The Possibilities of Strategic Finance

BY ELLEN CHAFFEE

STRATEGIC FINANCE IS ALIGNING FINANCIAL decisions—regarding revenues, creating and maintaining institutional assets, and using those assets—with the institution’s mission and strategic plan.

The concept known as “strategic finance” increasingly is being seen as a useful perspective for helping boards and presidents develop a sustainable long-term strategy to align an institution’s overall mission even in difficult economic times.

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TAKEAWAYS

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2 Institutions and boards need to control their own destinies in finding the resources to invest in growth and help local economies rebound, because the federal and state governments are not going to rescue them in the future.

3 Many boards need to get a better handle on what their institutions’ existing cost structures and cost drivers really are, including taking account of what the institution should be spending for deferred maintenance, information technology, and the like.
institution’s revenues and expenditures with fulfillment of its mission, assurance of its educational quality, and preservation and enhancement of its assets. The approach especially helps governing boards grapple with the long-range issues of staying true to institutional mission in difficult economic times, a challenge that governing bodies often do not have—or do not take—the time to focus on.

Whether it’s declining state funding, unsustainably large tuition increases, or inadequate gifts and investment returns, the challenges keep coming, and presidents and trustees everywhere are running out of “normal” coping strategies.

AGB recently gathered a group of experts to discuss the perspective provided by strategic finance, with the goal of illustrating how it can help institutions make strong connections among their strategic plan, long-range financial plan, and annual budget.

The roundtable’s participants:

Kent John Chabotar, president of Guilford College, former chief financial officer at Bowdoin College, and author of AGB’s book Strategic Finance.

Ellen Chaffee, AGB senior fellow, director of AGB’s Lumina Foundation project on Governance for Student Success, and president emerita of Valley City State University.

Larry A. Isaak, president of the Midwestern Higher Education Compact and chancellor emeritus of the North Dakota University System

Dennis P. Jones, president of the National Center for Higher Education Management Systems (NCHEMS)

Richard Staisloff, vice president for business, finance, and administration at the College of Notre Dame of Maryland

Jane Wellman, executive director of the Delta Project on Postsecondary Education Costs, Productivity, and Accountability

Chaffee: We want to help trustees and presidents lift their heads from crisis mode and really capitalize on the opportunity that the current financial climate has presented. Based on your experience, what are the main issues now that campus boards and administrators need to deal with to align resources with their mission or campus goals?

Isaak: With budgets in most of our states in very, very tough shape, I’m seeing governors and legislators wanting to be very targeted about appropriations for higher education. And I think that trend is going to continue for awhile. There will continue to be general appropriations for public college and university institutional operations, but, as much as possible, state officials will be targeting appropriations to specific purposes, such as financial aid or specific initiatives to increase the educated workforce.

Chabotar: I agree with that entirely, but the trouble is with a fixed budget—or a budget that’s declining—for either public or private colleges to do any new investments means you have to cut even more elsewhere in the budget. Thomas Langfitt at the Pew Charitable Trusts wrote about growth by substitution; this is almost like decline by substitution.

There’s no extra money for new kinds of investments. Deferred maintenance, faculty salary increases, tuition increases—we can only keep the lid on these things for so long. And to say we’re going to, in addition, invest in these new areas—which we really should be doing—is going to really take a sea change in long-term thinking.

Isaak: But that doesn’t diminish the need for it, especially because as we look at what governors and legislative leaders are pushing for, by and large they understand that in order for their economies to rebound and transition out of—at least in the Midwest—the traditional industrial and agricultural-based economies, they have to have a highly educated workforce and a newly educated workforce in some areas.

I think higher-education leadership has a wonderful opportunity to step up to the plate to say, “Here’s how we can help to make that possible.” But that will take a significant sea change, I agree, in terms of board and institutional leadership. We have examples out there, but it’s going to require significant leadership from boards and campuses.

Staisloff: Part of what I think Larry and Kent are saying is that institutions and boards need to control their own destinies. They’re not going to be rescued by the state or the feds going forward.

And they need to get their hands on the wheel in finding the resources to invest in growth and invest in moving forward. That means not putting time, attention, energy, and money into things that don’t drive the mission, that don’t drive the bottom line. And that’s the leadership component, I think.

Chabotar: In the private sector, there’s good news and bad news. The good news is that the enrollment debacle that most of us feared last fall didn’t occur in most cases. And remember, except for what I call the “Nifty 50”—the top 50 endowments—we privates are very enrollment-dependent.

Many of us were surprised that enrollment was fine and the discount rates weren’t outrageous. And in part that’s because of the unfortunate condition of many of the public universities, which had enrollment caps and appropriations cuts.
The challenge for private institutions going forward is twofold. One concern is what happens when the public sector starts to recover, as it will inevitably, and there’s a little more money for at least some publics to resume their enrollment increases. Remember that 80 percent of the students in this country go to public colleges and universities, so they already are the dominant players in the market.

And number two, what are we going to do about enrollment generally? I don’t think most of us have given enough attention to the fact that, even if we preserve our enrollments, the students of the future are going to be very different than the ones that many of us

have been used to, especially in terms of adults and in terms of traditionally underrepresented populations.

I’m not sure we’re really aware of that—in terms of culture, in terms of pedagogy, in terms of how we’re set up to do business.

Jones: What I see at the campus level, particularly in the publics, is that—with very few exceptions—they haven’t yet gotten anywhere close to the point of doing anything strategic. They’re just taking their cuts where they can.

I go back to an article I wrote back in 1993 on strategic budgeting, with a particular focus on the responsibility that presidents and boards have to maintain the institution’s asset structure in good times and in bad. They need to leave the place at least as strong as they found it.

But now what I see at some institutions is that they are paying no attention to maintenance of their core asset structure—they’re dismantling things without giving it a thought. And I think that really deserves to be put on the table.

Chaffee: Well, Dennis, some campuses think there’s a Chicken Little effect going on now and that the sky isn’t really falling—that they don’t really need to change that much and that the new normal won’t be all that different.

Wellman: I think you always hear that kind of dismissiveness in higher education. And, you know, things are not as bad as the worst-case scenario, and

so the message has to be that institutions need to figure out how to manage with the resources they already have and how to spend them strategically, so that they’re not just maintaining and protecting the institution, but also are meeting future needs for higher education.

We wouldn’t have as big a finance crisis, or this wouldn’t matter as much, if we weren’t also entering a period when we need to increase educational attainment in our country with, as Kent said, a rapidly changing type of student population.

The educational challenge that’s ahead of us is closing achievement gaps—reaching new populations and making sure that they have access to and obtain quality education. That educational agenda is far more daunting and challenging, I think, than the financial agenda.

But at the moment, I think the risk we face as an industry is that the instability in finance could become the excuse, if not the reason, why we fail in this generation to ensure that college is attainable for the next generation of Americans. So we’ve got to stabilize finance, and the strategic piece of this that’s going to be most difficult for many institutions is beginning that stabilization.

Institutions and boards need to control their own destinies. They’re not going to be rescued by the state or the feds going forward.

Chaffee: Stabilizing finance is, as you said Jane, a beginning. It is the platform on which the real work can begin. That real work includes bringing the trend lines of revenue and expense to a balance that is sustainable in the long term; educating more students to a higher level when many of them need more academic and financial help; increasing quality; and ensuring that the institution’s full array of assets—physical, human, and financial—is properly maintained and improved.

If we look at the responsibility of presidents and trustees to get beyond the current stresses and figure out what their approach to the challenges I’ve just outlined should be, what are some of the key factors that each
institution's leadership team should be analyzing in order to understand its unique situation?

Isaak: To me, the first thing that leaders should do is get a real handle on what the future educational and workforce needs are for their community, region, or state. And then drive your decisions about what the institution needs to do based on that. Data will show how many more educated persons are needed and in what areas.

Then you frame the agenda and make decisions both in terms of what’s needed for the community and to help people succeed. You keep that in front of you all the time, in front of the administration, in front of your faculty and staff—you say this is why we’re doing it, and this is what’s driving the decisions we’ll be making from this point on.

Wellman: I agree with that. Too many institutions, I suspect more in the public sector than the private sector, don’t really have a handle on their existing cost structures or cost drivers.

That includes programmatic costs and dimensions such as which programs are high-cost and low-demand, which have greater problems of degree attainment, or where student attrition is greatest. They need to have some diagnostic capacity to look at program-related costs.

There are also a lot of costs that are driven by things like the population of employees and where they are on the retirement curve, as an example. Another serious challenge is sustaining the benefit structure and paying for current and future retirees.

Institutions need to get a good handle on what their cost structures are and where their spending patterns are increasing, in order to manage and restructure in ways that support their attainment agenda. I completely agree with Larry’s primary point that if this is done out of context of the attainment goal, then you’ve lost the battle. It’s got to be all about management of resources to support the attainment goal.

Isaak: The only thing I would add is that the issue that needs to get on the table simultaneously is the cost of maintaining the asset base of the institution. So, for example, how big is our deferred maintenance bill right now, and how much are we going to add to it next year if we don’t do something about it? The same thing is true of technology.

Chabotar: I agree with Jane about the cost structure. The next step, once you find out the costs, is deciding what to do about them. Often, some investment in currently high-cost but mission-central programs would make them more cost-effective, as opposed to concluding they must be sacrificed. That’s always the temptation—to simply draw a line and say, “Oh, they’re high cost. Get rid of them.”

I think when you get into a crisis like this, faculty salaries and tuition and endowment-spend rates and state items like appropriations get a lot of the attention, but we don’t pay attention to the things like information technology and deferred maintenance.

What I’m recommending when I talk to folks is that they use placeholders. In your draft budgets, at least put in what you should be spending on IT, what you should be spending on deferred maintenance, what you should be reinvesting back in the endowment, and the like. And if, in fact, you can’t do that for a variety of reasons, you’re making an explicit choice to do A rather than B. Too often those tough tradeoffs don’t even make it to the table because we’re so consumed by the short-term crisis.

Chaffee: How can boards help without getting into the weeds?

Isaak: Focus, focus, focus. Keep asking, “Towards what end?” and keep the students’ success at the forefront of deliberations. Take on the major issue of either refining or restructuring your budget, but keep your focus on the main goals, that big picture.

Secondly, it’s important for boards to set performance goals for institutional leadership. That is an important role of boards and will help them stay on the big issues and then allow institutional leadership to work through the details.

I think we don’t use our boards’ political savvy and pull enough; board members can be very helpful in making sure that we protect our appropriations.

Chabotar: Boards ought to raise money. And public boards ought to be spending more time in state capitals and in the private sector, where appropriate. I think we don’t use our boards’ political savvy and pull enough; board members can be very helpful in making sure that we protect our appropriations.

Wellman: I understand and somewhat agree with Kent’s point about fundraising and the responsibility of the board. But too often, in public institutions, the first move is to seek to increase revenues, rather than to address costs.

Jones: I also think the board has to ask the hard questions about the effects of the budget on the balance sheet—that is, the institution’s asset base, as well as the operating budget itself. Board
members have to ask, “Where in this budget is the money for investment and is it pulled out separately, so that we can in fact make real choices with that money?”

In the asset base I include the typical facilities and technology, but also several other things: faculty and staff, including renewal through training and skill-enhancement; programs, adding, deleting, and—most important—reworking them on a periodic basis; students, a clear-eyed view of characteristics of the student body; and finance, the use and replenishment of reserves.

Only the board and the president have the overall institutional view and the responsibility to worry about the institution’s balance sheet—not just the annual budget, which masks and too often ignores the asset questions.

Staisloff: Ultimately, aren’t we saying that boards may well have to take the leadership in this shift from thinking about inputs—which most of the industry’s been focused on—to outputs? You know, what really is the return on investment? Where are our economic engines?

Chaffee: How about the board-president relationship? What advice or caution would you have for both trustees and presidents? These are times that require great courage. Boards and presidents need to be on the same page, and boards need to be prepared to back presidents up.

Jones: Yes, and one of the ways they have to do that is to ask presidents a set of questions that they have to respond to.

Chabotar: Don’t you think, Dennis, that if presidents wait to get those questions, they’ve lost the leadership battle? Boards get very nervous if presidents have allowed a vacuum to develop, in which presidents haven’t said, “Here is a process. Here are some questions. Here are some issues I really need the board’s help with.”

I’d never wait for questions from the board. I would be giving them the answers before they ask the questions.

Jones: I don’t disagree. The reality is that the president’s got to tell board members the questions to publicly ask.

Isaak: That’s right, and we need to remember that many boards are lay boards. Members have other jobs and probably serve on other boards. So it really is up to the institutional leadership, the president and other institutional leaders, to help the board define what the goals are for the institution, what the performance criteria are, and towards what end.

And presidents or institutional leaders are not doing their job if they’re not helping their board get there because, in the absence of that, boards will tend to get into the weeds.

Chabotar: When we talk about changes or what it takes to make changes or what our mission is, even if you have a strategic plan, a lot of board members—because of turnover—really don’t understand higher education as an industry. They can’t really engage the issues if they’re trying to draw parallels between the companies they come from and a college or university.

Staisloff: I agree. There’s going to be a real need to spend some time educating boards and making sure everybody’s clear about how our economic model works, because I think there’s misunderstanding and misapplication of models.

Then we need to develop some new tools, new data to present to boards so that they can be clear about where we are now. Then they can help figure out where we’re going.

Chabotar: Where does innovation fit with all of this? How much innovation is going to be required to deal with what we’re facing? How much change?

Wellman: The most important institutional change is going to be closing achievement gaps, serving historically underserved students, and making sure that those students are performing academically as they need to.

And that’s going to require a huge amount of attention to teaching and learning and educational outcomes. Adrianna Kezar, in a recent issue of Change magazine, says essentially, “The rap that higher education is resistant to change is somewhat oversold. The problem is we’ve got too much change going on that’s not strategic and not coordinated to support a coherent agenda.” And I think that’s very well said.

So managing change to make it purposeful and to make it support the goal of closing the achievement gaps is the biggest transformative task ahead, I think.

Staisloff: Much of the action is going to be at the community-college level if we’re going to hit some of these attainment goals that the Obama administration has outlined. How do we make that transition really seamless, going beyond just articulation agreements, so that we have a good hand-off from that two-year to the four-year experience?

Chabotar: We need genuine articulation agreements, because the community college is becoming an increasingly viable option for students, not only in terms of convenience, but also cost. Yet I think that many articulation agreements are not worth the paper they’re written on, because they claim institutions will take a certain number of credits. Yes, they’ll take them, but those credits don’t really apply to graduation requirements, and so the student’s still left having to take another year or more of credits.

Another implication for private colleges is that we really do need to, as Rick’s saying, focus more on accepting transfers from the community colleges. That will work if we are ready at the junior level to do as much in terms of orientation and first-year experiences and so forth for students transferring in as juniors as we do for freshmen—but we’re not.
Isaak: People have to hear and believe that increasing college attainment for all groups is important for the future of our community, our region, our state, our country, and this institution is going to step up the plate and provide the leadership to do that. That’s going to require significant change in how we do things. I think that that’s where a president and board need to provide the leadership.

Chaffee: Larry, that was a good summary of one key, maybe more than one, key point, and leads to something I’d like to focus on now. If we were to cast the themes we’ve been talking about as advice to trustees and presidents, can we sum up our advice?

Wellman: Well, the first piece would be—I know this sounds banal but it’s important—focus on the long term, not the short term. Don’t let the mentality of crisis and short-term budget cuts overwhelm your decision process. Focus on the mission of institution and the needs of the future and make the defining anchor of your strategic-financing agenda the overarching goals that are appropriate for your institution—whether that’s an attainment goal, a service role, and so forth.

Chaffee: Jane, you make another key point, which is to focus on the resources you have, more than on the resources you wish you had.

Wellman: That’s right. In very recent years, institutions had more money than they’ve ever had in the history of man, so the losses they’ve experienced are severe. Not to trivialize that, but there’s a lot of money in these institutions and through repackaging it and better managing the resources we have, we can do a good job.

Staisloff: I would say that boards and presidents are going to need to wrestle with what is core for their institution. How do we get back to a core? And that core, I think, would be defined by what’s really tied to the campus’s mission—not this extraneous stuff that we got into because we could over the past years. Focusing on the core also serves as an economic engine to provide resources to the institution.

Chabotar: I’d also suggest that boards and presidents become more data-driven in decision-making, asking, “Who really is the competition, what is our fundraising potential, what are the demographics of students going forward?”

And the board should set its own goals. If it’s going to be part of the solution, the board, not just the president, has to set goals for itself—particularly in terms of the key roles members need to play to support the strategic agenda.

Chaffee: AGB uses the term strategic finance to pull together many of the issues we’ve covered. How would you personally define the concept?

Isaak: It is making strategic investments, as opposed to general-support investments, and tying those strategic investments to very well-defined institutional goals.

Wellman: Another phrasing that we’ve used in strategic finance is aligning mission, strategy, revenues, and expenditures so that everything is aligned to achieve the strategic goals.

I think that the thing I hear that worries me most is the sense that the task ahead is daunting and difficult and the tone is one of management of decline; people are depressed. I think it’s so important for leadership to see this as an opportunity to take the institution to another level of attainment. Higher education in the United States is not about to slip off the edge into the ocean.

We’re at an important transition point, but it’s really not a terrible thing, and anything that can be done to shore up the institutional energy and create the sense of possibility and excitement for the work is, I think, time and energy well spent.

Staisloff: Well said; now is not the time to hunker down. There is heavy lifting to be done, but it can be done, and there are good models and best practices out there. We can go after the data that we need; there are tools we can bring to the table. We have a frame-

There is heavy lifting to be done, but it can be done, and there are good models and best practices out there.

Chaffee: For further information about strategic finance, see www.agb.org/strategic-finance-initiative.