TIAA Institute

Financial management as revenue growth slows

Building budgets, sharing results, and educating key constituencies

The TIAA Institute commissioned this paper to offer insights to all engaged in the hard work of ensuring institutional financial sustainability over the long term.

David Wheaton, Vice President of Administration and Finance at Macalester College, chaired the college's Sustainable Operations Task Force formed in the aftermath of the Great Recession. He describes how the task force captured and quantified the impact of powerful external trends affecting higher education, and the dynamic budgeting exercises Macalester has undertaken to model alternative paths to balancing revenue and expense growth rates.

The Sustainable Operations Task Force's work was driven by one overarching theme. That is, for the next decade:

The growth rate of available revenue
must equal
The growth rate of required expenses

For the college to sustain its operations, the slope of these two lines has to be parallel or diverging with the revenue line on top. While not particularly profound, execution of such a goal is challenging when the underlying cost structure carries annual demands for additional resources that are hard to deliver from the existing business model.

The most basic question is whether a college has constructed a value proposition for which people are willing to pay a steadily-rising premium price and whether that value proposition can be delivered with a slowly-growing expense base.

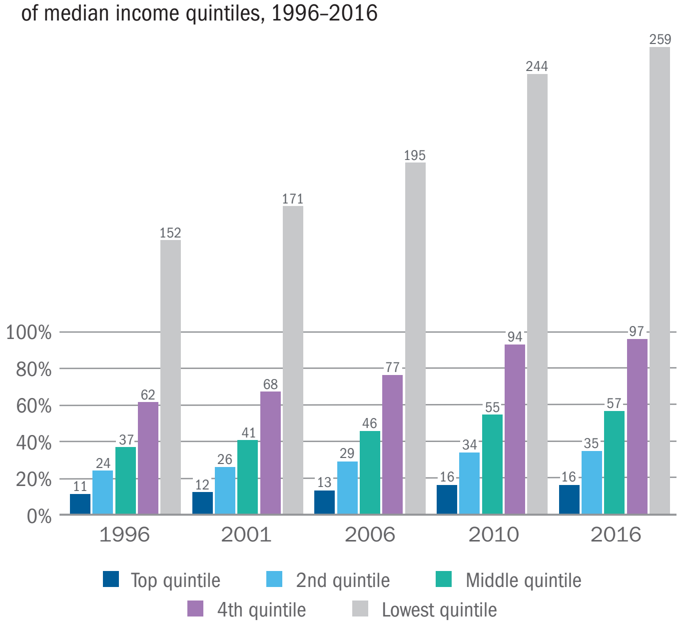
Widespread understanding of the basic premise that the slopes of a college's revenue and expense trajectories must match or favor the revenue side is an important starting point for all financial management strategies and tactics that follow.

Family income lags tuition growth

In the 20-year period from 1996 to 2016, total growth in median income adjusted for inflation ranged from a high of 21% in the highest U.S. income quintile to a low of -1% in the lowest quintile. Median private college tuition and fees rose by 120% on an inflation-adjusted basis during that same period.

Tuition and median income

U.S. private college average tuition and fees as a percentage of median income quintiles, 1996–2016



Sources: Income and Poverty in the United States: 2016 (United States Census Bureau; Report Number: P60-259; September 2017; Jessica L. Semega, Kayla R. Fontenot, and Melissa A. Kollar) and Trends in College Pricing: 2016 (College Board, trends.collegeboard.org).

Achieving sustainability

Any movement toward a sustainable financial structure requires action on both the revenue and expense sides, along with realistic modeling.

On the revenue side, however:

The U.S. higher education industry may have reached a point where revenue growth is facing a significant resistance point. For example, expanding the student body to enhance revenues from tuition is not a solution to the fundamental problem because, while it provides a one-time revenue bump, the increased head count can't be replicated year-over-year due to capacity constraints. Thus, expansion of the student body doesn't change the growth rate of the net tuition line, nor the revenue slope over the long term.

Adding new programs is not a solution because even a program with an attractive growth profile is not likely to offer enough incremental revenue to alter the fundamental revenue slope, which is dictated by the sheer size of the income flows from net tuition and the endowment draw; i.e., a new program that provides 10% more income still leaves about 90% of the institution's revenue growth anchored to the legacy revenue streams.

On the expense side, possible actions institutions can consider include:

Implementing different compensation models, including a split between ongoing and one-time payments; the ongoing portion could reflect the sustainable pace of increases, and the one-time payments could be a function of a particular year's results.

Having a serious discussion about the college's standards for managing the physical plant and other campus services, being careful to avoid steps that would be felt by students.

If financial conditions continue to deteriorate, also consider:

Articulating goals for faculty size and compensation based on current student-to-faculty ratio and median salary, and determining if these are still desirable and achievable.

Restricting staff salary growth by freezing the staff full-time employee count and looking for ways to reallocate funds if new activities are needed.

Realistic modeling

The decision-making process should be supported by careful modeling of possible or likely outcomes, including sensitivity analyses of the major assumptions to varying conditions and a description of how the institution will protect itself from the unexpected, along with at least an outline of possible contingency steps.

Educating campus constituencies

Transparency is key to educating and building support among faculty, staff and students, whose informed input and cooperation is crucial. Budgets should be presented in readily understandable formats designed for multiple audiences. Accessibility is key. At Macalester, campus budget presentations and board committee materials are virtually identical.

Read more

Wheaton, D. (2018). *Financial management as revenue growth slows: Building budgets, sharing results, educating key constituents*. New York, NY: TIAA Institute.

Realistic revenue strategies, along with disciplined cost control and resource allocation, are necessary ingredients for future success.

Key takeaways

- The board, president, and administrative and faculty leadership must understand the real dynamics of the higher education business model as reflected in financial results.
- Institutional leaders should look well past the next 12 months in order to inform intelligent near-term decisions.
- Analyses must be realistic about the possibility of improved conditions flowing from changes in strategy or tactics. With this clarity in hand, information must be widely and routinely shared with relevant constituencies, especially the campus community.