TIAA-CREF INSTITUTE:

ADVANCING HIGHER EDUCATION

FINANCING INSTITUTIONAL OPERATIONS IN HIGHER EDUCATION

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EXECUTIVE SUMMARY

In contemporary college and universities, the “taken for granted” is shrinking. Longstanding operational assumptions are being shaken as institutional performance claims are being countered with demands for hard evidence, competition for students and funding has intensified to new levels, healthcare and building costs are growing at rates that threaten support for other central priorities, and the global niche of the U.S. as a magnet for students, faculty, and researchers from abroad has eroded. In response, campuses and their leaders have begun to rethink their traditional business models.

This report reviews the emerging challenges and examines some creative responses institutions are pursuing. Comments of a leader panel convened by the TIAA-CREF Institute are summarized, and three recent reform initiatives are considered in more detail: highly differentiated pricing, decentralized decisionmaking and budgeting, and aggressive enrollment-management systems. For each reform, the arguments of proponents and skeptics are summarized and some implications of adoption are highlighted.

Decisions on these potential reforms call up enduring questions of control versus trust, and centralization versus localized adaptation. The report concludes with consideration of key questions for decisionmakers seeking effective adaptation and reform in this new context. At what level of the hierarchy should strategic decisions be made in the institution? At what level should prices be determined? What proportions of faculty should be employed full-time on tenure lines?

Leaders face two dangers in addressing such questions: that of stasis and over-caution, and that of unstinting, unthinking change threatening enduring values, loyalties and resources. At issue is how to facilitate agility, nimbleness and adaptability without going too far.

In U.S. higher education, reform is always in the air, and resistance as well. Earlier generations of leaders made their way over these same paths, laying the present foundation. Some significant financial reforms are available to institutions for the choosing. Those most attuned to the core cultures and values of their own institutions can best decide which might be worth pursuing and which might be better ignored.

INTRODUCTION

In contemporary college and universities, the “taken for granted” is shrinking. Longstanding assumptions about revenues, costs, and capital are being shaken as institutional performance claims are being countered with demands for hard evidence, competition for students and funding has intensified to new levels, healthcare and building costs are growing at rates that threaten support for other central priorities, and the global niche of the U.S. as a magnet for students, faculty, and researchers from abroad has eroded. In response, campuses and their leaders have mounted new defenses while simultaneously rethinking their traditional business models. This report reviews the emerging challenges and some creative responses institutions are pursuing. It concludes with consideration of key questions for decisionmakers seeking effective adaptation and reform in this new context.

BACKGROUND

The challenges noted above have brought important changes to the financial profiles of U.S. institutions in recent years. Although the ultimate implications of the changes are similar, public and private institutions have been threatened and changed in somewhat different ways.

On the public side, state legislators have begun questioning (and often reducing in real terms) longstanding subsidization levels for public higher education. Historically, dating back to the nineteenth century, states in the U.S. have provided institutional subsidies sufficient to maintain low tuition and fee levels for students, the rationale being that access to higher education serves the state’s purposes and should be offered at low cost to all citizens. State political leaders in the late 1990s and early 2000s, however, began to be hard pressed by growing constraints on state tax revenues and by ongoing growing state fiscal needs in K-12 education, transportation, healthcare, and corrections. Seeking budgetary flexibility to respond to these conditions, they targeted higher education. Political doubts were growing that higher education provides public benefits commensurate with its costs (Ehrenberg, 2000).

What is more, because higher-education spending is less formulaically driven than other forms of state spending and because it attracts appreciably less federal matching funding, spending for public colleges and universities is more discretionary. As a result, that spending is usually finalized in the later stages of the appropriations process in most states (Hovey, 1999). If other claimants have succeeded earlier, there is unlikely to be much left on the table for colleges and universities. In the end, it appears that state legislators across the nation in the 1990s and early

2000s chose to obtain flexibility for serving other public agendas at the expense of higher education (ibid.). Although funding has rebounded some in more recent years, there is little prospect for a return to earlier levels of state largesse. As state support for public institutions has stagnated, and institutions have lost previously assumed levels of growth in state subsidies, decisionmakers have been forced to consider their options for simply maintaining the quality of public institutions, much less improving it.

Private institutions have faced a distinct but parallel dilemma. Unlike public institutions, their tuition and fees have always been far closer to the actual costs of educating students. Nevertheless, those costs have not been fully covered. Estimates vary, but it seems safe to assume that up to a quarter of the costs of undergraduate education typically goes uncovered by tuition in private, not-for-profit schools (e.g., see Winston, 1999). The remainder has typically been covered by endowments, other fund-raising activity, and other campus enterprises. Thus, private schools share with their public counterparts a need to consider some difficult financial options.

Whether public or private, all institutions can and often do turn to raising prices. The past two decades have seen unprecedented tuition rises in both proportional and dollar terms (St. John, 2003). Strikingly, students and their families have not strongly resisted these rises, continuing to enroll in record numbers. Indeed, some schools may have gained through purposefully adopting a form of "luxury pricing:" raising prices to put them in a range close to that of their aspirational rivals (Lapovsky, 1998). But there are limits; policymaker and public disenchantment with rising costs appears to be growing (Field, 2007).

There are also limits to increasing or shrinking "production" (mainly, enrollments) as a response to financial challenges. Control over total enrollment size is limited in many settings, either legally or by contextual factors, and a variety of policy, scale, demand, compositional, and budgetary factors make it unclear whether, within typical size ranges, institutions gain or lose in net revenues when they do adjust their enrollments. Most institutions operate near capacity already, demand is high for postsecondary education, and it is a still seen by many as a public good – only at the elite levels is aggressive rationing even reluctantly accepted. In accredited institutions, core and necessary academic operations impose high fixed costs, notably for tenured faculty. Most fundamentally, changes in production volumes may be rather unlikely to stem from, and thus ultimately address, financial concerns. As Howard Bowen (1980) famously observed regarding colleges and universities, the pursuit of prestige and quality usually trumps the seeking of savings and efficiency.

When educational costs rise simultaneously with public resistance to higher tuition and fees, and when dramatic production changes are difficult, leaders must become creative. At the 2006 National Higher Education Leadership Conference sponsored by the TIAA-CREF Institute, a distinguished panel of institutional leaders detailed their own perceptions, approaches, and suggestions for confronting emerging financial challenges (see Hearn, forthcoming). Those comments provide a starting point for considering some recent developments in institutional finances.

INSTITUTIONAL RESPONSES TO FINANCIAL CHALLENGES

The institutional leaders on the panel shared a concern over the current and emerging competitive, regulatory and fiscal climate of higher education. The speakers from four-year institutions noted the continuing "arms race" for students and research funding, a race in which escalation seems quite possible and standing still may really mean falling behind. Speakers from public higher education also lamented continuing constraints on state support accompanied by growing reporting requirements. Although appropriations have rebounded recently (Schmidt, 2006), panelists gave no indication of optimism for a return to state funding levels of earlier years.

The panelists were also unanimous in arguing that the current climate demands data-driven, active institutional leadership. Critical to success, they argued, was knowledge regarding such issues as the sensitivity of students' enrollment decisions to tuition levels, the extent to which technology-transfer efforts pay off, the levels of subsidization in different state systems, the returns to accountability efforts, the risks and rewards in differing approaches to endowments, global competition for students, or levels of faculty salaries.

For this group, good leadership also requires both sensitivity and courage. They argued for engaging a wide range of voices and expertise, developing and nurturing productive community relations, being ethical and responsible in protecting institutional resources, and being attentive to institutional mission and the dangers of jeopardizing it. At the same time, the panelists stressed the necessity of boldness: looking into the longer-term future, and breaking out of established modes of doing business. A particular emphasis, they suggested, should be on designing and pursuing new kinds of partnerships with other institutions and with governments and corporations. Of course, creative risk-taking must be balanced with caution; what works on one campus may not work on another, and what is widely trumpeted as effective may in fact be oversold.

It was unsurprising that, beyond their more general observations, the panelists differed on some specifics, including the value of some of the most familiar new approaches in the financial management of higher education. Outsourcing, for example, seems ubiquitous across contemporary institutions, but some leaders on this panel and elsewhere express doubts. Where should institutions draw the line, and reject reliance on outsiders to provide non-educational services in residence halls, dining facilities, and the like? At some point, direct control over, and protection of, the longstanding core functions of the institution have to become paramount. But then, what educational opportunities might be lost by devoting scarce resources to keeping some traditional services in house?

Similarly, the panelists expressed mixed reactions to the various recent innovations in pricing. It would be a rare public or private institution that has not yet examined the recent trends toward unbundling tuition and fees, instituting new user fees, and raising tuitions in concert with increased discounting. Pricing innovation can extend beyond those familiar topics, however. Different academic courses and programs have different cost profiles and different market niches, and they need not be priced identically. Indeed, implementing selective variation may provide better returns by weeding out pockets of unnecessary, wasteful discounting as well as identifying promising niches for price cuts.

Leaders whose institutions have at least some pricing discretion as well as some useful data on student enrollment behaviors may wish to explore whether certain new and existing offerings might be profitably priced differentially from others. Price differentiation can be based not only on a course or program's associated equipment, space, and salary costs but also on such factors as enrollment numbers, the qualifications of instructors, the time of day or year of the offering, or simply the going market rate.

Of course, any discussion of price differentiation involves considering the extent and nature of cross-subsidization across programs on campuses, not always an easy topic (Bok, 2003). For example, how willing might a state college be to create financial incentives for students to move out of engineering and into Germanic languages? Price differentiation can bring appealing financial returns, but also risks and challenges to long-established ways of presenting educational choices to students.

The panelists, like many institutional leaders, also noted the interest in decentralized decision-making and budgeting, i.e., granting academic colleges, departments, centers, and other units increased fiscal and academic autonomy in concert with increased accountability. The goals of such efforts are to make the costs and returns of units' actions more readily apparent to decisionmakers in the units, and thus provide more clearcut incentives for decisions in the best interest of the unit and the institution. The terminology for decentralized approaches varies, featuring such phrasings as "incentives-based" decisionmaking, "responsibility centered" budgeting, and the notion of "every tub its own bottom."

Decentralizing is frequently cited as a key element in the new entrepreneurialism on campuses, but we are only now seeing substantive growth in the literature covering the virtues and risks of these approaches, (Priest and St. John, 2006; Hearn et al., 2006). As Ehrenberg (2004, p. 276) has noted, if institutions are to adopt decentralized approaches, the "designs of academic governance structures need to pay serious attention to reducing problems that decentralization will cause," including decreased attention to the common institutional good, duplication, inattention to broadened access, and inattention to cross-disciplinary possibilities. As with price differentiation, encouraging an entrepreneurial mindset among faculty and mid-level administrators can be a good thing, but the potential costs should always be borne in mind.

A final financially significant innovation considered by the panelists' institutions, and a familiar one on many campuses, is the development of increasingly aggressive and increasingly sophisticated institutional enrollment-management systems. Ensuring the success of all students in college has become a major priority of policymakers (Hearn, 2006), but at the institutional level, it can be expensive. Often, colleges can become more financially sound and efficient, at least by some definitions, by increasing their emphasis on admitting only well-prepared and highly motivated students. Having such a student body can reduce drop-out rates as well as expenses for recruitment, orientation, remediation, transfer operations, and so forth. Few colleges have that luxury however, as their admissions pools do not contain enough such students. And still fewer colleges would accept so homogenous a student body; enrollees would tend to come from predominantly middle and higher- socioeconomic backgrounds, from the strongest secondary schools, and so forth. U.S. college leaders strongly support admissions policies expanding post-secondary opportunities, but that determination brings with it financial challenges.

Systematic enrollment-management systems aim to ease those challenges. Such systems use mathematical modeling to help institutions target their tuition levels, admissions, and aid offers toward producing a student body that is financially rewarding as well as attractive for the institution on academic and policy grounds. Beyond admissions policies, these systems aim to maximize the chances for student success on campus by directing support services squarely on those most in need of them. Accepting full-paying and well prepared students and keeping them enrolled can provide resources for accepting academically and financially needy students and keeping them enrolled, but finding the optimal balance is not easy. Working well, enrollment-management operations balance schools' financial goals with their academic and policy goals, ensuring that pursuing one goal creates no unmanageable constraints for pursuing the others (Ihlanfeldt, 1980).

For understandable proprietary and competitive reasons, many aspects of individual schools' enrollment-management systems remain invisible to outsiders, who can only observe as an institution's student body evolves. This lack of publicly available information has persisted since enrollment management's beginnings and may fuel the concerns of some observers that these systems can disserve larger societal goals (Hossler, 1984). Competitive conditions and financial pressures have only grown in intensity in the years since the enrollment management's origins in the 1970s and, as McPherson and Schapiro (2007) have recently observed, college leaders need to keep in mind the implications of any financial reform for both quality outcomes and equity.

CONCLUSION: KEY QUESTIONS FOR DECISIONMAKERS

Higher education is certainly not in a crisis, or at least no greater a crisis than usual – as Birnbaum and Shushok (1998) have wryly observed, one is hard pressed to find a period in which higher education has not been widely described in public fora as being in a crisis of one kind or another. Yet current conditions unquestionably demand aggressive new thinking. For precedents, leaders might turn to other industries in other times.

After the U.S. Surgeon General's 1964 report on smoking and health, the tobacco industry faced a new environment for their core product. In their classic study of how the large tobacco firms responded strategically to emerging public concerns, Miles and Cameron (1982) noted that the most successful corporations pursued three approaches: domain defense, domain offense, and domain creation. Domain defense, they argued, is the mounting of vigorous challenges to the core product's value, most often through presentations in legislative hearings, argumentation in courts, and public campaigns. Domain offense is the development of product lines to meet emerging conditions, through product innovation and brand proliferation. Finally, domain creation is the widening of product markets to new populations, often abroad.

Analogously to the tobacco firms, colleges and universities have pursued these three options to varying extents. Recent examples of domain defense include the spirited responses of major professional and institutional associations, via public speeches, publications, and press releases, to the recent report of the U.S. Secretary of Education's Commission on Higher Education (U.S. Commission on the Future of Higher Education, 2006), which was highly critical of the costs and transparency of the enterprise. Domain offense has been most notable in the expansion of many institutions into summer and evening programming, on site and off, and into educational partnerships with other institutions. Domain creation is clear in the aggressive marketing of new programming and financial services to alumni, in the development of online offerings, in the investment in technology-transfer offices to generate new revenue opportunities from research patents and licenses, in the providing of camps and international programs, in the leasing of campus facilities for camps and sporting events, and, of course, in the sale of university-themed items and branded apparel. From Sunoikisis, a collaborative initiated by southern liberal-arts colleges to provide cost-effective course programming in the classics, to Stanford's wide array of travel/learning offerings, and from Harvard's expansively branded professional-education offerings to the University of North Carolina's lucrative "Tar Heel" themed merchandising efforts, institutions are following plans well established by other organizations in analogous contexts.

In pursuing options such as these, and such as those discussed by the TIAA-CREF Institute panelists, decisionmakers face a series of fundamental questions about who they are as leaders and about what values of their institutions are unshakable. These decisions call up enduring questions of control versus trust, and centralization versus localized adaptation. At what level of the hierarchy should strategic decisions be made in the institution? At what level should prices be determined? To what extent should stated tuition prices be fixed across students, as opposed to depending on the circumstances of a given student's enrollment? What should be the level of tuition discounting for especially desired students? How many necessary services should be outsourced? What proportions of faculty should be employed full-time on tenure lines?

At the heart of all of these questions, are two dangerous poles. At one pole lies the danger of stasis, of over-caution, of inability or unwillingness to adapt to rapidly changing circumstances. At the other pole lies unstinting, unthinking change threatening enduring values, loyalties, and resources. The strength of higher education, and the essence of its survival since its origins in the medieval era, has been in its steadily effective adaptation to changing environments. Preserving what must be preserved, while changing what is less central, has kept the enterprise alive and vital. Thus, at issue once again is how to facilitate agility, nimbleness, and adaptability without going too far.

It is easy to characterize this as a battle between hidebound values and necessary efficiencies, but that does both sides an injustice. Some changes may actually be necessary to preserve the core. Witness the expansion in the 1800s of institutions' range of course offerings, which brought many new students, graduates, and supporters to higher education, and tied it closely and profitably to the industrial revolution and societal notions of "progress." Likewise, witness the expansion of elite-college admissions over the past century to be more welcoming to those other than well-to-do white males; this choice helped preserve the standing and health of the nation's oldest institutions. At the same time, witness the refusal of institutions over the years to accept waves of reform aimed at increasing governmental standardization and control. If the special strength of U.S. higher education indeed lies in the freedoms provided by its relative autonomy from governments, as Burton Clark (1983), Clark Kerr (1995), and numerous others have argued, those refusals to accede paved the way for future, more effective reform.

In an era in which faculty and staff are increasingly being asked to consider such discomfiting notions as brands, niches, price points, image clarification, and the like, it is important to bear in mind that it was ever so. The back and forth between the marketplace and the timeless aspects of the academy, and between stasis and change, is not new. Reform is always in the air, and resistance as well. Earlier generations of leaders made their way over these same paths, laying the present foundation. Some significant financial reforms are available to institutions for the choosing. Those most attuned to the core cultures and values of their own institutions can best decide which might be worth pursuing and which might be better ignored.

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