

Will the economic downturn be the great equalizer in higher education?

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In the world of higher education, especially at private institutions, the conventional wisdom was always “the best and financially strongest institutions are those with the largest endowments.” Strong fundraising over the past 20 years helped many institutions build large endowments, which became major sources of annual income. Large endowments were also viewed as “insurance” against the vagaries of economic downturns, protection against swings in enrollment, and a safety net from unforeseen financial emergencies or budget cuts by state legislatures. Bigger was always better when it came to endowments.

But life has changed in higher education and changed very rapidly. The value of most endowments, just like our portfolios and 401Ks, has plummeted and along with it many of its historical advantages. Today, institutions with the strongest “bottom lines” are likely to be those with strong management and business plans that work in today’s economy, not necessarily those with the strongest endowments.

Historically, private colleges and universities have been grossly grouped into one of two categories – the well-endowed, and those that were “tuition-driven.”

Well-endowed institutions boasted endowed professorships and scholarships, facilities maintenance endowments, and often large unrestricted endowments. Tuition-driven schools, however, depended on student enrollments to generate the majority of their income – hopefully recruited at the lowest “discount rate” (a euphemism for how much the institution needed to lower or discount their published tuition to match the pocketbooks of applicants, or more specifically, their parents).

Nearly all institutional endowments enjoyed dramatic run ups in their size and earning power in the 90s, and private philanthropy fueled steady annual increases in fundraising. Those with the largest endowments and strongest fundraising often grew exponentially – further separating the “haves” from the “have nots.” Boards of trustees of the less well-endowed frequently lamented, “if we only had a bigger endowment.”

The great market crash has suddenly changed the landscape in higher education, and in some ways, it has become a great equalizer. And because of this, “tuition driven” isn’t necessarily the weaker position today.

Some reports indicate the value of the average higher education endowment has fallen by 26% in the past 12 months, with many institutions suffering more significant losses. For many well-endowed institutions, particularly the private ones, a 5% “draw” of income from their endowments represented a significant percentage of annual operating support, a revenue stream that had been reasonably predictable for many years – until now.

Today, both public and private institutions are suffering. Well-endowed institutions are looking at a 5% draw of a much smaller number (or in some cases simply protecting the original endowment principle), with next year not looking much better due to multi-year rolling average spending computations. Early evidence points to significantly diminished fundraising for many institutions in the first half of 2009. Similarly, falling tax revenues have forced significant cuts in appropriations for state institutions and student aid appropriations for students at all types of institutions. There is also evidence of even deeper tuition discounting to ensure enrollments do not dip, which in turn, adds more pressure to the bottom line.

That’s enough uncertainty to test the mettle of any college president or board chair, even Harvard. As *Boston Magazine* author Richard Bradley noted recently, Harvard’s endowment had ballooned to \$37 billion, making the institution that target of both envy and scorn. A year later “for the first time in decades, it will worry about merely paying its bills.”

Which brings us to the simple point – the economics of higher education have changed. They have changed very suddenly and may have changed for the foreseeable future. Who will be the eventual “winners” in this topsy turvy time for higher education? For now you might put your money on community colleges. In Indiana, Ivy Tech reported a spring term 2009 enrollment increase of 10.4%, and recent media stories point out that many campuses actually have too many students – a problem many institutions would welcome right now.

Only time will tell if well-endowed institutions will regain the value of their investments. And tuition-driven institutions who raised their discount rates this year to hit their enrollment goals may find they gave away the store.

The likely winners, both short term and long term, will be those institutions that historically placed a high premium on strong fiscal management – an issue which received relatively little attention or accolades during strong economic times. Such institutions are built to survive this downturn. You might recognize them as institutions that have programs that are attractive to students, have held true to their mission, have tuition rates that address value as much as price, and have strong cost containment already in place. They are also institutions with strong leadership from both senior staff and trustees.

These institutions are not panicking in these times because their fundamentals remain strong. Whether an institution is well endowed, tuition driven, state supported, private, large or small, what will likely keep it strong is leadership and solid fundamentals.

No one will likely look back on 2008 and 2009 nostalgically as the “good old days,” but much like the banking industry, housing industry and maybe the auto industry, the economic downturn has leveled the playing field. It has leveled it in a way that well-run and strongly led higher education institutions will not only weather the downturn, but come out the winners on the other side.