Financial Concerns: Shifting the Tuition-Setting Paradigm

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I'm not sure how I ended up speaking to a conference dedicated to independent school risk management, given that I can claim no particular expertise in legal matters, insurance, or the more arcane aspects of HR policy.

Instead, my perspective is that of a "school junkie." I have been affiliated with schools for more than 60 years as the son of a Headmaster, a trustee of nine independent schools, a former Dean of Admission at Princeton, and the founder of a company that has provided consulting services to more than 500 independent schools over the past 26 years.

It is from those perspectives that I speak to you today, for I am well acquainted with what I regard as a serious risk confronting independent schools: namely, 30 years of tuition hikes that were well above the rate of inflation and that now are threatening the competitiveness and in some cases the very survival of independent schools, especially those that are not well endowed.

More broadly, though, I want to raise the alarm about the truly worrisome questions lurking beneath the affordability crisis:

1. How is it that some Boards of Trustees have allowed their schools to fall into such a precarious state?

2. Why – when there are so many trustees with a strong background in business and finance – have Boards been so slow to recognize and respond to the twin crises of affordability and cost control?

3. What can be done to ensure that Boards will not miss the next crisis coming down the pike?

I am speaking to you this afternoon not as a critic, but as a concerned observer of independent schools – an industry I love and admire. However, it is an industry in which the financial and governance practices need to change.

My goal in this talk is to explain why.

The Scope of the Threat

For the past two generations many independent schools have taken a page from colleges and universities in that they:

1. Built costly new facilities, often without raising the funds to fully pay for their construction or their future upkeep.

2. Broadened the curriculum by adding multiple electives, many of which had more to do with the faculty's interests than the educational merit of the classes.

3. Made an aggressive effort to improve faculty salaries without a full consideration of the long-term budgetary implications.

4. Moved too aggressively into technology without a careful analysis of the costs of the personnel, training, and equipment or an understanding of how the technology would enhance the learning of the students.

To finance all of these initiatives, both colleges and independent schools have priced themselves much too aggressively. Education is not the only industry to do this. In a recent *Time* magazine article on spiraling health care costs, Steven Brill observed that:

> *In a trend similar to what we've seen in nonprofit colleges and universities — where there has been an arms race of sorts to use rising tuition to construct buildings and add courses of study — hospitals improve and expand facilities...., buy more equipment, hire more people, offer more services.. . . and then raise executive salaries because their operations have gotten so much larger. They keep the upward spiral going by marketing for more patients, raising prices, and pushing harder to collect bill payments. (*"Bitter Pill: Why Medical Bills Are Killing Us," 20 February 2013*)*

Independent schools now face tremendous competition – from one another and, in many communities, from excellent public, charter, and magnet schools. Yet for the past 30 years most have continued to raise tuitions at an alarming rate, seemingly oblivious to the long-term effects of this policy.

What I have observed is that the *upward* spiral in tuition is too often accompanied by a downward spiral in other key indicators of the school's health. Typically, once the affordability tipping point is reached (and this will vary from community to community), the following occur:

1. **Applications and enrollment numbers decline, often leading to the admission of students who are less mission-appropriate, leading, in turn, to a need for expanded learning services.**

2. **Demand for financial aid rises substantially. According to NAIS, the percentage of students receiving financial aid since 2008 has increased from 21% to 25% at day schools and from 37% to 45% at boarding schools.**

3. **With increased resources devoted to financial aid, faculty/staff raises are eliminated or diminished, generating morale and possibly recruiting and/or retention issues.**

4. **Increased emphasis is placed on annual giving to balance the budget, but the increase in financial aid families effectively shrinks the pool of donors, and the increase in financial aid allocations creates resentment among struggling full-pay families, who then may be less inclined to support annual giving.**

5. **Increased pressure on the Head of School to spend time away from school to cultivate donors, lessening the amount of time he or she can spend on being the school's educational leader and/or developing and implementing strategies to improve the school's competitive position.**

The implications for schools seem clear – and potentially disastrous. For many independent schools to remain viable, their Boards must act aggressively to reverse the downward spiral.

Are they up to the task?

The Board's Role in Shaping Tuition Strategy

Frankly, I am puzzled that so many Boards of Trustees have been so slow to recognize and respond to the threat posed by ever-escalating tuitions. Perhaps it has something to do with the increasingly common use of trustee term limits. If all trustees roll off the Board after two three-year terms, where is the historical perspective?

Or perhaps it is because most Boards don't routinely receive the information they need to make well-informed decisions. For example:

1. When setting tuitions, how many Boards are given a 20-year longitudinal chart indicating the extent to which the annual tuition increases exceeded the annual rate of inflation?

2. How many Boards analyze the process by which their tuition are set? Though the late management guru Peter Drucker made the observation nearly two decades ago, it is still true today that *too many nonprofits engage in cost-based pricing rather than price-based costing*. In other words, rather than the Board and the administration making some assumptions about what the market can afford, the Board allows the administration to build a budget based on what the various program directors would like to do. Because schools are filled with bright and creative people, they will always come up with good ideas about programs to be funded. Too often missing from the conversation, however, is a rigorous analysis of what the marketplace can bear.

With respect to tuition-setting, for example, my experience has been that most Boards have approached this decision annually with relatively little attention to the strategic implications. I hope this paradigm is changing, but I know that Boards have traditionally been presented with the following bits of data:

1. How the school's tuition compares to that of peer and competitor schools (a statistical analysis that promotes lemming-like behavior rather than truly strategic thinking).

2. How tuitions would need to rise given various faculty salary increases and enrollment projection scenarios, promoting the approach of choosing the least objectionable option.

While this information is interesting to ponder, there is very little evidence that it has contributed to sound decision-making over the past two decades. That is why I think for many schools, the shift in the tuition setting-paradigm needs to begin with a conversation between the Board leadership and the school administration regarding the data the Board should review each year as part of the tuition-setting agenda. In my view, this conversation should lead to a governance policy document that specifies what data will become a routine part of the process.

The vital information Boards *do not* routinely see includes:

1. Demographic data about the number of families with children in the school's key zip codes who can afford the tuition at various price points, based on current NAIS/NBOA affordability analyses – and how those numbers are projected to change in the coming decade.

2. Information about how the percentage of families choosing various school options (independent, parochial, public, magnet, etc.,) is changing. Too many Boards spend too much time looking over their shoulders at their rival independent schools when they should be paying more attention to the fact that families may be opting out of the private school market altogether. For example, despite the fact that the population in this country is growing, the number of applicants submitting SSAT scores to boarding schools has been flat for the past decade – and this includes the ever increasing number of international students.

3. Historical comparative data. It used to be that a year of private school tuition was comparable to the cost of a new Ford sedan. Now, boarding school tuition is more likely to be in the ballpark of a new BMW, Mercedes, or Lexus.

4. Boards of day schools should also receive data about the relationship between the actual costs of providing educational services with the tuition rates charged for each division.

   For example, many PK-12 independent schools are increasingly struggling to fill their earliest entry grades. But who should be surprised that families looking ahead to 18 years of educational expenses are balking at preschool tuitions of $25,000 or more? Perhaps it is time to stop asking the parents of kindergarteners to foot the bill for first-rate athletic facilities and state-of-the-art science labs their children will not set foot in for a decade.

Tom Nammack, the Head of Montclair Kimberley Academy in New Jersey, decided that the tuition MKA was charging primary school parents was simply too high. After researching how other schools had structured tuition and after gathering demographic research from NAIS and government agencies, Tom concluded that MKA needed not only to reduce tuition rates but also to restructure as well. Previously, MKA charged the same tuition for students in grades Pre-K through 5. Now, MKA has one level of tuition for Pre-K and Kindergarten, another level for grades 1-3, and another for grades 4 and 5. Before these changes, tuition for preschool would have been $25,000 annually. Now it will be $18,500 for pre-school children; Kindergarten was lowered to $23,500 from $25,000. These numbers are still high, but the movement is in the right direction.

In addition to changing the pricing structure, MKA has altered the timetable for announcing the next year's tuition rates for the youngest grades. Rather than setting tuitions in January, Pre-K and Kindergarten tuitions will be set in November, allowing families to plan and apply with full knowledge of the next year's tuition. And MKA may well let these Pre-K and Kindergarten rates stay the same for a few years. Perhaps most significantly, Tom sees a direct correlation between the tuition changes and the increase in applications for next year's Pre-K and Kindergarten classes that MKA is experiencing.

Similarly, Oak Knoll School of the Holy Child – also in New Jersey – is introducing what it calls a "Bold Tuition Initiative" for the next school year, significantly reducing tuition in Kindergarten through Grade 4. Head of School Tim Saburn noted on the website that he hopes the move will help to make the school "a more realistic investment for our youngest families."

Presumably, as these schools demonstrate a commitment to bringing in new families at reduced tuition rates, they are creating the good will necessary to retain these families over time. Boards might also want to consider locking in tuition rates for as long as a student remains enrolled, which is what Alexandria Friends School has done. Not only will this calm the anxiety of prospective parents, but it may well help with retention efforts as well.

If schools are lucky, their tuition reductions may be fully or partially offset by increased enrollment and decreased demand for financial aid. Most schools, however, will need to consider implementing strategic cost-reduction strategies as well.

The Broader Strategic Picture

Though Wickenden Associates is primarily a Head of School search firm, we have consulted with a dozen Boards over the past two decades in strategic planning. I've also participated in the strategic planning process as a trustee at nine independent schools. From these experiences, I have concluded that many independent school strategic planning exercises fail because they duck the hard choices while promoting costly ventures that are likely to undermine long-term financial sustainability.

Let's face it. Nobody wants to publish a strategic plan filled with gloom and doom, particularly because these documents generally lead directly to a case study for a capital campaign. I doubt that most of the successful business people populating independent school boards would put up with these rosy-scenario plans in their own organizations. Yet I have rarely seen independent school strategic plans that called for the following:

1. Walking back the enthusiastic over-commitment of schools to increasingly smaller class sizes even as that commitment threatens their viability. As Pat Bassett so wisely recommended in his excellent piece on the *Twenty-Five Factors Great Schools Have in Common*:

    > *Redefine the ideal classroom setting as one of* <u>intimate environment</u>, *not small classes, since the former can occur in schools or classes of any size and even online, and the latter can miss the point of intimacy.*

2. Rarely have I seen a strategic plan that called for the abolition of mediocre, under-enrolled, or overly expensive programs. In fact, I have not even seen a plan that called for a rigorous review of all programs in the context of the school's mission. How many AP courses is enough in an upper school of 300 students? How much should schools indulge the interests of faculty members in offering obscure electives such as The History of Opium or The History of Rock 'n' Roll?

    And even though I have a love of athletics and played two sports in college, even I am astonished at the rate at which sports offerings have multiplied in independent schools. Why aren't schools in need of belt-tightening looking to eliminate some sports? Football is one obvious example. It is both expensive and dangerous. Concussions abound, and the risks are both health-related and legal. An orthopedic surgeon friend of mine told me that his financial success is a function of skateboarding, ice hockey, and football – where the injury rate exceeds 100%. Some schools, like Princeton Day School, have already moved in this direction.

3. Rarely have I seen a strategic plan that included a commitment to using educational technology to reduce costs as well as to expand programs. Why isn't every small school looking at distance learning as a means to enable students to take courses for which there is little demand? Why aren't software programs being more fully utilized to teach world languages?

4. Rarely have I seen a strategic plan that included the establishment of policies that link program and facilities additions directly to <u>endowed resources</u> to ensure that these additions do not become a future drain on the operating budget. How many schools are now struggling to support the maintenance of facilities that were constructed a decade ago without an adequate endowment for upkeep?

5. Rarely have I seen a strategic plan that had a clear-eyed approach to financial aid and tuition discounting that moves beyond the inspiring rhetoric about diversity and access to laying out the negative implications – such as no raises for the faculty – of ever expanding financial aid budgets coupled with tuition hikes in excess of inflation.

6. Rarely have I seen a strategic plan that demanded evidence that the increased expenditures in the advancement offices are linked to improved performance in admissions and fundraising. I recognize that, in this increasingly competitive educational marketplace, schools must pay attention to marketing. But I have doubts that some of the money now being spent in these endeavors is well invested. For example,

    a. I recently heard an ad for a mid-Atlantic boarding school on WFAN, a NYC sports radio station. These 30-second ads cost a lot but convey little in the way of what value a family would get from enrolling its student in this school.

b. Similarly, on a recent flight from New Jersey to Seattle, I noted that the video screen on the back of the seat in front of me had a series of ads about a host of things – hotels, spas, vacation spots, AND an independent, single-sex day school in Ohio. Although I have no idea what the ad cost, I would be surprised to learn that the return on investment justified the 30 seconds of visibility this school received at 35,000 feet above sea level.

c. The admissions package of one 400-student, K-12 day school includes at *least a dozen individual four-color brochures* on different programs at the school. What is the message being sent to cash-strapped prospective families who are debating whether they can afford the tuition? Certainly not that their money will be well invested in the education of their children! In general, many of these viewbooks and ancillary admissions materials – as well as school magazines and other development publications – are more noteworthy for their extravagance than for their value. When online viewing of these materials is now becoming increasingly common, might this be an area where schools could economize?

7. Rarely have I seen a strategic plan that set truly ambitious financial goals. While visiting one school recently, I learned that the school leadership and the Board made a commitment to set the tuition at the 50th percentile of schools with a comparable enrollment while also making a commitment to pay the faculty at the 75th percentile. How? By controlling the size of the faculty and staff, building facilities that are easy to maintain, not being encumbered by debt, and by negotiating aggressively with vendors.

One area where I think schools are beginning to make significant progress is in the development of faculty evaluation and compensation systems linked to performance and hiring difficulty rather than adhering to a salary scale that is linked to seniority and academic degrees. I have recently seen a number of different evaluation and compensation systems introduced, specifically at the Haverford School in Pennsylvania and at the Schools of the Sacred Heart in San Francisco – both of which were designed to ensure that the school was getting maximum value from the teachers it employs.

And while I ought not to say this given that I'm in the Head search business, I think schools should take a hard look at the Head's salary. It makes sense to pay Heads what the school can afford rather than relying on the NAIS statistics that link compensation to enrollment and geographical location without factoring in debt service or the size of the endowment.

The salaries for Heads of Schools are going up – in general – at a much faster rate than those for the faculty. While I do not for a moment think that being a Head of School is an easy job, I am uncomfortable with the fact that many Heads are now being paid 10 times or more the salary of a beginning teacher. Why not have the Board adopt a policy whereby the Head of School would receive a salary that is no more than six or seven times what the beginning teacher receives but then be eligible for a bonus if and only if certain mutually agreed upon goals were achieved.

By the way, one school we know is controlling costs by encouraging many of the senior administrators – including the Head – to teach one course during the year. If four administrators do this, that amounts to one FTE.

The Bottom Line

I cite all of these examples of strategic cost-cutting initiatives not because I think every Board should implement each one, but because I think all trustees must begin to view their role much more in terms of driving their schools in the direction of price-based costing and greater efficiency.

Furthermore, if we are going to expect Boards to change the process by which tuition is set, they must be given the data they need to decide wisely. In essence, Boards need to define what those data are and the format in which that data should be presented.

We must change the mindset that has guided tuition-setting for too long. Whether this change is initiated by the Head, the CFO, or the Board is not important. Ideally, it will be a collaborative effort among like-minded leaders committed to the long-term sustainability of the schools they serve.

What is vitally important, however, is that this change be institutionalized as a routine part of Board practice in the tuition-setting process. It is only in this way that a true paradigm shift can be accomplished and maintained through the inevitable turnover of leaders at both the administrative and Board levels.

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