Current State of Financial Health for Private Masters and BACC Institutions

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Introduction

Our continuing interest about the financial health of smaller and mid-sized private institutions is based on our long-standing interactions with them. We often hear senior leaders of these institutions express concern about their current financial circumstances, generally driven by enrollment and cost structure issues. These leaders worry about addressing and resolving the challenges facing their institutions and higher education generally, the changing landscape of higher education, and which challenges are temporary or permanent.

According to the Carnegie Classification (Categories), there are currently 880 private institutions defined as four-year Masters and Baccalaureate institutions, excluding those defined as Special Focus. In this article, we examine the financial health of approximately 315 of these institutions from our proprietary database, providing information and analysis of their financial health and suggesting improvements or needed steps they should consider depending on the state of their financial health. While our sample is not statistical, we believe that an extrapolation to the overall population is reasonable. Our extrapolation concludes that 275 (31% of the institutions in these classifications are under significant financial stress (i.e., in poor health) and another 280 (32%) would be at significant risk (i.e., fragile health) from either a specific negative demographic event (e.g., enrollment decrease) or a significant economic downturn or negative financial event.

To further support our point regarding the number of institutions that are currently experiencing financial stress, Moody's Investor Services recently issued a Higher Education sector comment1 that places a negative outlook on higher education due to declines in enrollment patterns, with an estimate that 23% of private institutions will experience a decline in net tuition revenue in 2018. The institutions in these Classifications are very dependent on net tuition so if they are experiencing declines in the year following our review, then the pressures we see will be exacerbated.

Executive Summary and Conclusions

Our analysis leads us to conclude that the majority of Masters and Baccalaureate private institutions are in stark financial condition and under severe financial stress and duress. We see a broadening dichotomy in financial health between the wealthiest and least wealthy institutions in these Categories. This difference is reflected in their overall financial health, and their ability to produce operating margins and maintain their physical assets. The top 3 deciles demonstrated superior financial strength, operating margins in excess of the threshold value of 2%, while generally maintaining their age of facilities. The bottom 3 deciles have had operating deficits for at least the last 2 years, implying these institutions have created structural deficits (a structural deficit exists when repeatable revenues are less than committed costs), with their operating margins declining over the past 5 years. Investment in physical assets has been lower in these deciles, resulting in an age of facilities almost a year higher than the top 3 deciles. Our experience indicates that these structural deficits will grow over time, without significant management intervention, and that the intervention usually requires a fundamental reassessment of the business and academic model of the institution. Exacerbating the dichotomy between the institutions in the highest and lowest deciles is that the lowest

1 Moody's Investor Services, Higher Education: Declining Enrollment Credit Negative Due to Continued Pressure on Net Tuition Revenue, May 28, 2018

deciles are demonstrably less healthy from a financial perspective in 2017 than in 2013, with a significant decline in the CFI of almost 50%. The fiscally healthiest institutions showed stable to slight improvement in their median CFI. While the wealthier institutions generally have larger endowments, the drivers of their superior operating returns are more related to their ability to grow net tuition and other student revenues at least equal to the rate of increase in their institutional costs. Institutions in the lower deciles should likely be focused on sustainability, which is akin to survival, due to financial pressures. Students selecting an institution have a right to believe the institution they select will be viable (i.e., thriving) with investments in the programs they take, expansion in the quality of the institution and a degree that will carry weight in their future endeavors.

How We Performed Our Data Analysis

Our Data Analysis utilizes our proprietary database of over 600 public and private institutions' financial statements, including approximately 315 private institutions in the Masters (Larger, Medium and Smaller Programs) and Baccalaureate College Arts and Sciences Focus and Diverse Fields categories. The data is from audited annual financial statements for fiscal years ending in 2013 through 2017, the most recent data available.

Our Data Analysis' purpose is to assess and present our view of the overall financial health of the institutions in these combined Categories and suggest areas for the institutions' governing boards and senior management to examine. We have focused our Data Analysis to these Categories since we believe these institutions have a similar focus in their instruction programs, are very dependent on student tuition revenues, and face similar severe financial stresses, conditions and issues. While the Research and Doctoral level institutions also face some of these stresses, they have significant other revenue sources and stresses in their research and medical operations functions and activities.

Our Data Analysis assesses the 2013 to 2017 information using statistical deciles, with medians calculated for each decile. In order to use trend analysis for the same cohorts, we determined the deciles for 2017 and then placed them in the same decile cohort retrospectively. We believe that our approach has a sufficient number and breadth of institutions in these Categories to draw conclusions on the institutions in these Categories as a whole, eliminating the need for random sampling or having all the institutions in the Database.

To analyze the data, we used our proprietary tools from our publications *Strategic Financial Analysis for Higher Education, Seventh Edition* (published in 2010) and the Update to the 7th Edition, (published in summer 2016). These publications describe a framework for financial analysis and provide tools and metrics to use, including the Composite Financial Index (CFI) SM, a metric that reports an institution's overall financial health. While our framework describes and uses 25-30 ratios, our Data Analysis has focused on the CFI and its four core ratios, and two ratios that focus on physical plant age and renewal levels.

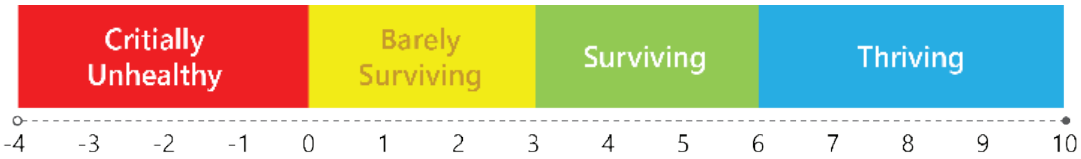
The CFI is a way for institutions to measure themselves and their progress against four key indicators of financial health: sufficiency of reserves, leverage to acquire physical assets, asset performance, and operating results. The weighting of the individual ratios that comprise the CFI emphasizes the two

balance sheet ratios - Primary Reserve Ratio and the Viability Ratio. In our 40 years of higher education finance research and analysis, we have found that balance sheet health and wealth are the greatest indicators of an institution's long-term financial health. Operating results fluctuate annually, especially for colleges that have a significant investment portfolio that is subject to market fluctuations. By emphasizing the balance sheet ratios, the CFI focuses attention on two important questions over which institution leaders have control:

- Does the institution have sufficient reserves to fund operations and cover outstanding debt?
- Is there sufficient debt capacity to accomplish institutional goals?

We have developed a scoring scale for the CFI as described in our publications. For purposes of this Data Analysis, we determined that a more simplified version of our CFI Score Chart SM is more useful.

MODIFIED SCALE FOR CHARTING CFI PERFORMANCE SM



Institutions need to assess and view their long-term financial health in terms of sustainability (surviving) and viability (thriving). Institutions with a CFI score of -4 to 0 are Critically Unhealthy and need to focus on short-term liquidity issues and consider exigency in order to survive. Indeed, some of these institutions might well question whether survival best serves their students. Institutions with a CFI of 0 to 3 are Barely Surviving (i.e., poor health), those with a CFI Score of between 3 and 6 are Surviving (i.e., fragile health), and those with a CFI Score over 6 are Thriving. Institutions that are Barely Surviving do not have sufficient financial health to be successful in attracting students and have robust program offerings, although they may continue to exist for many years, if not decades. Institutions that are Surviving have sufficient financial health and resources to re-engineer and transform the institution to have it thrive, if successful. Those institutions that are Thriving can use their resources to experiment with new initiatives and

Results of Our Data Analysis

Our overall assessment of the financial health of Baccalaureate and Masters Categories institutions is that the majority are under significant financial stress (i.e., more than half are fiscally sick or very sick). Thirty-one percent of the institutions have a CFI score of below 3, the threshold value of financial health. Of the institutions in the first decile, 16 (50%) have CFI scores below 0. Institutions in these groups (Critically Unhealthy and Barely Surviving) have also experienced a decline in their health since 2013. The financial health of institutions in the 4th through 7th deciles (those Surviving) have generally remained flat from 2013 to 2017. And the Thriving Group comprised of the 8th through 10th deciles have seen some increase in their financial health over this period. Significantly, the difference in the CFI scores between the 1st and 10th decile in 2013 was 6.3 (8.0 to 1.7) while in 2017 it was 8.4 (8.4 to 0.0), indicating that the variance between the healthiest and "sickest" of institutions is widening at a rapid rate.

Composite Financial Index	2013	2014	2015	2016	2017
Tenth Decile	7.98	8.72	7.73	6.83	8.41
Ninth	7.20	7.85	6.56	5.62	7.10
Eighth	5.75	6.63	5.72	4.81	6.42
Seventh	5.98	6.27	5.26	4.18	5.70
Sixth	5.15	4.99	4.66	3.81	4.82
Fifth	3.89	4.37	3.50	2.48	3.96
Fourth	3.00	3.73	2.84	1.98	3.07
Third	2.62	3.03	2.12	1.72	2.41
Second	2.92	1.91	1.50	0.91	1.41
First Decile	1.72	1.01	0.32	-0.18	0.00

To understand the causes of the changes in the CFI, we analyzed the four Core Ratios (Primary Reserve, Viability, Return on Net Assets and Net Operating Revenues).

The Primary Reserve Ratio compares Expendable Net Assets to Operating Expenses and represents the level of expendable equity to operating size. While 20% of the institutions consistently have levels below the threshold value of .4x, the third decile has consistently hovered around the threshold. The ratios showed a decrease in 2015 and 2016, resulting from poor or negative investment returns as indicated in the annual NACUBO-Common Fund Study on Endowments and the persistent pressures on net tuition revenues. The ratios generally increased across the deciles in 2017 due to positive investment returns.

Primary Reserve Ratio	2013	2014	2015	2016	2017
Tenth Decile	3.67	3.97	3.81	3.35	3.60
Ninth	2.46	2.68	2.98	2.45	2.65
Eighth	1.10	1.38	1.32	1.22	1.37
Seventh	1.45	1.48	1.32	1.19	1.23
Sixth	0.98	1.16	1.00	0.90	0.98
Fifth	0.65	0.79	0.75	0.64	0.73
Fourth	0.48	0.58	0.55	0.47	0.56
Third	0.43	0.51	0.49	0.42	0.44
Second	0.18	0.32	0.26	0.16	0.20
First Decile	0.30	0.27	0.14	0.06	0.08

The Viability Ratio measures an institution's Expendable Net Assets against its property-related debt amounts, with a threshold value of 1.25x indicating that the institution has sufficient equity to repay its debt, plus some cushion. This Ratio indicates that the institutions in the data analysis are highly leveraged, with 50% having scores below the threshold value. These institutions would find it difficult to borrow additional funds if needed for plant renewal, program transformation or re-engineering operations. The lowest 30% (Barely Surviving) have mostly seen declines in their Viability Ratio during the period, another indicator of the severe stress they are facing. Those institutions that are Surviving and Thriving have generally seen an increase in their Viability Ratios, caused by their investment returns and ability to generate expendable resources from operating surpluses.

Viability Ratio	2013	2014	2015	2016	2017
Tenth Decile	5.53	6.45	5.55	4.61	4.91
Ninth	2.85	3.47	3.24	3.03	3.29
Eighth	1.58	1.87	1.79	1.74	1.99
Seventh	1.82	1.96	1.89	1.55	1.73
Sixth	1.32	1.42	1.31	1.14	1.37
Fifth	0.92	1.17	1.02	0.93	1.11
Fourth	0.65	0.88	0.96	0.82	0.93
Third	0.64	0.70	0.83	0.68	0.72
Second	0.33	0.44	0.40	0.27	0.30
First Decile	0.49	0.31	0.23	0.09	0.13

The Return on Net Assets Ratio measures whether the institution is financially better off than in previous years by measuring total annual economic return. Based on the level and change in both physical and financial assets, this ratio provides the most comprehensive measure of growth or decline in total financial wealth. Those institutions that are Barely Surviving have seen a significant decrease in this ratio during the period, most often because operating losses have not been offset by sufficient positive investment returns or support. Surviving and Thriving Institutions have generally seen substantial variation in this ratio over the period with the variances principally caused by changes in their investment returns. We have added the endowment returns to this chart, as referenced by the NACUBO annual endowment study which looks at returns across a broad range of institutions, noting the negative or small investment returns in 2015 and 2016.

Return on Net Assets Ratio	Threshold value = 6.00%				
Tenth Decile	8.99%	11.66%	1.77%	-4.24%	9.32%
Ninth	7.94%	11.41%	0.87%	-4.36%	8.40%
Eighth	8.76%	11.06%	2.86%	-0.99%	9.31%
Seventh	9.24%	10.11%	1.73%	-3.39%	8.41%
Sixth	8.79%	8.03%	3.01%	-2.38%	7.08%
Fifth	8.73%	8.17%	1.33%	-1.73%	8.01%
Fourth	6.73%	8.59%	1.96%	-1.07%	6.03%
Third	7.05%	8.66%	0.57%	-1.35%	5.76%
Second	8.29%	7.65%	1.17%	-2.29%	5.34%
First Decile	6.25%	4.97%	-1.55%	-3.17%	-0.13%
Average net annual investment return	11.70%	15.50%	2.40%	-1.90%	12.20%
Median Net Annual Investment Return	11.70%	15.80%	2.20%	-2.10%	12.50%

This ratio fluctuates the most of the core ratios, and is influenced heavily by investment performance. The significant conclusion is that for most of the years analyzed, the return on net assets exceeded the threshold value of 6%, and is very dependent on investment performance.

[2]

The Net Operating Revenues Ratio reflects the annual operating surplus or deficit generated, and ignores total investment return, contributions for endowment or plant, and changes in postretirement obligations and interest rate swap liabilities. This Ratio shows that most of the institutions in the data analysis are under severe operating stress, with 50% having deficits in 2017,

2 Commonfund Endowment Study, February 2018

and 70% under the threshold value of 2.0% in 2017. The trend line is very important for this ratio, with those that are Barely Surviving showing not only declines during the period, but also several years of operating deficits. Surviving institutions have also shown a decrease in this ratio during the period, with 3 of the 4 deciles under the 2.0% threshold value, as well as two deciles showing operating deficits. These trend lines for the first 7 deciles suggest that the lower 3 deciles (Barely Surviving) have created structural deficits while the next 4 (Surviving) have operating environments with an elevated risk for creating structural deficits. The difference between these two groups is the retained wealth in the higher deciles, but structural deficits, over some period, will reduce that wealth. Each institution in this situation should examine needed changes to their operating models to staunch the lower operating results.

Thriving institutions have also seen decreases indicating that they are not immune to operating pressures, but have enjoyed higher operating returns, due to their ability to attract and retain students and maintain their net tuition revenues amounts.

	2013	2014	2015	2016	2017
Net Operating Revenues	Threshold value = 2.00%				
Tenth Decile	4.32%	5.36%	4.71%	4.06%	5.51%
Ninth	1.98%	2.27%	1.41%	0.28%	1.15%
Eighth	4.67%	3.68%	3.95%	3.18%	4.48%
Seventh	2.78%	2.09%	3.63%	0.66%	2.50%
Sixth	4.48%	-0.25%	1.38%	1.19%	-0.60%
Fifth	2.27%	2.18%	1.06%	0.90%	1.28%
Fourth	1.00%	1.49%	1.57%	0.97%	-0.69%
Third	1.01%	1.01%	-0.43%	-0.96%	-1.64%
Second	3.47%	1.27%	0.57%	0.05%	-0.18%
First Decile	0.37%	-2.26%	-2.62%	-2.97%	-4.22%

We also analyzed two key metrics related to facilities – Age of Facilities Ratio and Physical Asset Reinvestment Ratio. The Age of Facilities Ratio is a simple to calculate metric that determines the relative age of an institution's physical plant. While not as detailed or accurate as the Facility Condition Index or other plant metrics, it is easily calculated. The Physical Asset Reinvestment Ratio compares the amount spent on capital improvements versus the institution's depreciation expense (a measure of plant asset usage). When assessed together, it provides insight into not only the age of facilities, but also if the institution is maintaining and renewing its plant assets at a sufficient level.

The Age of Facilities Ratio indicates that most institutions analyzed are struggling to maintain their plant assets, as all deciles are over 14 years with 5 deciles over 15 years. This is the higher end of the range we consider appropriate for institutions in these Categories. This Ratio has increased in all the deciles, indicating that institutions are deferring some capital improvements, especially larger projects. Further assessment of the Physical Asset Reinvestment Ratio also indicates a decline in capital spending with those Barely Surviving and Surviving institutions showing the greatest decrease as they reduce their capital spending to save cash for operations.

[1] Moody's Investor Services, Higher Education: Declining Enrollment Credit Negative Due to Continued Pressure on Net Tuition Revenue, May 28, 2018

Age of Facilities	2013	2014	2015	2016	2017
	Threshold value = 12 to 14 years				
Tenth Decile	13.57	13.99	14.22	14.14	14.15
Ninth	14.30	14.77	15.58	15.59	15.72
Eighth	12.66	13.13	14.41	14.03	14.05
Seventh	13.30	14.02	14.87	15.12	14.95
Sixth	11.29	11.50	13.06	13.78	14.25
Fifth	14.30	14.37	14.50	14.56	15.59
Fourth	12.94	13.23	14.19	15.02	15.24
Third	13.79	13.59	14.27	14.62	14.80
Second	16.10	15.65	15.10	15.15	15.15
First Decile	13.76	13.85	16.09	14.98	14.91

Reinvestment of Plant Ratio	2013	2014	2015	2016	2017
	Threshold value = 1.00				
Tenth Decile	1.60	1.49	1.23	1.75	1.74
Ninth	1.41	1.20	1.34	1.33	1.60
Eighth	1.24	1.15	0.85	1.18	1.19
Seventh	1.28	1.30	1.30	1.22	1.41
Sixth	1.41	1.05	1.08	0.97	0.99
Fifth	1.63	1.37	1.15	1.02	1.13
Fourth	1.08	1.06	0.87	0.70	0.94
Third	0.84	1.04	0.83	1.02	1.01
Second	0.96	0.97	1.05	0.93	1.00
First Decile	1.24	0.94	1.13	0.75	0.66

What Institutions Can Do -Where Do They Go From Here?

We acknowledge that financial health neither necessarily implies superior academic quality or programming, nor successful student outcomes. However, lack of sufficient financial resources will assuredly negatively affect the ability of an institution to maintain existing programs, develop new programs, allow sufficient training and development of faculty and staff, and provide sufficient resources for continued upkeep of physical facilities. Each of these must have continued investment, in some balance, to ensure that the institution continues to thrive.

As noted above, the Thriving institutions would appear to be financially sound and not in crisis requiring immediate remediation. The institutions defined as Barely Surviving or Surviving need to think quickly and agilely about reshaping their institutions. We believe that the comments below apply to all institutions in varying degrees because, regardless of overall financial health, there will be continuing unabated pressure on the primary revenue source (tuition) and the financial health of even currently sustainable institutions will weaken.

Institutions often use year over year analyses as the focal point of financial conversations. The understanding of trends needs to be over a much longer time period because the year over year comparisons do not clearly define the long-term implications of the short-term trends. A case in point is that

when an incoming class has been accepted, the institution has created at least a four-year cohort, with ongoing and commensurate financial aid commitments. Another example is when a building is brought on line, the institution has accepted a 30-year (or more) operating cost obligation, even if the construction costs were funded by gifts.

Examine enrollment related trends and effectiveness of the 4 key Inter-related enrollment strategies.

Examine enrollment related trends and effectiveness of the 4 key Inter-related enrollment strategies. The board and senior leaders need to take an objective look at the financial condition of the institution. If enrollment and net tuition revenue trend lines have been negative, the plan to adjust the trend lines needs to be realistic. As an example, all institutions in this study are student revenue dependent, with some up to as much as 90% of their operating revenue sources. The management of this critical revenue source will be the primary determinant of the `institution's financial success. We add that the success of the students will be the determining factor in the overall institutional success.

Think of net tuition revenue as a four-legged stool, with each of the legs needing to be the same length as the other three or the stool will not support the sitter. The legs' same length is the balance and interactions between these four factors, which will often be in conflict with each other. Two of the "legs" are related to the student enrollment while the other two are related to the net tuition pricing. In essence, volume and rate, respectively.

The two volume-related "legs" are a) student recruitment and b) student retention. We purposefully use student recruitment instead of admissions because the process to identify and obtain students is an active, not passive process. The two rate-related legs are the overall tuition pricing strategy and the institution's discounting strategy. We firmly believe that there needs to be a discounting strategy rather than what we see in many institutions, which is solely a discount budget. These four areas require strategies and policies that are coordinated and complimentary with each other, extending to allocating resources to ensure that each policy (stool leg) works with the others (same length). If not, the stool will not be balanced and supportive of the institution's mission and goals.

Examples of ways these four factors may get out of balance with each other and not work together holistically include:

- If recruited students are academically or emotionally unable to meet the rigors of the institution, retention will suffer; expanding student enrollment and perhaps lowering standards will require greater resources to retain those students through academic mentoring, career counseling, student support and such.
- If pressure to fill the classes is so great that unaffordable discounts are offered, net tuition will not meet institutional needs; the institution's tuition pricing strategy should be questioned since significant discounts are required to meet enrollment goals, as well as student retention may be affected.
- If discounts are too low, recruitment will suffer, which may also result in lower student quality to make enrollment goals.

Our experience indicates that if an institution plans on increasing enrollment at the same time it is reducing its discount rate, success is likely dependent

on selected programs that, by reputation and performance, can command higher net pricing. It is unrealistic to assume that traditional programs that created the need for greater discounting will sustainably allow for a reduction in those discounts while simultaneously attracting more students.

When designing a plan to create sustainable increases in net tuition revenues, a potentially successful recruitment plan needs to consider at least the following factors:

- Viability and marketability of existing program
- Regional and national interest in the programs the institution is investing in
- The economic factors affecting primary recruitment areas.

Each of the four strategies need to be explicitly defined as to their individual goals and objectives, as well as how they interact and support the other three strategies, including addressing their inherent conflicts. Changing any of the four strategy legs needs an explicit statement as to which programs will attract more students, where the students will come from, and the rationale why potential students would select this institution instead of a competitor. Assessing how well each of the legs is working with the others is a continuous process of self-examination, feedback and subsequent change. It is difficult, but required.

Compare the relationship between net tuition revenues and the direct cost of instruction.

Compare the relationship between net tuition revenues and the direct cost of instruction. Often, we see studies that examine various institutional costs against selected peer institutions. These studies are important to understand overall strategy, but are incomplete because they do not consider the affordability within the institution. As an example, assessing the cost of instruction will generally include comparisons of compensation and benefits to other institutions, assessments of how many courses professors teach, and an attempt to reduce under-enrolled sections of courses.

The issue with these analyses is that they ignore the affordability of the overall program. Based on our experience, if the direct cost of instruction exceeds about 35% of net tuition revenues, and the is more than 70% tuition dependent, there is a high degree of likelihood that the institution will generate structural deficits, unless there is under-investment in other areas. This is primarily due to the need to incur positive margins to cover plant, compliance, student services and other administrative costs.

A comparison of net tuition revenue per credit hour to net direct cost per credit hour will highlight affordability issues. This analysis leads to an understanding of under-enrolled majors, costs of course releases for faculty, underutilization of facilities, etc. Often under-enrolled sections will need to be held because the section is part of upper level major's program and the course must be held if the student is to complete the required course of study on time.

This usually results in a disproportionate allocation of resources to a small portion of the student base, likely impairing the ability of the institution to invest in program renewal that affects more students.

Review programs offered with numbers of graduates by program, and compare current programs to current and future market trends.

Review programs offered with numbers of graduates by program, and compare current programs to current and future market trends. In order to attract a wider range of students, many institutions over a long period of time have added major programs, as well as graduate and certificate programs. Most have been quicker to add than to delete offerings, leading to unaffordable institutional scope creep. The number of programs supported, over a long-term historic horizon (e.g., 30 years in 5-year increments) would help understand how resources are deployed. Should the trend in average enrollment by program demonstrate significant declines in many programs, resources are fragmented, adding to the institutional financial burden.

A part of this analysis would be the number of students graduating from each of the programs, correlated to national or regional interest in the discipline to understand whether some program modification or marketing could cure the lower enrollment, or if the lower enrollment is a result of waning interest in those programs.

We would expect some disparate graduation rates from the most popular to least popular programs, but if a handful of the majors graduate most of the students, the resource allocation model is distributing resources to service a disproportionately small number of students. However, beyond the financial implications of under-enrolled programs, the institution must challenge whether the same small number of students being taught all their upper level courses by the same few professors is good pedagogy.

Assess overall investment in physical plant, including changes in square footage per student

Assess overall investment in physical plant, including changes in square footage per student. When institutions begin to see fiscal difficulties, the level of maintenance of existing facilities tends to diminish. However, even in fiscally thriving institutions, over the years there has been an explosion of investment in capital that exceeded the growth in student enrollment. Student life has changed dramatically to meet the demands of a very different student base than 30 years ago in terms of living quarters, dining options and incremental facilities for recreation, gathering, and counseling. Emphasis on sciences requires more lab space with up-to-date equipment. Use of academic facilities has narrowed the effective academic week to require expanding classroom space to accommodate students and faculties in a smaller window of teaching hours.

A useful analysis is a comparison of square footage per student (full time equivalent or FTE) in 5-year increments over at least the last 30 years. Our experience indicates that there has been a dramatic increase in the square footage per student, which has added substantially to the operating costs of the institution, even in an environment where some maintenance has been deferred (which would be a further cost add-on).

Create a long-term financial plan correlated with a priced strategic plan, and examine financial viability for at least the next five years.

Create a long-term financial plan correlated with a priced strategic plan, and examine financial viability for at least the next five years. As stated previously, institutional business models need to match the student cohorts, and trend lines require longer-term views than are afforded by annual operating budgets. The best opportunity to provide changes occurs when

there is a clear understanding of where the institution will be if existing trends continue. The opportunity to provide substantial and meaningful intervention is when the planning horizon extends forward at least 5 years, and includes synchronized capital and operating budgets with operating budgets being on an all funds basis.

Virtually all institutions have invested substantial time in developing a strategic plan. Generally, those plans are focused on creating a bold new future that will redefine or better define the institution. However, few plans include estimates of the financial resources (and sources of those needed funds) necessary to carry out the plan, and in many cases the annual budget process is not connected to the strategic plan.

If the strategic plan drives the allocation of resources, the institutional focus would be clearer and there would be greater assurance that the amounts spent are moving the institution toward its goals more efficiently.

Consider whether the best option for the institution is to affiliate with other institutions.

Consider whether the best option for the institution is to affiliate with other institutions. After examining the institution's current financial situation, its current strengths and forecasting a reasonably achievable future that considers both internal and external factors and challenges, the most rational next step may be to find partners to forge alliances that preserves the promises to existing students and ensures that future students will have the opportunity to experience what is best about the institution.

Our analysis indicates that 30% of the Masters and Baccalaureate institutions are under significant financial pressure (Barely Surviving). The trend lines have been declining for the past five years and there is no reason to believe that there will be any abatement of the external pressures these institutions face. Another 40% are currently in reasonable, but not superior financial position (Surviving). These institutions, generally experiencing stable financial condition and operations, are subject to the same external pressures but will have difficulties finding the resources to allow a transformation of the institution so they can move to a higher financial footing. Continuing current trends will move these institutions to lower levels of financial health over time. And a sudden downturn, whether in investment markets, philanthropy, or continued operating budget revenue sources, indicates that these institutions will not be able to maintain their status quo and current levels of financial health.

Considering the various forms of affiliations and potential partners is a time-consuming and lengthy process, and should be addressed while the institution still has reasonable levels of financial health, versus when facing crises in cash shortages and liquidity shortfalls.

Our Final Observations

The pressures and challenges Masters and Baccalaureate institutions face represent permanent trends. Many of these challenges, such as the available pool of potential applicants, are beyond the control of the institution. However, the challenge to the institutions, from the board of trustees to senior leadership, is to create a plan that responds to the issues. The beginning point for that response is a clear understanding of the current situation. A realistic view of a course of action that has attainable goals and a specific plan with expected outcomes should logically follow.

For the lower 3 deciles of these institutions (Barely Surviving), the data clearly suggests that, regardless of the specific path chosen, the actions will need to be dramatic as changes at the margins have likely already occurred. However, actions at the margins do not represent enough of a solution to the issues that exist. These institutions require bold leadership and commensurate actions to move to improve their financial health and ensure their long-term survival and prosperity.

For institutions in the 4 middle deciles (Surviving), there needs to be investments in transforming the institution to allow growth of the institutional mission through academic programming with the expected result of financial health improvements. For the Thriving institutions, or the higher 3 deciles, deploying resources to compete in the future state are appropriate to ensure continued viability.

About the Authors

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