has traditionally been done — assigning blocks of classrooms to department chairs based on faculty requests — and an enhanced approach that effectively allocates classrooms by leveraging metrics through a cross-functional analysis. In the latter approach, the metrics are analyzed according to factors such as cost-to-educate, margin by student type and program, under- and overcapacity departments, faculty availability, course popularity, core requirement or elective, building usage in nonpeak times, and the history of oversubscribed or undersubscribed sessions. These factors are brought together in a solution to identify inefficient use of physical space and as a response to board requests for space utilization studies before upgrading or building additional facilities.

Beyond reducing the cost to educate, performance improvement can also be measured by mission-related factors such as increased number of students served, improved on-time graduation rates due to course availability, expanded investments in learning and teaching technology, and increased allocation of research space, along with many other nonfinancial factors.

Data analytics can assist institutions that are struggling with their bottom-line financial performance. However, data analytics can also benefit those institutions that are financially stable by illuminating budget-neutral changes that can deliver enhanced educational outcomes. Financial performance as measured by operating margins only tells half the story; enhanced operational performance that has a significant impact on educational outcomes tells another story altogether. Maintaining a 5% or 10% operating margin is a financial measure; doing so while expanding program offerings, initiating degree programs or improving four-year graduation rates is a performance improvement measure.

Heightened interest in student outcomes is another driving force in data analytics. Constituents are demanding proof of educational outcomes, including student retention and graduation rates, and post-graduation job placements. Institutions that can illustrate success in these areas are at a significant competitive advantage.

Analytics can help you validate trends, pinpoint root causes of existing issues and take a comprehensive analytical overview of institutional performance as a whole.

Assessing and measuring budget tradeoffs related to investments in specific intervention and milestone-driven initiatives is an area where data analytics shines. Data is aggregated, analyzed and explored across many dimensions, including at-risk students' demographic and academic profiles (e.g., major, and full/part time, residential/nonresidential and employment status), as well as programmatic factors and programs (e.g., academic and career advisement, college readiness bridge programs, access to technology-enabled classrooms and interactive learning tools). Analytical models can be developed to compare past performance based on at-risk student retention and graduation, with predictions of future performance based on changes to specific criteria and programs.

Scrutiny of academic performance and investments in new academic programs amidst the challenges of a competitive marketplace are prompting institutions to make decisions that are fact-based, satisfying strong faculty senates and governing bodies, which increasingly require a data-driven focus. Institutions continue to strive to understand their current academic model by looking at traditional metrics such as faculty productivity. But to deliver truly improved performance, they must consider additional data, including research quality; faculty tenure status; faculty salary-cost-to-revenue ratios (including adjuncts) by major; the ratio of sponsored research-to-release time by school, department and major; available teaching hours; enrollment patterns and oversubscribed courses; and the ratio of release time for curriculum innovation as compared to research. With so many factors to assimilate, a holistic and objective fact-based approach to data analytics can prepare an institution to navigate difficult — often political — waters and enhance performance in a financially sustainable manner.



In analytics, human factors are as integral as data

To perform meaningful analytics, databases and technology tools are critical. However, this is not simply an IT exercise — at its core, data analytics involves people and their commitment to the mission. It is essential to involve a variety of perspectives to ensure fair representation of stakeholders. Input must be sought about what data should be gathered and analyzed, how analytics will be interpreted and converted to performance insights, how decisions will be derived from the business insights, and how opinions about facts and data will be synthesized into action.

In the end, data analytics comes down to the human element. University leadership needs to champion the desire for a better, more holistic decision-making process based on an understanding of the relationships between business drivers and their outputs. The traditional analysis functions of departments such as Institutional Research, Finance, Academic Affairs, Student Affairs and Office of Sponsored Research need to be reassessed, and new skills introduced for analyzing different types of data. These changes require leadership and institutional commitment to succeed.

The highly competitive nature of higher education, increased scrutiny by stakeholders, changing demographics of the nation and tuition/fee sensitivity create an environment in which improving financial and nonfinancial outcomes cannot be achieved based solely on the conventions of student selectivity and tuition increases. The true power of data analytics lies in establishing a dedicated, ongoing program that enables higher education institutions to gain insights into their operations and to improve performance into the future.

Steps to instituting data analytics

Prepare your institution for optimal results from data analytics:

- Invest in technology (e.g., data warehouse and analytical tools) to capture desired data and create correlations.
- Establish performance metrics beyond financial measures and agree on mission-driven indicators.
- Acknowledge the human element and the importance of effective change management.
- Build collaboration into the process in order to view the institution as a whole rather than as a collection of departments and interests.
- Develop or acquire personnel to bring data analytics and business intelligence skills into your institution.
- Commit to act on the trends and insights discovered through data analytics.
- Create a cross-functional steering committee that can set aside other biases in order to act on the analysis.
- Dedicate institution-wide focus to an ongoing data analytics program, as opposed to conducting a one-time exercise.



University management model

Data sources

Asset/space data

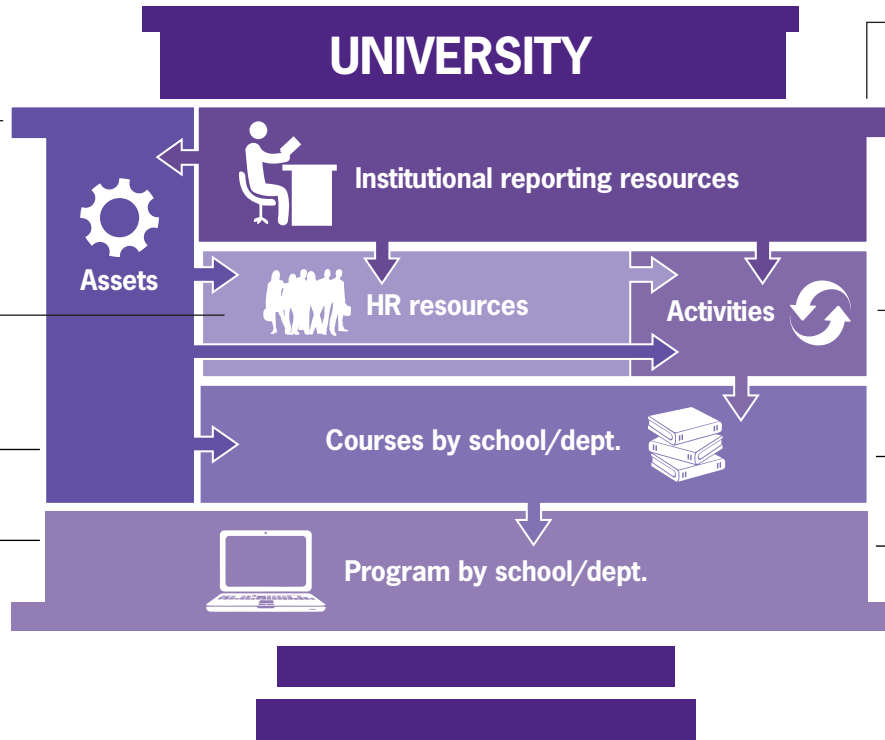
Entity
Campus
Buildings
Rooms
Room type
Floor area

Payroll

Payroll structure
Personnel

Timetable information

Room/class type
Hours by course
Lab by type
Lab by course and research program



Data sources

Reporting resources

GL structure, expenditure and activity assignments
Enrollment management
Registrar
Labor distribution
Sponsored research
Academic and departmental productivity reports

Activities

Instruction
Graduation/outcomes
Sponsored research
Service and research
Administration and compliance
Maintenance
Student services

Student records

Course by program
Program
School/department
Campus
Teaching period
Course and program level
Fee type



Engaging faculty to improve financial performance

Larry Ladd, Director, National Industry Specialist, Not-for-Profit and Higher Education Practices

Faculty is at the core of the higher education enterprise. While everyone plays an important role in the success of a college or university, faculty do the direct work of instruction and research. While others at the institution have a choice of industry in which to work, faculty have made a decision to do their life's work on campus, often at the same institution for their entire career. Whether they realize it or not, they have the most at stake in the success of their college or university.

But while they certainly want higher education and their own institution to thrive, faculty can have a fairly narrow view of what that success looks like. From the moment a faculty member entered graduate school, success was measured by his or her own individual performance, and performance as measured by peers. Institutional success is a concept that is not built into their world view. If they've done well in their individual efforts teaching and conducting research, they're likely to think their own success equates — or is a sufficient contribution — to their institution's success. Any broader measure of institutional performance is beyond their experience. And with their loyalty primarily to their colleagues and their discipline, they might not be keeping tabs on the marketplace and the business end of higher education.

Change is necessary for every college and university, yet faculty tends to be the most resistant to change. How can you broaden faculty's perspective from individual to broader institutional performance and engage them to become a partner in change?

7 lessons in change management

No. 1: See faculty members as your partners rather than your opponents. That's another way of using the familiar phrase "assume good intentions." Faculty can smell a fraud a mile away. And, like anyone else, faculty will take you seriously only if it's clear you take them seriously.

No. 2: Communicate, communicate, communicate. Remember that the communication goes two ways; you have as much to learn from faculty members as they do from you. So challenge your mantra might be "educate and listen." And use every medium for your communication, both electronic and face to face.

No. 3: Demonstrate that the challenges you face are typical of the industry, not unique to your college or university. The hardest sell for faculty is convincing them that the administration cannot change the environmental factors affecting the industry. (Yes, many believe that you should try.) Faculty often believes that more paying students would enroll if only there were a better admissions effort or that more funds would come in if fundraising were more robust.

No. 4: Make a strong case for change — a case based on academic, not business, values. Many faculty members assume, for instance, that their institution can continue indefinitely without change, the way institutions have been able to operate until recently. Show how continuing on the present course is not sustainable and that they will not have the kind of students they want to teach or the resources they need for conducting research. And, in constructing the case for change, avoid indisputable assertions (truisms) when possible, instead offering propositions you are open to discuss. For instance, don't say, "Our tuition is too high." Instead, you could say, "In light of this comparative information I've gathered, do you think that tuition is too high?"

No. 5: Build relationships with the key opinion leaders on the faculty, particularly those who are most likely to resist your initiatives. Their trust, even if they disagree, is essential.

No. 6: Use and respect faculty governance processes. Make sure that every relevant committee and stakeholder group has an opportunity to understand the issues and shape them, and to offer their perspective. Not only does that show respect for faculty, but it also means any opposition you face will be based on facts rather than procedural grounds.

No. 7: If you have contact with higher education leaders at the national level, urge them to engage with national professional associations that can help faculty understand the key trends that make "business as usual" impossible. Faculty at your institution are most likely to be responsive to messages from their profession.

When faculty members have an understanding of the case for change and you've earned their confidence in your commitment to transparent communications, you are more likely to have a partner in the inevitable give-and-take of performance improvement efforts. At the least, you'll replace entrenchment with reluctant acceptance.



7 lessons in change management

- 1 See faculty as partners 
- 2 Communicate 
- 3 Demonstrate that your challenges are not unique 
- 4 Make a strong case for change 
- 5 Build relationships with key opinion leaders 
- 6 Use and respect faculty governance processes 
- 7 Urge higher ed leaders to engage with professional associations 



Recognizing, averting risk of financial failure

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Financial failure is an increasing risk for all organizations — due in large part to a confluence of contributing factors. When these factors take hold, it is very difficult to regain financial stability and keep from failing. Colleges and universities finding themselves in this precarious position have been known to compromise their strategic goals, reduce critical investments in infrastructure, cut the extent and quality of services, and make other spending and revenue choices that begin to significantly challenge the institution's ability to survive.

Institutions need to be mindful of how shifts in annual enrollments, changing perceptions of academic quality and market performance, and deferred investments in facilities and services will affect their competitive position, and take early remedial action to avoid the serious downturns that can lead to failure.

Expansions of core programs into new interdisciplinary programs can bring renewed market attention to your institution and differentiate it as well.

Monitor and respond to these 10 financial warning signals

This list is not all-inclusive; instead, it highlights indicators that, if ignored, could lead to significant financial difficulties in the not-so-distant future. These signals are not new to higher education, but their impact and velocity are dramatically increasing. This is due to the current economic climate, coupled with the inability of most institutions to differentiate themselves from their peers and adopt an operating model that is responsive to the evolving needs of students and changes in the traditional view of the college experience.

1. Enrollment declines in core competencies.

Nationally, enrollment in four-year colleges and universities of traditional-age (i.e., post-high school) U.S. college students is continuing to trend downward, with some geographical regions affected more than others. The specific impacts on programs that have been institutions' core competencies need to be addressed aggressively through the identification of new competencies or outreach to nontraditional college-age students. Serving the needs of veterans, foreign students and adult learners has undeniably provided opportunities for new growth markets, prompting institutions to be innovative in introducing new core programs to meet the increasing demands and unique needs of these constituents. Expansions of core programs into new interdisciplinary programs can bring renewed market attention to your institution and differentiate it as well. Examples include graphic design and entrepreneurship, and journalism with an ethics concentration.

Investment portfolios of higher education institutions have been called upon like never before to provide for operations and strategic investments.

A fundamental element in assessing your enrollment challenges is an understanding of market perception about the quality of your programs and faculty. Turning around and redesigning programs may require additional investment in faculty and facilities or establishing affiliations with other institutions. Building the reputation of a new program will necessitate increased focus and investment, as does improving the perception of an existing program's value. Program reputation will be built in large part on the prestige of the faculty and the extent to which they are published, the power and influence of the alumni who have come through these programs, and the strength and breadth of the interface between the classroom and business enterprise affiliations/partnerships. These programmatic and institutional attributes are not easily accomplished. They are shaped over a long period of time and require the long-term intentional actions of many across the institution.

2. Discounted tuition exceeded by the cost to educate.

While tuition rates continue to increase nationally, this growth has in large part been offset by increasing discount rates required principally to attract and retain students. A National Association of College and University Business Officers study noted that student tuition discount rates, on average, were as high as 46% for the 2013–14 academic year, the highest ever.¹ Now that the federal College Scorecard is available, tuition comparisons across institutions and the cost of attendance are in the public realm. A high tuition discount rate attracts families worried about affordability, but before you make such an offer, nail down the true cost of the education you provide. Many institutions have been dismayed to learn that the fully loaded cost to educate a student significantly outpaces the discounted tuition and fees received. Other institutions have realized that the costs of dormitories, meal plans and other auxiliary services are not fully covered by related revenues.

If the operating margin from student-related revenues is negative, substantial analysis is required to align tuition rates with cost structures. You might need to turn to increasing enrollment through lowering the academic standards required for admission, increasing the student-to-faculty ratio above planned levels or generating non-student-related revenue.

3. Living off the endowment to cover operating costs.

As is the case for other segments of the not-for-profit sector, investment portfolios of higher education institutions have been called upon like never before to provide for operations and strategic investments. With declining margins caused by shrinking and less profitable enrollments and increasing operating costs, many institutions have supplemented their board-approved spending policies with additional board appropriations to fund unbudgeted operating costs, underwrite capital campaigns, pay for voluntary retirement plans, or provide a sufficient level of liquidity for operations or servicing or refinancing existing debt. Additional endowment appropriations, beyond the annual spending policy, can lead to a reduction in the purchasing power of the endowment and an erosion of the principal. Combined with lackluster market performance, the endowment could be significantly diminished.

Economic trends over the past several years have in fact further weakened endowments, which have been reporting losses or lower-than-anticipated returns. This makes smaller institutions particularly vulnerable and increasingly tuition-dependent. Institutions with the largest endowments also have vulnerabilities. Because of their reliance on endowment performance, many have constructed and developed campus facilities and infrastructures that are increasingly costly to maintain. Others with large endowments have adopted tuition pricing models that can significantly reduce individual student tuition if household income is below defined thresholds. These institutions' strategic decisions to expand their campuses and/or reduce (or eliminate entirely) tuition for certain students meeting defined criteria are predicated on the continued growth and performance of their endowments.

¹ Marcus, Jon. "Colleges keep increasing discounts to keep students coming," The Hechinger Report, July 2, 2014.

Institutions whose fundraising efforts have been focused on specific operating and programmatic purposes may now need to dedicate their fundraising to growing their endowment. Board decisions to supplement annual spending-rate appropriations should only be in support of strategic initiatives. Moreover, the long-term implications of supplementing annual board-approved spending distributions, even if only for strategic initiatives, should be carefully analyzed, with due consideration of how such decisions will reduce the purchasing power of the endowment.

4. Not selling your brand to alumni and donors.

When contribution revenue declines from expected levels, institutions come under additional pressure to salvage operating results by curtailing spending without perhaps sufficiently considering the impact on strategic goals and student choices, preferences and perceptions. Identifying other revenue sources may be a strategy to pursue in response to such declines; however, risks and costs associated with new revenue sources may be difficult to assess. Such short-term decisions regarding cost cutting or revenue enhancement can have long-term effects on the brand, which in turn can greatly affect alumni engagement in fundraising.

Alumni giving (and more broadly, all philanthropy) still has not fully rebounded to prerecession levels and is highly dependent on the overall economy. Institutions that are not constantly engaging with their alumni and courting other donors — both when making strategic changes in direction and promoting ongoing activities and successes — can expect to experience dropping contribution revenue.

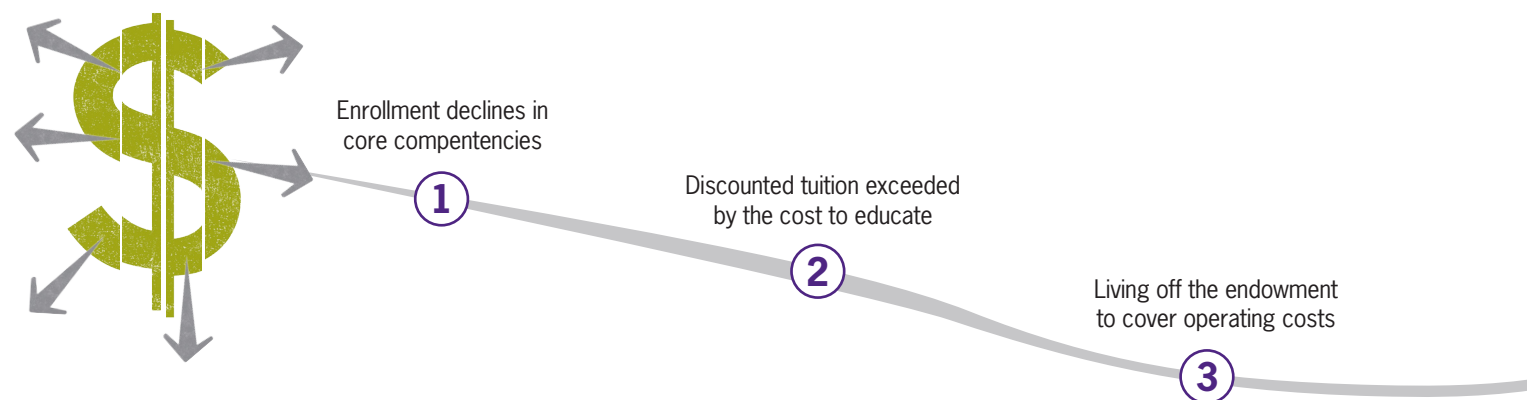
In general, if the average annual alumni gift is less than \$100, leadership should take aggressive action, because this is a clear indication that alumni are not sufficiently engaged. A comprehensive capital campaign should be considered; performing appropriate feasibility studies to shape, size and guide the campaign is likewise critical.

5. High cash outflows into new building/capital projects.

It is a false belief that new campus buildings and facilities will inherently attract new donors and lead to greater enrollment. New construction instead often leads to additional debt and operating costs. Debt loads can bring an institution to a crisis point and should be considered a key warning sign, especially if there is not a reasonable expectation of donations to support large capital projects.

Movement from variable-rate to fixed-rate debt issuances or even taxable issuances, which afford more flexibility in how the proceeds may be used, should be considered. Careful consideration should likewise be given to debt modeling, which often requires external financial advice. Two general rules to consider are that your total debt service should not be in excess of 10% of your total annual operating budget, and that expendable net assets should be 125–200% of your institution's long-term debt outstanding.

10 warning signs of financial failure



6. Deferred maintenance.

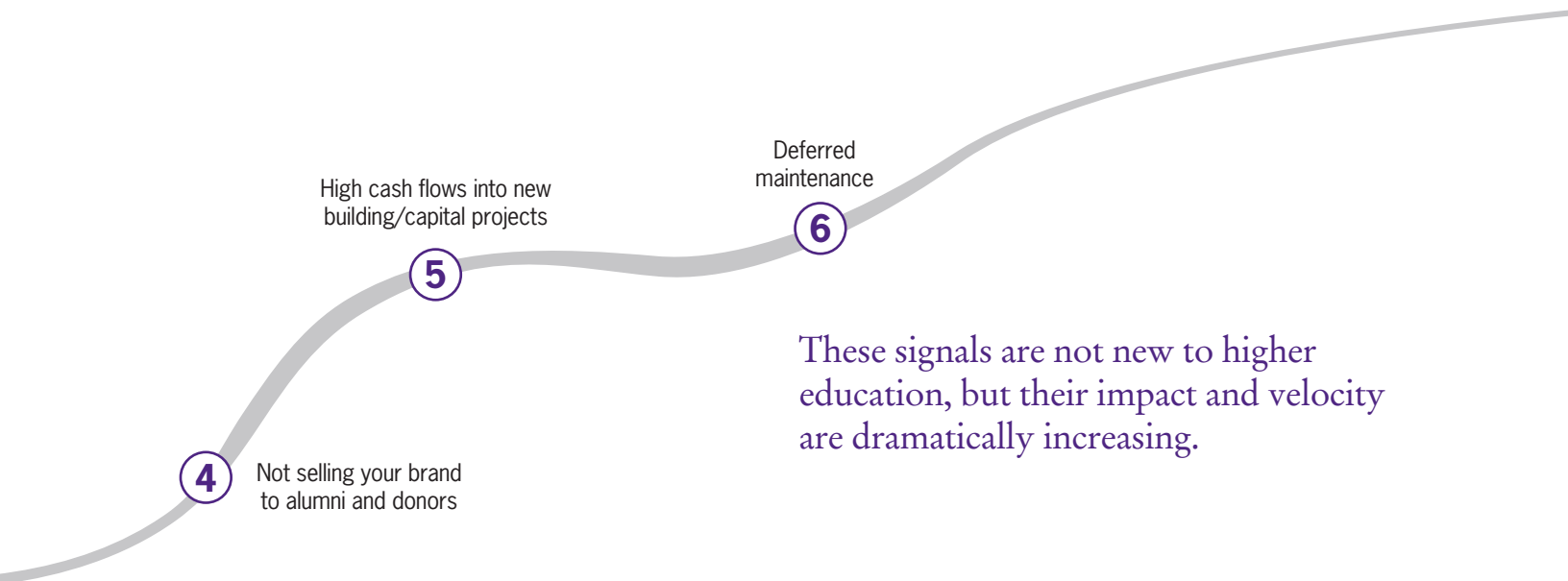
Over the past decade, institutions have made rational and intentional decisions to defer remediation and restorative projects across their aging campuses in order to focus resources on higher-priority initiatives and imperatives. However, identifying deferred maintenance needs is critical; if not performed, deferred maintenance can leave an institution with deteriorating facilities that are unusable, inefficient and environmentally unfriendly, and in some instances, unsafe. Moreover, an aesthetically pleasing campus can positively influence prospective students and donors.

As a matter of good operational practice, an institution should perform a comprehensive study of its campus assets to identify, prioritize and determine the restoration cost to meet deferred maintenance needs, including those to bring buildings into compliance with relevant codes and regulations. Further, best practice has been to establish sinking funds — which could be determined as a derivative of annual depreciation expense— to set aside for these efforts. Before simply building new facilities, consideration should be given to ensuring existing facilities are adequately maintained. Overall, if an institution cannot demonstrate that at least 40% of its deferred maintenance needs are funded, this is a strong indicator of current and future financial strain. Underfunded deferred maintenance needs were noted as a key factor in the closing of Antioch College.²

7. Low financial scores issued by the DOE

The federal Department of Education (DOE) issues annual financial composite scores for many institutions of higher education. The DOE's composite metric is used in determining if schools can participate in federal Title IV aid programs, specifically student financial aid, and in assessing the general financial stability of an institution. The DOE evaluates compliance with refund reserve standards, finding answers to questions such as: Does the institution have enough cash to return Title IV aid funds when required? Is it meeting financial obligations, e.g., maintaining sufficient solvency? Is it current with debt obligations and compliant with relevant covenants?

Given the DOE's structured process for evaluating institutions, your institution has the opportunity for proactive self-examination and improvement. This will better equip your institution to respond to DOE inquiries, as well as to identify potential pitfalls and opportunities. Questions that your institution should be asking include these: What is the overall student default rate on our institutional and federal loan programs (it should not consistently exceed 5% annually)? What are accreditors saying about our institution? Have they placed or threatened to place our institution on probation or issued warnings? Fully understand all DOE rating criteria in order to better gauge your institution's financial health.³



4 Not selling your brand to alumni and donors

5 High cash flows into new building/capital projects

6 Deferred maintenance

These signals are not new to higher education, but their impact and velocity are dramatically increasing.

² Lyken-Segosebe, Dawn, and Shepherd, Justin Cole. "Learning from Closed Institutions: Indicators of Risk for Small Private Colleges and Universities," TICUA Research, July 2013.

³ Federal Student Aid, U.S. Department of Education. "Financial Responsibility Composite Scores."

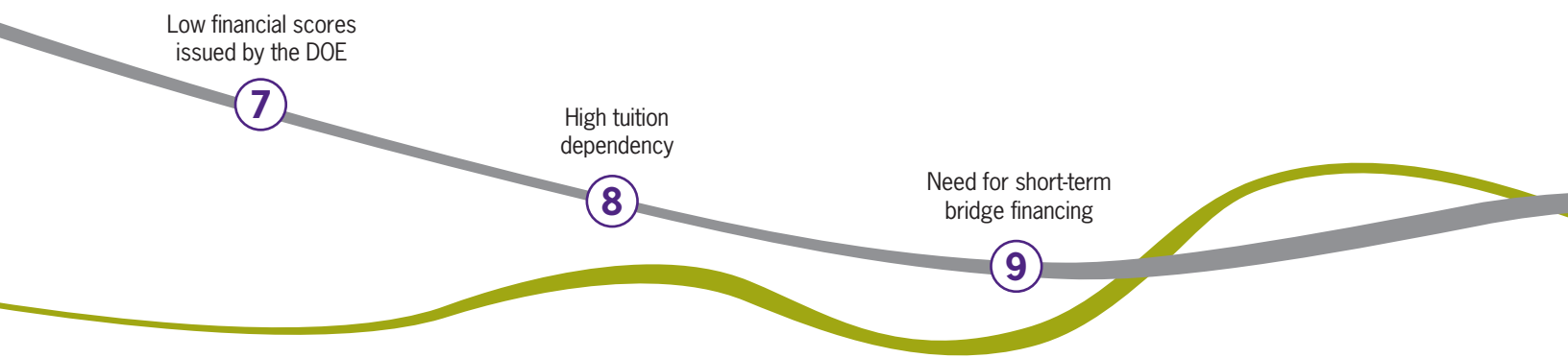
8. High tuition dependency.

Ideally, core revenues should not be primarily derived from tuition. When more than 85% of tuition accounts for your core revenue, this is a signal that the institution's operating performance, including cash flows, is highly vulnerable and sensitive to annual enrollments. This tuition dependency restricts the institution's ability to contemplate long-term investments. Given the trend of lower enrollment, higher tuition discounts and students'/parents' sensitivity to tuition costs, declines in annual tuition revenue, as compared with prior years and forecasts, should be expected. For an institution highly dependent on tuition revenue, extreme reductions in enrollment can lead to financial crisis. By the time the final size of the academic year's enrollment is confirmed, substantially all operating costs are locked-in, affording limited flexibility to align operating costs with revenues.

It should, however, be recognized that many tuition-dependent institutions have been able to consistently demonstrate strong enrollment. For these institutions, the stability of their enrollment is likely the result of any one or a combination of the following — uniqueness and strength of program offering and the cachet of their brand, alumni and market affiliations, and credentialed nature of faculty. Capitalizing on these strengths or investing to develop them is critical to the long-term success and sustainability of tuition-dependent institutions.

9. Need for short-term bridge financing.

When an institution must obtain short-term financing to fund operations in the fiscal year's last quarter, it can be an indication that tuition revenues (and cash flows) are not sufficient to cover core expenses and the institution may be in financial crisis. Other cash flow constraints can occur due to an inability to collect past-due student receivables (often caused by poorly developed policies and collection activities) or the coming due of significant unfunded investment commitments tied to alternative investment positions and related strategies to which an institution contractually obligated itself. While it is not uncommon for institutions to experience some level of cash flow strain during the summer months — giving rise to the need to borrow under lines of credit or perhaps liquidate investments on a short-term basis to provide sufficient cash flows — the underlying causes of cash flow strains during this period should be found. Even more dire circumstances may be indicated if an institution is experiencing cash flow strains at other points during the year, e.g., in late fall or mid-spring. If these cash flow strains are the cause of any of the following, your institution may be in or on the cusp of significant financial strain — intentionally aging vendor payables more than 90 days to maintain cash balances, maximizing drawings against lines of credit, borrowing from plant or quasi-endowment investment funds, concerns about funding payroll, reducing or deferring payments to retirement plans, or indefinitely postponing planned capital improvements or maintenance projects.



Recognize nonfinancial indicators of struggle

Even factors not inherently financial can exert a good deal of institutional pressure. The following is a summary of nonfinancial indicators of potential operational strains:

- 1. Lowered admissions standards** — An institution might lower its admissions standards when it is having trouble attracting students. However, lowering selectivity can affect reputation, which in turn may negatively affect enrollment, tuition and, ultimately, contributions. A defensive posture is rarely a successful one. It is wiser to elevate the brand; increase selectivity; and offer campus services, facilities and academic options to be competitive and differentiated from peers.
- 2. Reduction in full-time faculty** — Reducing full-time faculty may be a sensible measure to lower operating costs in the short term — an option attractive to institutions addressing financial challenges. Calculations must be made to avoid concurrently reducing the quality of education and faculty resources for research projects, and negatively affecting the student-to-faculty ratio.
- 3. Accreditors reconsidering accreditation status** — Any threat to accreditation status is a strong indicator of financial challenges. Cost cutting that appeared fiscally responsible a few years ago may be resulting in a lower quality of education, which puts primary mission and reputation in jeopardy.

Consider using key performance indicators (KPIs) and scorecards to assess financial and nonfinancial operational challenges, and recognize key warning signals. See in this report “Keeping strategic goals in focus through KPIs, scorecards,” by Grant Thornton’s Dennis Morrone and Mary Foster.

Each institution needs to evaluate the activities that regularly contribute to pulls on liquidity and the periods in which they occur, take a clear-eyed view as to those underlying causes and their severity, and quickly take remedial action if there is reason for concern.

10. Unsustainable program additions.

Many seemingly profitable and growing institutions have seen their margins consistently decline in recent years. One of the principal drivers of declining profitability is the desire to satiate the expanding academic needs of students. Expanding the extent of academic offerings/disciplines sometimes garners greater enrollments. However, offering additional academic courses doesn’t always result in profitable growth. In fact, additional programs at times generate losses and undermine the profitability of other, perhaps core, academic programs.

Accordingly, if your institution is in this situation, assess the number of students enrolled in these noncore programs, and the fixed and variable cost structures that complement the enrollments. Perform analysis and modeling of all peripheral academic offerings to evaluate their contribution margin or loss. See in this report “Utilizing data analytics to improve performance,” by Grant Thornton’s Mary Foster, Anthony Pember and Matt Unterman.

Historically, institutions of higher education were for the most part believed impervious to macroeconomic events. When the economy was experiencing a downturn, more individuals would return to college for higher-level degrees to better position themselves for success. When the economy was vibrant, college enrollments were strong. Today, neither scenario is a given. With educational paradigm shifts — including the emergence of the lifelong learner, convenient online educational programs and other alternatives claiming market share, unsustainable tuition hikes and the increasing cost of operations — colleges and universities are no longer insulated from ubiquitous market strains. They must take charge of their future by watching out for signs of trouble and acting decisively to keep on track.

Unsustainable
program additions

10



Delivering an informed analysis of research activities

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Since the 2008 recession, universities with considerable research programs are increasingly asked about the cost, value and mission impact of their activities. Many find it difficult to validate their responses with comprehensive data.

Universities typically have ready access to direct and indirect administrative and facility costs incurred by sponsored (externally funded) research projects. They also know the costs of the university's "share" of internal research projects — direct costs of research personnel and other expenses — not reimbursed by federal, state and private funders. For many universities, however, this is where the data flow stops. Because most universities haven't quantified the costs of the trade-offs that commonly occur (e.g., bestowing course-load release time and expanding administrative and support duties of existing staff) against the benefits (e.g., reputation, academic enrichment and commercialized revenue streams) of their research activities, they don't have a complete answer when board members, state funders and other stakeholders ask, "How much does research — both

sponsored and internal — cost the university?"

Receiving a degree from an institution perceived as more prestigious than a lower-cost option has inherent value for students. However, when many institutions are viewed as comparably prestigious, the cost of attendance becomes a deciding factor. An institution can lose competitive advantage when that cost of attendance is higher because of the cost of research activity. When research costs are not well-understood or, worse, underestimated, opportunities are missed to streamline and create efficiencies in research functions that would keep the institution competitive.

At a time when state appropriations to public universities continue to shrink and private universities are under pressure to demonstrate value relative to the cost of tuition, research costs and relevance to mission are in the spotlight. To better understand — and validate — costs, benefits and trade-offs, institutions need the right business processes to provide the data and technology systems to support the analytics.

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Capture total costs for sponsored, internal research

Most universities engage in both sponsored and internal research activities. Sponsored research projects are awarded by external competition and funded by research contracts and administrative departmental budgets that absorb unreimbursed overhead. In contrast, internal research is seldom externally funded and is supported by academic budgets for faculty salaries and academic administrative support. Both types of research typically result in some level of faculty course-load release time. Research projects are important to the institution's brand and tenure-track faculty, who engage in and publish research to achieve tenure and individual status.

Both types of research can benefit the institution in prestige and overall competitive standing. Capturing the value of this research and understanding its relationship to costs incurred are of paramount importance in order to prioritize investments in faculty and research facilities and manage tuition increases.

The process for capturing the total costs associated with these two types of research entails capturing data from two different institutional areas — the office of sponsored research projects and the department of academic affairs. Many times, universities consider only the unreimbursed costs of sponsored research as their total cost of research and have not developed the processes for capturing the costs associated with faculty release time.

Data collection is the foundation; analytics is the quantifier

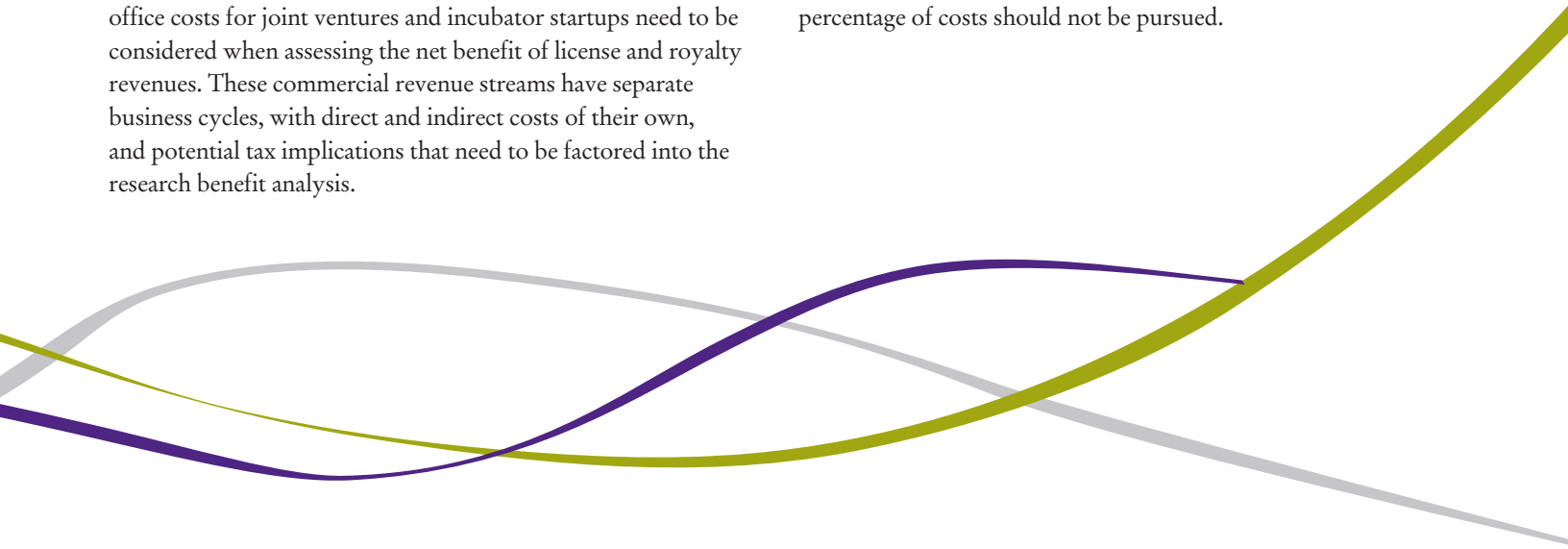
Prioritizing the cost data to be captured helps determine the best software solution, business tool and cost allocation methodology. Information needs to be extracted from various internal databases, and activity-based cost models need to be developed such that cost components are assigned to sponsored and internal research activities. Tracking and allocating the full costs of grant, contract and compliance support; preaward and contract management staff; custodial, training and technology staff; and facility management are often overlooked.

Sponsored research awards often generate license and royalty revenues, and universities cite these as benefits of their sponsored research activities. While these revenues are an ancillary benefit, the associated costs of the intellectual property commercialization efforts and project management office costs for joint ventures and incubator startups need to be considered when assessing the net benefit of license and royalty revenues. These commercial revenue streams have separate business cycles, with direct and indirect costs of their own, and potential tax implications that need to be factored into the research benefit analysis.

Analysis of sponsored research data informs decisions

Universities generally maintain a database of sponsored research projects that tracks direct and indirect costs by project, award and fiscal year, and a scorecard that tracks the number and dollar value of awards from year to year. But more often than not, there isn't data or a visualization tool that shows the year-to-year patterns of indirect cost rates (i.e., mean, medians, deviations, lowest rate and highest rate), institutional matching funds and direct grant support. Understanding the ratios and rates of funding by federal agency and science discipline in comparison to the university's research priorities can be missed.

This is where analytics can be brought in to put data collection to good use. Mining sponsored research data can reveal patterns of growth for aligning research areas with institutional strategy. Grants that do not align with strategy and do not cover a certain percentage of costs should not be pursued.



Decisions to pursue certain specialized, top secret or other investment-intensive research must be based on an understanding of support activities, which require more specialization than the typical personnel and facilities needed to conduct other research. Examples of specific support functions include certification for drug testing labs and animal care and control, single-use encrypted Internet lines, expanded institutional review board functions for conflicts-of-interest compliance, ethics training and certification, specially trained billing staff, hazardous waste compliance and certification, specialized ventilation systems, and sterilized environments. Capturing the initial investments and ongoing operational costs of these activities is critical, not only for evaluating the total cost of research, but also for developing facilities and administration indirect cost rate proposals.

In many cases, new research facilities are partially funded by leases to third parties that are conducting separate or collaborative research. Depending on the nature of the research, a portion of these third-party lease arrangements may be unrelated to the exempt purpose of the university and could have tax implications. In addition to being able to quantify the cost of research to the university, tracking direct and indirect costs of unrelated business income is important to determine deductible expenses to the IRS and other taxing jurisdictions.

Another aspect of data analysis is understanding the level of personnel costs associated with direct, indirect and research support activities. The analysis of direct personnel costs takes into account salaries and benefits. Those institutions without a federally approved fringe benefit rate can find that different benefit packages (e.g., family vs. single health insurance coverage, pension status and adjunct vs. full-time faculty) of personnel working on a grant can unexpectedly exceed the approved direct-cost budget and increase the institutionally funded share. It should be noted that an approved fringe benefit rate does not always protect the institution from unexpected project overruns if researchers use the fringe benefit budget to cover other direct expenses of the project. Often these costs are hard to track unless specific reporting systems are in place. Furthermore, analyzing salary structures across the research categories (e.g., bioengineering, computer science, health sciences, engineering, environmental sciences and psychology) and the growth or contraction by sponsored funders of those research areas can highlight opportunities for resource reallocations. For example, high cost structures in low-priority research areas that have experienced reductions in federal awards may indicate that the best use of personnel would be in instruction and not in research. The prevalence of research assistants, external collaborations and junior faculty on grants directly influences cost structures; developing insights into how to better maximize staffing across groups of related or similar grants can prove quite advantageous.



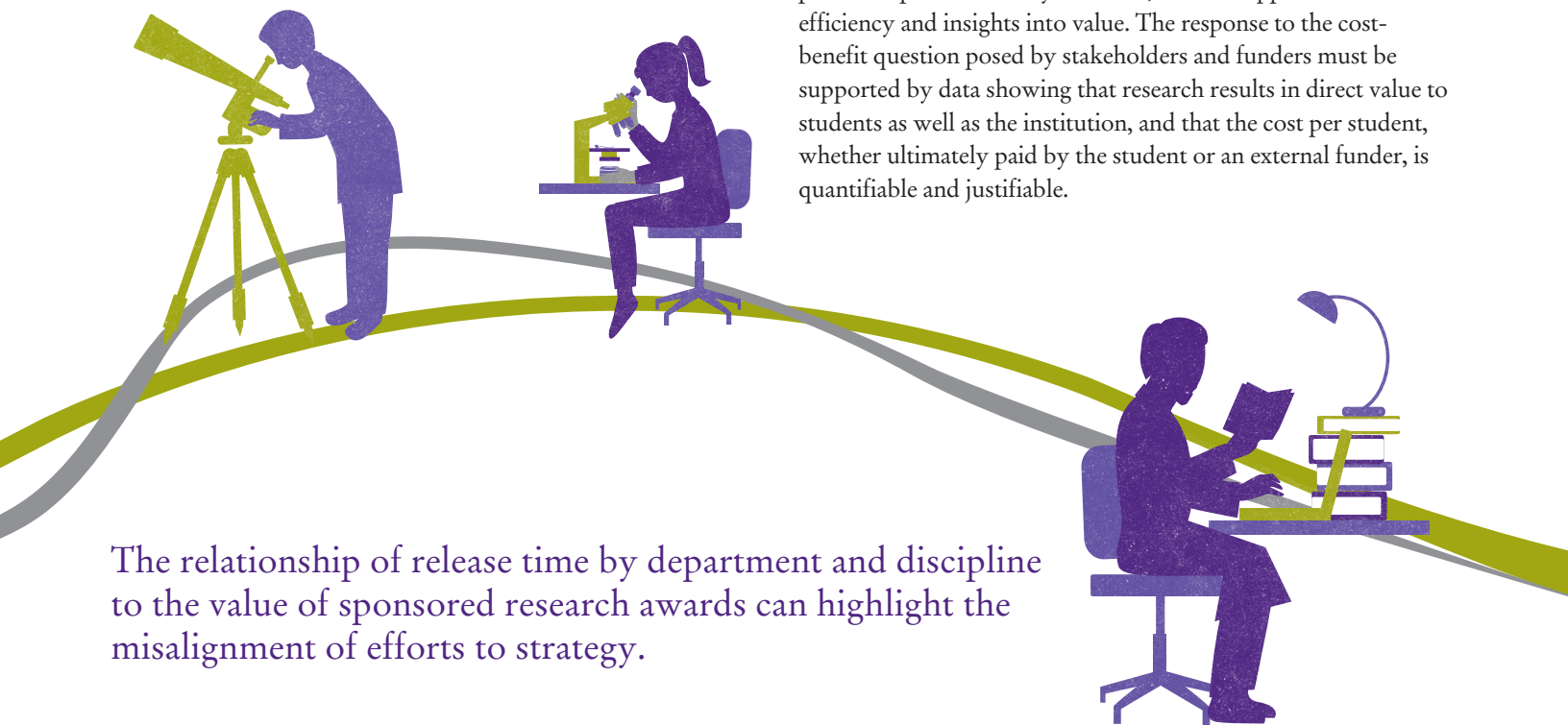
While personnel costs related to research activities can be mined from the sponsored research project systems, the impact of course-load release time needs to be obtained from academic affairs or similar systems. The relationship of release time by department and discipline to the value of sponsored research awards can highlight the misalignment of efforts to strategy. Given that research activities and grants span several years, a lost or unrenewed grant can reflect a short-term disruption to the research-teaching ratio. Enhancing the preaward and post-award planning systems can help to allocate resources in such circumstances. When faculty are entirely supported by grants and contracts, a lost or unrenewed grant will create labor charges not covered by any source of revenue. The ability to track these costs by department is essential, and faculty productivity reports are useful in identifying plans to measure faculty preaward and grant proposal efforts.

The analysis of research costs needs to assess the amount of release time given to tenured, tenure-track and nontenured faculty for internal research and service projects, as compared to externally funded research. Externally funded research raises the profile of an institution and brings a source of revenue. Internal service projects may be integral to the university's mission, as is the case for land grant institutions. These projects — e.g., agricultural sites that provide services to rural areas — can bring an enriched academic experience to students who participate in them. Some internal research may be conducted solely for the professional stature of a particular faculty member and carry with it “branding prestige” for the institution. Other internal research supports tenure-track faculty professional development for tenure, but has less institutional and student value. Most of these activities result in the reduction of teaching loads, which are then covered by adjunct or nontenure-track faculty. Insights into both the quantifiable costs and qualitative aspects of the nonteaching efforts of faculty can help universities assess their policies for course-load release and the increased costs to educate students.

The true cost and value of research

With research activities embedded in many aspects of the academic enterprise, teasing out costs is essential. A well-defined process captures not only cost data, but also opportunities for efficiency and insights into value. The response to the cost-benefit question posed by stakeholders and funders must be supported by data showing that research results in direct value to students as well as the institution, and that the cost per student, whether ultimately paid by the student or an external funder, is quantifiable and justifiable.

The relationship of release time by department and discipline to the value of sponsored research awards can highlight the misalignment of efforts to strategy.





Redefining defined benefit plans to meet challenges, improve exits

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Like their for-profit counterparts, higher education institutions are doing away with overly generous defined benefit plans to make them more affordable and less risky. They are seeking the best approaches to do so, mainly freezing their pension plans with the ultimate goal of terminating them.

After a lofty start, plans are being reeled in

Changing plans is possibly more difficult in the higher education community than in other industries, since the cultural norm has been a standard of great retirement benefits focusing on active income replacement payouts. It is still generally believed a viable leveling of the playing field with corporate America, a way to be competitive with for-profit organizations on a total compensation basis. Defined benefit plans have offered institutions an opportunity to recruit, retain and reward top talent. They gained momentum in the 1980s and continued to be a wise strategy during the 1990s, when the stock market yielded favorable results and provided growth to plan assets, helping to drive up plans' funded statuses. This minimized the need for significant contributions from plan sponsors and created a sense of security for participants and plan sponsors alike. With limited cash outflow for institutions, it was a bit of a back-burner topic for many boards and executive teams.

Moving through the 2000s, a series of events unfolded as a perfect storm. The dot.com bubble burst, stock market performance precipitously declined and interest rates were extremely low, resulting in the decline of plan financial results, thus forcing a significant increase in plan funding obligations due to regulatory requirements and basic long-term funding expectations. This was compounded by the federal government revising pension plan funding requirements, as well as the FASB issuing revised standards that updated the method for plan sponsors to calculate and report plan assets and corresponding liabilities. In the years since, many plans have experienced volatile results due to fluctuating short-term interest rates and large swings in the investment returns of the plan assets. The fiduciary and fiscal responsibilities for plan sponsors administering defined benefit plans were decidedly affected and significantly heightened through the years.

For-profit organizations and higher education institutions alike are carefully re-examining retirement options afforded their employees. With fiscal stewardship at the forefront, more institutions are deciding to close their defined benefit plans to new entrants or freeze the plan's accrued benefits. They often couple such a change with the introduction of defined contribution plans as an alternative or replacement vehicle. Defined benefit pension plans continue to evolve and shut down as a sole choice for pension funding.



Changes must balance talent attraction, fiscal reality

It is clear that with the combination of adverse and ever-changing markets and continued low interest rates, many plans are extremely underfunded. For-profit organizations have acted quickly to manage the risk of sponsorship by either transitioning plan designs to a defined contribution approach or implementing comprehensive governance structures to manage risks and keep the plan compliant. Higher education institutions have had no choice but to follow suit, with each institution making choices about financially responsible changes that will yet maintain an advantage in the competition for talent.

The varied approaches all coalesce around consistent themes — managing risk, improving funded status and reducing volatility. The IRS- and FASB-prescribed methods for determining discount rates focus on fairly short-term rates, which recently have been at historic lows and resulted in much higher plan liabilities. Observed and projected increases in life expectancies are additional factors for heightened liabilities, with pensions paid for a longer period of time than originally anticipated. In defined benefit plans, these significant risks are borne solely by the plan sponsors. Even with closing or freezing plans and employing new strategies to mitigate investment risk, plan sponsors must consider interest (discount) rate risk and mortality (longevity) risk, which are essentially outside of their control. As a result, there has been an across-the-board rise in obligation-focused investing strategies, tying the asset mix to obligation maturity. Lump sum distributions and annuity buyouts are also appearing more frequently. As your institution contemplates termination strategies, keep in mind these key points:

- **Cost of the termination** — Typically, interest rates used to determine termination liability are lower than those used for funding and accounting requirements, which can result in a liability higher than expected. Plan sponsors should not be caught off guard if the assessment of different scenarios includes significant required cash flow expectations, which can be heavily influenced by this approach. Understanding these scenarios can help to drive budgeting discussions and board member education around the potential impact.
- **Time horizon to termination** — Full funding on a termination basis is heavily dependent on the difference between the plan assets and potential termination liability. Depending on the plan sponsor's cash requirements, the magnitude of this difference will likely influence how long it will take to attain a fully funded status. Therefore, in addition to the assessment of the plan liabilities and funding scenarios, a carefully prepared company/organization cash flow, performance analysis and reserve review should accompany this decision-making process.
- **Funding strategies** — The choice is to fund the minimum under the Pension Protection Act rules or contribute at a higher level to attain full funding sooner. While the opportunity to meet the minimum funding standards is available, it is important to have a reasoned discussion relative to the long-term implications for this approach, even when the plan is well-funded or at least reporting to be “well-funded” under reduced standards.

- **Asset allocation** — Investment strategies for assets in a plan can be aggressive in hopes that earnings will help close the funding gap, or conservative to avoid possible losses that will widen the gap. Therefore, the asset allocation determination process when the objective is to sustain the plan indefinitely may be vastly different than a plan that is considering one of the termination or freezing scenarios. It is critical to adjust your investment allocations and strategies to align with the overall plan objective.
- **Risk management during termination** — Particular attention should be paid to potential accounting implications, strict PBGC filing requirements and time frames. The decision-making process benefits from the inclusion of a larger cohort of colleagues and subject matter experts with specialized knowledge of not just benefit plans, but also potential regulatory, legal and financial reporting issues, as well as ongoing administration concerns.
- **Communication with plan participants** — Communication must be transparent and constant throughout the process. In addition, the approach and language should be crafted carefully to mitigate HR issues. A best practice is including a marketing or communication expert on the team.

The reality is that the majority of frozen defined benefit plans will ultimately terminate. A carefully planned and coordinated effort will provide your institution with the greatest success and ideally, the lowest cost.

Factors to keep in mind when contemplating termination

Cost of termination

Time horizon to terminate

Funding strategies

Asset allocation

Risk management during termination

Communicate with plan participants

Accepting China's welcome to its higher education sectors

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As demand for higher education swells in China, U.S. institutions are increasingly being welcomed. They can find participation financially rewarding and mission satisfying.

They will also find that while education is still highly regulated, China is loosening some restrictions and encouraging foreign investment in order to improve overall education standards, expand offerings and train more students to meet rising employment requirements. A U.S. higher education is of great value to Chinese students, and study in the United States is especially prized. If living abroad is not possible, the next best thing is getting a U.S. education in China. With this new demographic of eager students in a fast-growing market, an enormous opportunity awaits those institutions willing to work through the regulatory and business hurdles associated with establishing a presence in China.



U.S. institutions can participate in two education sectors

The two major education sectors in China are academic education, and vocational education and training (VET). Academic education institutions are akin to U.S. colleges and universities, which are the most likely to invest in this sector because of the similarities in focus and structure. The VET sector comprises technical schools; this would be a natural fit for specialized U.S. institutions that offer focused skills development, such as computer training or English as a second language. Both sectors are governed by the Catalogue for the Guidance of Foreign Investment Industries,¹ which places heavier restrictions on academic education than the VET sector.

Academic education: A mirror of U.S. colleges and universities

Foreign investors in academic education are restricted from establishing a wholly foreign-owned enterprise (WFOE). This means that U.S. higher education institutions must find an institution within China as a partner whose brand and administrative resources can be leveraged in recruitment and delivery. Typically, the Chinese partner provides teaching venues and facilities, administrative approval and registration, recruitment and promotion. The U.S. institution provides curriculum design and faculty.

A U.S. higher education is of great value to Chinese students, and study in the United States is especially prized. If living abroad is not possible, the next best thing is getting a U.S. education in China.

² Ministry of Commerce. *Catalogue for the Guidance of Foreign Investment Industries (Amended in 2015)*, March 10, 2015.

In general, the U.S. institution has three investment alternatives:

- **Faculty placement**
The U.S. institution cooperates with its Chinese partner to establish faculty in the Chinese university. Faculty are not part of an independent legal entity and are subject to the Chinese university's administrative requirements, making this a simpler arrangement than the other two alternatives.
- **Joint venture**
The U.S. institution collaborates with its Chinese partner in creating a cooperative joint venture. Because it is an independent legal entity, a joint venture is subject to more stringent application criteria and rigorous approval procedures. But more comprehensive majors and academic programs/courses can be offered.
- **Cooperative program**
The U.S. institution provides its Chinese partner with limited curriculum and faculty that can be temporarily established for designated courses. For the U.S. institution, this alternative may be preferable because the approval procedures are relatively simple and allow greater flexibility in daily operation.

VETs: Much like U.S. technical schools

Foreign investment in VETs is unprecedentedly hot. Because the Chinese government is unable to meet increasing demand for technical job skills in such growing fields as IT and English, it has adopted measures encouraging foreign participation in this sector. The Catalogue for the Guidance of Foreign Investment Industries places VET in an “Encouraged Industries” category, meaning that a foreign investor can create a WFOE to perform VET activities and not be obliged to find and depend upon a Chinese partner. Through the WFOE, a U.S. institution can organize social activities for recruitment, networking and choices in delivery, operating as independently as in the United States. The choice can be made to offer education in China, the United States or online.

Sometimes there are local practices that investors need to follow and adopt in order to facilitate approval. For example, the wording of scope of activities on the business license is key, and working through it with local advisers and the relevant Chinese authorities can help get it approved.

Gain an informed market entry perspective

Your institution should seriously consider establishing a representative office or a service WFOE to explore opportunities or support existing operations.

- **A representative office**
This is an arm of the U.S. institution established to provide liaison and auxiliary services, which include studying the feasibility of investing in education in China, conducting market research, and acting as a liaison between U.S. institutions and Chinese parties. Setup and ongoing compliance requirements are simple, and no capital commitment is required.
- **A service WFOE**
This is a legal entity that allows activities — primarily consulting services — outside of a representative office's limitations. A service WFOE has wide applicability; i.e., it can be established to identify opportunities with more than one Chinese partner. Because it is permitted to delve into complicated matters, a service WFOE is a good choice for evaluating faculty placement or a cooperative program, both of which present complications in not being independent legal entities. Compared to a representative office, setup and compliance requirements are somewhat more complex.

Market entry research and marketing support can be performed through either of these two channels as you begin or continue your business — and mission — investment in China.

Because China is vastly different from the United States in rules and regulations, business environment, culture, local practices, and multitudes of nuances, U.S. institutions will be most successful when they obtain Chinese professional advice as they explore investing in the Chinese higher education sector.

Tax considerations when operating internationally

Over the past 10 years, many U.S. organizations have broadened their reach and expanded their operations internationally. That trend is likely to accelerate over the next several years, and higher education institutions will very much be a part of that increased pace.

As attractive as investment in education in China has become, tax rules and interpretations for foreign investors are complex. If your institution is contemplating an overseas expansion, whether in China or another country, take these points into account:



Nonprofit status

- Does the country have a charity designation?
 - Do the planned activities fall within the allowed purposes?
 - Are there capital or membership requirements?
 - Are there tax benefits to the designation?
 - Can foreign entities obtain this designation?
- Are there filing/registration requirements?
 - Do you need to file, or is your institution exempted?



Legal information

- Are you required to create a legal entity in the country of operation?



Personal benefit restrictions

- Are there legal prohibitions on granting certain benefits to your employees, such as loans, sales of assets or fringe benefits?



Tax treatment

- Will the institution be subject to income tax?
 - If tax exemption or reduction is available, does an application have to be submitted?
 - Would exemptions/reductions be available to all income or just purpose-related income?
 - Do you have to register with the tax authorities?
- Will you be subject to consumption taxes (i.e., sales, VAT) on your purchases and/or sales?
 - If tax exemption is available, does an application have to be submitted?
 - Do you have to register for collection and remission of consumption taxes?
- Will the institution be able to receive tax-deductible contributions from residents and taxpayers in the country of operation?



Fundraising

- Can you solicit contributions?
- Are there restrictions or prohibitions on fundraising events?
- Are there registration or reporting requirements?



Tax returns

- Is the institution or its newly formed corporation subject to annual (or other) filing requirements?
- Will you have to pay any estimated taxes?



Local tax

- Are there local tax practices to follow?



Fiduciary responsibilities

- Is the board or management or those overseeing the operations in the country of operation subject to specified responsibilities, reporting or disclosure?
- Has a local director been hired to facilitate operations?



Employment tax

- Have employees' tax home determinations been made?
 - Are employee assignments considered temporary?
- How should benefits be treated for tax purposes?
- Have local employees/contractors been hired?
 - What are the proper filings/withholding requirements?
 - Are there mandatory benefits?



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- Benefit plan audits
- Agreed-upon procedures

Tax Services

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- Form 990 and 990-T filing positions
- International operations
- Compensation and benefits consulting
- Revenue generation
- Unrelated business income

Advisory Services

Mark Oster
National Managing Partner
Not-for-Profit and
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- Strategic planning and governance
- Operational improvement
- IT
- Business risk (including ERM, fraud and financial data misrepresentation, and construction audits)
- Valuation
- Transaction support (including due diligence and merger integration)
- Restructuring and turnaround
- Forensic, investigation and dispute



“ We chose to work with Grant Thornton based on their national reputation in the higher education and nonprofit sectors and their broad array of technical expertise. We described our needs, and they responded with a positive and reassuring approach; they were genuinely interested in coming alongside us and helping to figure out a strategy to move us forward. They were very thoughtful about taking the time to understand our issues, culture, history and leadership.

As an organization, we're now aligned and making sustainable changes for long-term success. We couldn't have done it without the expertise and national perspective that Grant Thornton provided.”

— **Cynthia Hale**, Associate Vice President for Personnel and Budget,
University of Maryland, College Park



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