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Sustainability

Using the right measures to gauge health

The Situation

Over half of schools that closed over the past five years were in good standing with the department of education, as measured by their financial responsibility ratio. Many worked diligently to ensure that they would not be subject to sanctions but wound up missing bond payments or just plain running out of cash.

In light of this, CFO Colleague has developed a sustainability scorecard that is a much more predictive gauge of institutional health. Today, we will share what we saw that prompted the creation of this instrument and review it, with the hope that it becomes a guide for your campus during these turbulent times.

Agenda

Intro: What we are seeing

I. Characteristics of Sustainability

II. The Scorecard

III. Your Questions

About CFO Colleague

In our twelfth year, CFO Colleague has been privileged to work with over 200 campuses to improve performance and better gauge operations and financial futures. Our team of twenty professionals has extensive experience in private higher education and shares a commitment to institutional health and individual excellence.

In a world of uncertainty and lean resources, you need a CFO Colleague

Together, achieving more

What we are seeing – *(5 Cs)*

1. Changing demographics felt unevenly
2. Cutting future-oriented spending
3. Covenant defaults
4. Cash deficiencies
5. Closures

But, we’re also seeing …

1. Reinvention of academic structures
2. Reimagining staff and support functions
3. Recruitment strategies driven by retention
4. Refreshing facilities, equipment and technology
5. Renewing institutional commitment to the mission

Getting from here to there

We start with assessing where we are.

We are witnessing the flip side of the marginal revenue equation. 100% of the net revenue we received from each lost student is extracted from the bottom line.

How we respond to determines our eventual trajectory. We thus developed the "Sustainability Scorecard" as a gauge to determine how well we are contending with the challenges of today, and to create a platform for change.

I. Characteristics of Sustainability

A. Operating measures

1. Surpluses recorded each year
2. Growth of freely available cash
3. Commitment to campus renewal
4. Growth in student net revenues

Why places are closing

In each case where an institution has closed, it has been the lack of cash that has precipitated it. Some called it the "cause" but we view it as the ultimate effect. The board also considered the prospects for the future. Is NTR growing? Are facilities well cared-for? Is there a plausible plan to deliver surpluses?

B. Management Behaviors

1. Leaders acting like managers
2. Budget to budget financial planning
3. People addition celebrated – extraction avoided
4. Bristling against measures of accountability

Management Behaviors

While all want their areas to perform well, it is when the challenges faced by the institution are ignored, in favor of what I want for my area, that the train comes off the track. A manager mentality, versus a leadership perspective

Our leadership must be typified as a unified team that thinks institutionally, sacrificing and recalibrating areas under their purview for the good of the organization; to reinvest and redeploy resources.

We don’t do this well.

An Example - Enrollment

1. Prospective families consider:

Reputation, Facilities, Connections, Programs, Kindness, Spiritual Emphasis, Convenience, Cost, Safety, Outcomes

2. When those areas are not resonating

Enrollment increases financial aid and adds employees because those are the areas that are within their control

3. But what if …

We identified and addressed the deficient areas wholistically?

Strategic Planning and Continuous Improvement

The Strategic Plan: How we set ourselves apart over time

Continuous Improvement Process: Constantly enhancing our effectiveness and efficiency

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C. Commitment to the Future

1. Our marketing is consistent and meaningful
2. Our facilities are up to date and effective
3. People are compensated appropriately
4. Programs are relevant and in-demand
5. We plan to bolster our cash balances

Commitment to the Future

It is fascinating to understand that those who are seeing deficits are almost always guilty of spending TOO LITTLE. Oh, there are board members and banks who think the problem is spending too much but institutions too often make non-personnel cuts first.

They then are frustrated by low admission yields and employee turnover.

Essentially, the REAL deficit is much greater.

D. Aiming for healthy output / input

1. Comp / NTR $\leq$ 70%
2. Non-Trad NTR $\geq$ 40% of overall NTR $\frac{\text{Traditional}}{\text{Non-Trad}} = 1.5$
3. Ext Affairs $$ $\leq$ 50% of annual fund
   Advancement
   Public Relations
   Alumni Affairs
4. Auxiliary Net $\geq$ Student Life + Athletics

Healthy Ratios

When we specifically connect what we spend to what we bring in and manage it with discipline, confidence is built in our ability to deliver positive performance.

II. The Sustainability Scorecard

A. Do you make money?

Example College	X X X	= Entry Cell			
CALCULATIONS	*(in 000s)*	**RAW**	**WEIGHT**	**WEIGHTED**	**FINAL**
Change in Unrestricted Net Assets	833	0.03	3.0	0.09	0.09

- ***A primary, contemporary stewardship measure.***
  - ***Are we living off the accumulated savings that others set aside, or***
  - ***Are we preparing for the future?***

A surplus is the bedrock of financial health. It must include depreciation expense, since that provides funds for capital spending and debt retirement.

Those who don't include depreciation tend to underspend on facility renewal and equipment refreshes. They also tend to borrow to refresh equipment and facilities. This is included by the department of ed.

B. Is our primary business growing?

Example College	X X X	= Entry Cell

CALCULATIONS	(in 000s)	RAW	WEIGHT	WEIGHTED
NTR Last Year	15,198			
NTR This Year	14,776	(422) Change in NTR		

- ***When NTR grows, we give evidence to our commitment to the mission***

NTR must increase to cover inflation, at a minimum. When it is decreasing, demand and the ability to cover needed costs declines.

The department of ed doesn't measure this.

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C. Are we investing in our campus?

Year over Year:

(Increase) Decrease LTD	(1,247)	
Increase (Decrease) ROU Assets	106	
(Increase) Decrease ROU Liabilities	104	
+ CY Capital Spending	2,647	
- CY Depreciation Expense	4,128	(232) Capital Improvement

- ***Adding debt is a negative. Exceeding depreciation expense is a positive.***

A measure of sustainability is whether we are reinvesting in our plant and equipment. When we are not, it is a hidden deficit.

The department of ed encourages us to borrow to pay for investing in our campuses. It's the opposite of what we should be doing.

D. Do we have free cash?

+ Cash on hand	2,409		
+ Investments	50,153		
+ Pledges for restricted gifts	1,380		
- Net Assets with donor restriction	52,727		
- Line of Credit outstanding	0		
- Accounts Payable & Accruals	1,150	65	Operating Liquidity

- *Using restricted funds for operations is a negative, as is drawing from a line of credit.*

Cash must be unfettered, not borrowing from endowment and not using other restricted funds for operations.

Also, a reliance on a line of credit can become a permanent use of that resource, monetizing losses.

The department of ed doesn't directly measure this.

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III. Putting it Together

A. The Components

Example College	X X X	= Entry Cell

CALCULATIONS	(in 000s)	RAW	WEIGHT	WEIGHTED	FINAL
Change in NTR	(422)	-0.03	3.0	-0.08	-0.08
Capital Improvement	(236)	-0.01	3.0	-0.03	-0.03
Operating Liquidity	65	0.00	3.0	0.01	0.01
Change in Unrestricted Net Assets	833	0.03	3.0	0.09	0.09

Total = **0.0**

MONITOR

B. The definitions

- The first one (Change in NTR) represents the raw percentage change for this year, versus last
- The last three are divided by unrestricted operating expenses
- All are weighted by multiplying by 3
- The maximum is 1.0 and the minimum is -1.0
- Passing is 0.0 but a school is **monitored between 0.0 and + 0.2**
- **Below a 0.0 is a failure** and **above a 0.2** indicates that **the school is healthy**

IV. How we respond

A. Rethinking Programs

- Shedding funds adding
- Surveys of non matrics and prospective families
- Purchasing online courses to add specialties
- Engaging in platform reduction

B. Investing in areas that need attention

- Thoughtful marketing that answers real questions
- Always improving the physical plant
- Selling off unneeded facilities/land
- Compensation improvements

C. Thoughtfully and respectfully reducing headcount

- Voluntary Separation
- Reduction in Force
- Transferring from one area to another (versus posting)
- Providing funds to invest in the future

D. Our Practice/Products are directed toward this

- Institutional Health Assessment
  - Identifies trends and relationships that gauge health
- Marginal Revenue Analysis of academic programs
  - Programs whose percentage is below expectation are encouraged to find ways to improve
  - Programs that don’t even cover faculty costs will need to be curtailed
- COMP4cast
  - Five forward years of projection, including full financial statements
  - Innumerable “what if” scenarios to consider with varying inputs

D. Our Practice / Products - *continued*

- Administrative Services Assessment
  - A look at all of your support functions to identify potential efficiencies
  - Identifying areas of *underinvestment* as well
- GAP sourcing
  - Accounting functions performed by qualified professionals
  - Improving audit and financial reporting outputs
- Turnarounds – *We've been involved in many*

V. Your Questions

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