‘Strategic Finance’ for Colleges:
Looking Beyond the Bottom Line

Administrators and trustees at some colleges are expressing new interest in a “strategic finance” approach to restructuring and planning.

Simply put, strategic finance involves rigorously identifying the full expenses of programs to gain a complete picture of their costs—including indirect costs (like utilities and marketing) that are rarely quantified to that scale.

With that information, an institution or system can better identify where costs might be out of line and where to invest to take advantage of new opportunities, untapped demand, and, in the best tradition of the academic mission, societal need. Large public institutions in Indiana, South Carolina, West Virginia, and Wisconsin, as well as many private institutions, have already taken the plunge.

The general level of financial analysis by colleges is still relatively unsophisticated—privately, one expert calls it “primitive.” Any movement that pushes institutions closer to actually adding up the direct and indirect expenses of the programs they offer is a good first step toward understanding what makes higher education’s spiraling cost model so unsustainable.

“It’s absolutely going to force a lot more attention on what we can afford to do,” says Jane V. Wellman, executive director of the Delta Project on Postsecondary Education Costs, Productivity, and Accountability. She has been pounding the table for this sort of truth-in-spending approach for years.

She sees strategic finance as a tool that will not only help institutions identify the “barnacles that go along with the academic costs” (the rising expense of benefits, for example) but also help rein in the many “trophy-building exercises” that fuel the rise in college costs.

Some of the biggest offenses: chasing higher rankings by buying students with merit aid, or a loftier research pedigree by hiring star professors who don’t teach.

More clarity, contends Kent Chabotar, president of Guilford College, could even strengthen the case for continuing so-called unprofitable programs and using (diminishing) cross subsidies to support programs that fall within the institution’s mission-guided strategic priorities.

Those subsidies will be “easier to justify because they’ll be out there,” he says, even as he allows that people “might be ticked” when they understand which programs receive support.

FROM THE CHRONICLE OF HIGHER EDUCATION AND THE CHRONICLE OF PHILANTHROPY
More than a year after President Obama proposed eliminating the bank-based system of distributing federally subsidized student loans and giving the savings to education, the measure is now law.

Yet for all the drawn-out battle over the landmark student-loan bill, the measure will result in limited gains. It will provide only a portion of the money the president had sought for some of his key higher-education goals.

Pell Grants, the government’s main aid program for financially needy students, got billions of dollars less than expected. Community colleges, seen by the president as key to his hopes for a broad expansion of college attendance and graduation rates, also got a fraction of the intended amount. Other programs fared even worse in the final legislative compromise.

Nonetheless, administration officials say, the crucial fact is that, at a time of severe economic stress, college has become more affordable for millions of students.

The new law ends a decades-long debate over the best method for the government to deliver its low-interest student loans. It terminates a complicated system of subsidizing private loan companies in favor of the Education Department’s method of distributing the money directly to colleges and students.

Savings from the switch were originally estimated at $87-billion over 10 years. The bill, in the version that first passed the House of Representatives last September, would have given most of that money to education programs, primarily the Pell Grant, but also historically black colleges and other minority-serving institutions, community colleges, and a grant program to help states and institutions improve college-completion rates.

In the end, the compromise legislation provided less than half that much money—about $43-billion—for spending on education programs. Most of it, $36-billion, is going to bolster the Pell Grant. The largest additional chunk, about $2.5-billion, has been allocated to minority-serving institutions.

Even though the Pell Grant program is the overwhelming beneficiary of the student-loan law, it remains unclear just how far the budget increases will go toward achieving the broad goal of expanding access to college.

The need for the aid is growing rapidly, as more students enroll in college and more people become eligible for the grants in a struggling economy. In the 2008-9 academic year, the government spent $18.3-billion delivering Pell Grants to about 6.2 million students. By the 2010-11 academic year, it expects to spend nearly twice that much, $32-billion, on 8.4 million students.

At the same time, more than a third of the Pell Grant money will be used to cover past shortfalls in appropriations for the program, rather than for future increases.

As a result, the maximum Pell Grant award, set at $5,550 for 2010-11, will remain at that level for the following two years.

It will then increase by the rate of inflation in each of the next five years. Mr. Obama had asked for 10 years of annual increases at a rate of inflation plus one percentage point, which would have brought the maximum value to an estimated $6,900 by 2019-20, or about $1,000 more than the law will now provide.

Even so, colleges and students cheered the increases the law does contain for the Pell Grant and the effort to make sure the maximum Pell award at least tries to keep pace with inflation.

Private colleges are spending more on grant aid than ever before. After years of stability, the average tuition-discount rate for full-time freshmen entering college in the fall of 2008 rose to 41.8 percent, up from 39.1 percent in the previous academic year.

Those numbers come from a survey by the National Association of College and University Business Officers. A college’s discount rate is the difference between what students actually pay to attend and the institution’s sticker price.

Several factors account for the average rate’s increase in 2008, the business officers’ group says in its “2009 Tuition Discounting Study Report.” The recession cut into families’ ability to pay for college at the same time that many institutions were facing extra pressure to keep enrollment levels stable. Those economic stresses combined with an already competitive student recruiting environment to drive up institutional grant awards.

“These increases in discount rates, however, have come at a high price for many private colleges,” the survey’s authors wrote, and institutions “had to implement salary freezes, hiring freezes, staff reductions, and other cost-cutting measures in order to increase their spending on institutional grants.” Net tuition revenue fell 2 percent from 2007 to 2008, according to the survey, as discount rates outpaced total gross tuition and fee increases.

Nacubo collected data from 355 private four-year colleges for the latest report. The survey looks at tuition for first-time, full-time freshmen. The average discount rate jumped rapidly from 1990 to 2002, rising from 27 percent to 39 percent. But rates had been stable since 2002, hovering around 38 percent.
College enrollment continues to rise, and student aid along with it. But graduation rates have remained level.

That’s the latest news from the U.S. Education Department’s statistical arm, drawing on data just released for 2008. About 57 percent of first-time, full-time students pursuing bachelor’s degrees at four-year institutions completed their degrees within six years at the colleges where they had begun their studies. That’s the same rate as in the 2007 data, the National Center for Education Statistics reported in an analysis drawing on a series of surveys.

About 52 percent of students graduated within five years, and about 36 percent graduated within four years, the surveys found.

The center collected data from the more than 6,600 institutions nationwide that are eligible for federal student aid under Title IV of the Higher Education Act. The data cover students who began seeking degrees in 2002 at four-year colleges and those who started at two-year institutions in 2005.

Disparities in graduation rates existed among students who attended private nonprofit institutions and those who attended public institutions.

Private nonprofit colleges had the highest graduation rates. About 65 percent of their students graduated in six years. At public colleges, the average rate was about 55 percent. At private for-profit colleges, the rate was about 22 percent.

Women were more likely than men to graduate within four, five, or six years at all institution types except private for-profit colleges.

Seventeen percent of men at those institutions graduated in four years, compared with about 12 percent of women. About 20 percent of men graduated within five years and about 24 percent within six years from for-profit institutions, in contrast to women, whose graduation rates there were about 15 percent and 21 percent in five and six years, respectively.

College enrollment again grew across the board in 2008, with a total of 19.6 million undergraduate and graduate students enrolled in Title IV-eligible institutions.

About 62 percent of those students were in four-year colleges, 36 percent in two-year colleges, and 2 percent in institutions with degree programs lasting less than two years.

About 76 percent of first-time, full-time students received some form of financial aid for the 2007-8 academic year, up from about 73 percent the previous year, the department reported. The increase was spread fairly evenly across higher education, but the for-profit sector saw the biggest jump.

The full 71-page report, “Enrollment in Postsecondary Institutions, Fall 2008; Graduation Rates, 2002 and 2005 Cohorts; and Financial Statistics, Fiscal Year 2008,” is available as a PDF file at:

Conflict-of-Interest Policies for College Boards Vary Widely

Trustees are a college’s ultimate decision makers. Whether approving a building project or directing endowment money, they can affect everyone on the campus. But what happens when a trustee also has a business relationship with the institution?

An investigation of 618 private colleges and universities by The Chronicle of Higher Education found that one in four have financial ties with trustee-affiliated companies. The relationships are common at both small liberal-arts colleges and large research universities. The connections, ranging from a few thousand dollars’ worth of business to multimillion-dollar contracts, involve banks, law firms, construction companies, and insurance conglomerates.

About 90 percent of college governing boards have conflict-of-interest policies, many of which forbid members to vote on matters in which they have personal stakes. The Internal Revenue Service requires colleges to disclose potential conflicts on their tax returns, a stipulation designed to promote transparency and discourage abuses. But how conflict-of-interest polices are written varies widely, as does the level of disclosure in tax forms. Some colleges name names and give dollar values for those relationships, while others provide only boilerplate statements.

Conflicts involving boards have caused hand-wringing in some higher-education circles for decades, particularly when a scandal flares. Where to draw the line remains murky. What happens if the college decides to fire a trustee’s company? How does the board publicly disclose the financial relationship? Should the trustee be recused from board meetings at which the company’s contract is discussed? Is the company’s fee fair, and can the board properly vet the amount? Is the trustee’s primary loyalty to the college—or to his or her own business interest?

Some experts draw a bright line. Richard P. Chait, a professor who studies college governance, says colleges should almost always avoid doing business with trustees’ companies. If a company offers a deal that a college simply can’t pass up, then the trustee involved should probably be asked to leave the board. Taking a casual view of trustee conflicts “is exceedingly ill-advised,” Mr. Chait says. “It doesn’t set the right ethical tones.”

Colleges have long courted financiers as board members, for good reason. Investment bankers often donate big money, and they can offer free advice and access to the invitation-only world of high-end investments. But dozens of colleges go further, according to tax documents, investing with firms that have ties to trustees.

In the economy’s boom years, many colleges clamored to cash in on the strong returns of hedge funds and other alternative investments, and trustees with connections helped pave the way. But such funds were hit hard in the recession, and colleges’ relationships with trustees who are investment bankers now look more dubious.

Another problem stems from how secretive private investment firms can be about their business. Hedge funds in particular are subject to less regulation than conventional investments are, and generally don’t have to account for where their money goes or how they perform. In addition, hedge funds are typically not liquid, meaning that colleges cannot easily gain access to their assets. That lack of flexibility can compromise a board’s ability to make investment decisions.

Boards should proceed with “great care and consideration” when weighing whether to invest with a trustee-affiliated firm, says Richard D. Legon, president of the Association of Governing Boards of Universities and Colleges. The AGB singled out investments for extra attention in guidelines issued last year on trustee conflicts.

Where possible, Mr. Legon says, boards should avoid trustees’ firms when looking for investment opportunities. “There are ways to access that talent” beyond the board, he says.

Colleges and board members alike are generally unwilling to make public many details about their financial relationships with trustees’ companies. In most cases they let tax forms do the talking.

And the forms don’t say much. The brief statements in those documents describe common methods of minimizing conflicts, such as prohibiting given trustees from participating in meetings where the investments in question are discussed.

The number of institutions that allow business relationships with trustees is on the rise, hitting 56 percent compared with 46 percent two years ago. That’s a finding of the latest endowment study from the National Association of College and University Business Officers and the Commonfund Institute.

One institution ahead of the curve is Washington and Lee University. New trustees there receive detailed training, including a 56-page primer with case studies describing their legal responsibilities. Trustees are regularly reminded to avoid conflicts of interest and to disclose any business and financial relationships with the university or its affiliates.
Small academic programs offer benefits, like an intimate environment and a focus for scholarship. But as the recession wears on and colleges keep looking to cut costs, some programs’ small size may put them at risk of extinction.

Many colleges have lots of these potentially endangered species, an analysis by The Chronicle of Higher Education has found.

For example, at a majority of colleges examined, at least one-quarter of all academic programs each awarded no more than seven bachelor’s degrees in 2007-8, the most recent year for which data are available.

To be sure, colleges can point to good reasons for maintaining smaller programs. Some, like mathematics and philosophy, offer general-education courses that students take to satisfy distribution requirements. Those enrollments can well exceed the number of students majoring in those fields.

And cutting some small programs would not necessarily save money. Small programs do not always have their own departments and staffs. Often a single department can oversee multiple academic programs.

The number of degrees awarded is only one of many factors that colleges and universities should consider when weighing the value of a program, says Robert C. Dickeson, a higher-education consultant and former college president. Another factor is the opportunity for a small program to grow.

There is also the attraction of a diverse course catalog. Admission officers often argue that a greater variety of academic courses will help to draw students, Mr. Dickeson says—even though, he adds, that idea is not well supported by evidence.

“On every campus I visit, there are programs listed on the books and on their Web site, and there’s no one enrolled in them,” he says.

Increasingly, though, programs with small numbers of degrees face scrutiny and possible cuts. With that in mind, The Chronicle of Higher Education examined U.S. Education Department data on degrees awarded in 2007-8 to identify institutions and programs that produce few degrees.

Data on degrees awarded in 2007-8 came from the annual Completions survey of institutions, which is carried out by the U.S. Department of Education’s National Center for Education Statistics and is available from the center’s Integrated Postsecondary Education Data System, or IPEDS.

The Chronicle chose to define a small program as one that awarded seven or fewer bachelor’s degrees. That cutoff was derived from an Education Department taxonomy covering 377 disciplines called the Classification of Instructional Programs. The large majority of programs in that group bestowed more than seven degrees, on average.

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Using that cutoff, The Chronicle examined data on a total of 1,187 institutions categorized as research, master’s, or baccalaureate arts and sciences by the Carnegie Foundation for the Advancement of Teaching.

In reporting data, universities may omit academic disciplines in which they awarded no degrees. And the data include degrees awarded by colleges as first or second majors.
Making Entrance Tests Optional Involves Shades of Gray

When a college stops requiring standardized admissions tests, no rainbow magically appears. Its endowment doesn’t grow. Its costs don’t shrink.

Nonetheless, tales of going “test optional” often have a romantic tinge. In them, admissions deans, worried about equity and anxious teenagers, decide to do the right thing by casting off those terrible tests. After that, everything on the campus improves.

Another reading is that competition alone compels colleges to drop their ACT and SAT requirements. In this rendering, colleges care more about their image than anything else.

In fact, the decision typically melds various motives, arising from a place where marketing and mission overlap. Data often drive a change of heart, but numbers alone don’t always explain why—or when—a college alters its testing policy. Over the last decade, dozens of private liberal-arts colleges have done so.

But going test-optional is not piece of cake. So Angel B. Pérez tells his colleagues at conferences. “It takes a long time to get your procedures together,” says Mr. Pérez, director of admission at Pitzer College, in California, which stopped requiring admissions exams in 2004.

Although news accounts often refer to a monolithic “test-optional movement,” such policies are as different as colleges themselves. Pitzer, for instance, does not require test scores from applicants with a 3.5 grade-point average or above. Those with lower grades may submit a graded math exam and a graded English paper in lieu of ACT or SAT scores.

Mr. Pérez believes the option is good for students, but it presents his staff with various challenges. For one, the policy requires them to collect all those high-school exams and papers, coordinate with professors who volunteer to evaluate the work, and then factor those evaluations into their admissions decisions.

Moreover, many admissions databases weren’t built with test-optional policies in mind. So when a college downloads a student’s information via the Common Application, for instance, it might receive test scores that the he or she doesn’t want that college to evaluate. This means admissions officers must double-check to make sure that they are complying with each applicant’s wishes.

To remove a test score from an evaluation is to remove a common reason to admit or deny a student. “Philosophically, we love that,” says Mr. Pérez. “But it actually makes selecting a class far more difficult.”

While the debate over admissions tests involves big, philosophical questions about fairness and aptitude, obstacles to going test-optional often involve practical concerns, like the number of chairs in an office. A move to more-holistic evaluations of applicants might require additional staff members, more space, and new marketing materials. In other words, things that cost money.

Over the years, Robert A. Schaeffer, public-education director at FairTest, a nonprofit group, has consulted with hundreds of admissions officials about their testing requirements. Recently he has worked with a few colleges where, he says, officials are already convinced of the benefit of going test-optional. “The challenge is getting it to be a priority,” he says. “The thing we’ve heard during the economic downturn is that the decision makers on admissions policy have bigger things to worry about, like yield and deposits.”

Some Students’ Papers Are Uploaded to Bangalore to Be Graded

Lori Whisenant knows that one way to improve the writing skills of undergraduates is to make them write more. But as each student in her course in business law and ethics at the University of Houston began to crank out—often awkwardly—nearly 5,000 words a semester, it became clear to her that what would really help them was consistent, detailed feedback.

Her seven teaching assistants, some of whom did not have much experience, couldn’t deliver. Their workload was staggering: About 1,000 juniors and seniors enroll in the course each year. “Our graders were great,” she says, “but they were not experts in providing feedback.”

That shortcoming led Ms. Whisenant, director of business law and ethics studies at Houston, to a novel solution last fall. She outsourced assignment grading to a company whose employees are mostly in Asia.

Virtual-TA, a service of a company called EduMetry Inc., took over. Its aim: to relieve professors and teaching assistants of a traditional and sometimes tiresome task—and even, the company says, to do it better than TAs can.

The graders work for EduMetry, based in a Virginia suburb of Washington. But they are concentrated in India, Singapore, and Malaysia, along with some in the United States and elsewhere. They do their work online and communicate with professors via e-mail. The company advertises that its graders hold advanced degrees and can quickly turn around assignments with sophisticated commentary because they are not juggling their own course work, too.

Whether Virtual-TA is that better way remains to be seen. Company officials would not say how many colleges use the service and acknowledge that the concept of anonymous and offshore grading is often difficult for many colleges to swallow.
Earlier this year, lawmakers in Nevada approved a 6.9-percent midyear cut for higher education. It came on top of a 24-percent cut in state funds the system had already been dealt in last year’s budget session.

As a result, Nevada universities are preparing to close colleges, departments, and programs. Demoralized professors are fleeing the state. Thousands of students are being shut out of classes at community colleges. And the worst may be yet to come, in Nevada and elsewhere.

Shortfalls in California, which faced the largest budget gap in the nation this year, have grabbed much of the attention as tens of thousands of students were turned away from public colleges and tuition rose by more than 30 percent. But other states’ public higher-education systems are getting hit just as hard or harder.

A handful of states have been spared the brunt of the recession so far, providing an opportunity for them to improve their national standing in terms of higher education. Leading those states by far is North Dakota, whose higher-education system has seen an 18.5-percent increase in state funds over the past two years.

Among other states that have been spared the deep budget cuts in higher education seen across the country are two, Arkansas and West Virginia, that also want to improve their public universities’ standing. They rank 49th and 50th, respectively, in the proportion of residents age 25 and older with bachelor’s degrees, according to the Census Bureau.

And Texas has set its sights on creating the nation’s premier higher-education system. It is setting aside hundreds of millions of new dollars to bolster the research and prestige of its universities.

Elsewhere, the outlook is bleak. Utah saw the biggest percentage drop in state general-fund spending over the past two years, while also facing one of the fastest projected growth rates in high-school graduates. Arizona’s budget gap was nearly as large as California’s, by percentage of its general-fund budget, and it is facing much faster growth in its traditional college-age population. Florida, too, is seeing rapid population growth and big drops in state spending that have resulted in large cuts in higher education.

In Colorado federal stimulus dollars have made up close to one-fifth of the total state budget for higher education in 2009 and 2010 combined, making the state the most heavily reliant so far on that temporary pot of money for financing higher education. Illinois is facing a cash-flow crisis, with the state last month falling more than three-quarters of a billion dollars behind in budgeted payments to its colleges. Over the past five years, Rhode Island, South Dakota, and New Jersey have seen the fastest drops in state higher-education appropriations per full-time-equivalent student.

State spending on higher education has already been declining, in terms of the proportion of state budgets spent on public colleges and the proportion of college budgets that come from the state, and generally has not kept pace with enrollment growth and inflation over the past several decades. The recession has only exacerbated the trend. It has been so deep and lasted so long that many fiscal analysts say it could be years, if ever, before state spending on higher education rebounds to anything close to previous levels.

Other budget pressures on states, including growing Medicaid rolls, increasing pension liabilities, and escalating prison costs, are only intensifying. In many places, politicians and their constituents adamantly oppose increasing revenues through new taxes. And even when the economy does begin to bounce back, state revenues typically lag in their recovery by at least two years.

Where will those trends leave public higher education? Some college leaders say institutions’ base lines of state support will simply be reset to lower levels, with the new fiscal reality leading institutions to narrow their missions, limit course offerings, and require students to pay increasingly greater shares of the cost of their education. But other college experts worry that, without more-fundamental changes in how institutions operate, the budget trends that have been accelerated by the economic downturn of the past two years will lead public higher education down a path to mediocrity.

### Boston Rethinks Payments in Lieu of Taxes

A panel named by Boston’s mayor has been debating a proposal to standardize the agreements under which colleges and other nonprofit organizations make payments in lieu of taxes.

In the current system, each institution negotiates its own agreement with city officials, an arrangement under which some institutions’ payments are considerably more generous than others.

The panel, which has been at work for more than a year, is set to recommend that nonprofits pay 25 percent of what they would owe if they were not tax-exempt.

Colleges say the increased payments could lead to layoffs, higher tuition, and a decline in the number of students willing to pay more to study in Boston. But city officials say colleges could cover part of what they would owe by developing programs to benefit residents, such as scholarships for city students.
The Humanities Really Do Produce a Profit

Robert N. Watson, a professor of English at the University of California at Los Angeles, recently took strong exception to statements by the university’s president, Mark G. Yudof, about higher-education finances. Following are excerpts from Mr. Watson’s essay in The Chronicle of Higher Education:

The humanities—philosophy, art history, English literature, Slavic languages, musicology, and the rest—are quaint, elderly relatives that the real, serious, modern university (consisting of technological researchers and the professional schools) subsidizes out of charitable tradition but has trouble pampering during difficult times.

The president of my university, the University of California, made that clear on national television not long ago: “Many of our, if I can put it this way, businesses are in good shape. We’re doing very well there. Our hospitals are full, our medical business, our medical research, the patient care. So, we have this core problem: Who is going to pay the salary of the English department? We have to have it. Who’s going to pay it in sociology, in the humanities? And that’s where we’re running into trouble.”

President Yudof probably meant no disrespect when he identified us as the “core problem” of the budget crisis, and maybe I’m mistaken to hear more resignation than enthusiasm in the assertion that an English department is “trouble” that you nonetheless “have to have.”

But he is mistaken about the economics—and you probably are, too. As Jane Wellman, executive director of the Delta Project on Postsecondary Education Costs, Productivity, and Accountability, said in a New York Times article last fall, English students usually generate a profit. “They’re paying for the chemistry major and the music major. ... The little ugly facts about cross-subsidies are inflammatory, so they get papered over.”

According to spreadsheet calculations done at my request by Reem Hanna-Harwell, assistant dean of the humanities at the University of California at Los Angeles, based on the latest annual student-credit hours, fee levels, and total general-fund expenditures, the humanities there generate over $59-million in student fees, while spending only $53.5-million (unlike the physical sciences, which came up several million dollars short in that category).

The entire teaching staff of Writing Programs, which is absolutely essential to UCLA’s educational mission, has been sent firing notices, even though the spreadsheet shows that program generating $4.3-million dollars in fee revenue, at a cost of only $2.4-million.

So, the answer to “Who’s going to pay the salary of the English department?” is that the English department at UCLA earns its own salary and more, through the fees paid by its students—profits that will only grow with the increase in student fees.

That isn’t an eccentric calculation. Of the 21 units at the University of Washington, the humanities and, to a lesser degree, the social sciences are the only ones that generate more tuition income than 100 percent of their total expenditure. Cary Nelson, president of the American Association of University Professors, recently cited a University of Illinois report showing that a large humanities department like English produces a substantial net profit, whereas units such as engineering and agriculture run at a loss.

Because that evidence runs up against the widespread myth that other units and departments subsidize the humanities, and up against such well-entrenched forces within the university, it is regularly ignored or even suppressed.

University budgets, fraught with indirect costs and shared infrastructure, are far too complicated for an amateur to master, and people in other fields would surely emphasize other numbers. We’re all in this leaking, listing ship together, and the humanities will have to bear some of the pain of bailing it out.

But when a university’s own leaders begin talking about higher education as if it were just another business rather than a great collective legacy, by making English professors the scapegoat for hundreds of millions of dollars in operating deficit, they need to hear some other voices. The assumption that the humanities are a vestigial parasite within an otherwise self-sufficient institutional body is dangerously wrong.

For a complimentary copy of the complete essay, send a request by e-mail to chronicleletter@chronicle.com