Leading to Results:
Unconventional Ways to Limit Operating Costs and Bolster Your Budget

A workshop delivered March 2, 1017, at the National Association of Independent Schools Annual Conference in Baltimore, MD, in collaboration with co-presenters Olaf Jorgenson, Head of Almaden Country School (CA), and Bernie Noe, Head of Lakeside School (WA)

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The three recommendations I'll make with respect to what independent schools might do to control costs are:

1. Follow the advice of legendary management consultant Peter Drucker, whose admonition was: ***"Nonprofits should engage in price-based costing, not cost-based pricing."***
2. Consider adopting the ***Mind the Gap*** model developed by Richard Soghoian, the Head of School of Columbia Grammar and Preparatory School in New York City.
3. Make cost control an important governance function of the Board.

I. PETER DRUCKER'S ADMONITION

To explain what Drucker meant, let's examine how most independent schools build their budgets.

Usually the budgeting process begins with the CFO asking the administrators responsible for managing a budget to indicate what their needs are for the next academic year. For the most part, this results in budget managers requesting *more* money for their respective programs. Those reviewing these requests – namely the CFO, the Head of School, and the Finance Committee of the Board – may make cuts here and there, but generally each budget manager receives an increase. Implicit in such a process is that the operating budget increases each year, and with it comes an annual increase in tuition.

In Drucker-speak, those responsible for building the budget determine how much it ***costs*** to fund the programs and services of the school. Once the costs are determined and estimates about the next year's enrollment are made, the CFO then does the math to determine what the tuition (i.e. the ***price***) should be. This is ***cost-based pricing***.

Rather than proceeding in the aforementioned manner, Drucker would argue that the first step in the budget building process should be a ***demographic and economic analysis*** to determine what those living in a given market could theoretically afford. As all of you know, markets vary. Areas like Seattle and San Jose, where Ole and Bernie lead their respective schools, are booming, with the populations and the economies of both areas growing. The opposite phenomenon, however, is occurring with independent schools located in the Rust Belt. Because the affordability index of these two geographical areas varies considerably, demographic and economic analyses should be done to determine what the families whose income is in the ***top three or four percent*** of a given market can afford.

The next step when setting tuition would be for the leaders of the school to ***make an assumption*** of what percentage of a family's income could be allocated for tuition for the education of one child. Undeniably, this is difficult. However, the late Peter Aiken, who founded the independent school data research company, JRPO, hypothesized that a family could afford 10 percent of its income for the education of one child. Assuming that this is a reasonable guideline, a family with an income of $200,000 could theoretically afford to pay $20,000 in independent school tuition. Given that the average independent day school tuition is now $25,000, families making $200,000 or less would find themselves unable to afford the tuitions of 60 percent of the independent schools in this country.

Those who march to the Drucker drum would then decide ***what percent of their market*** should be able to afford their school. Assuming that only the top two percent of the market can theoretically afford to pay the tuition, if a Board then decides to expand the school's market by lowering the tuition affordable by, say, the top four percent, such a tuition reduction would theoretically double the potential market for the school. Once those responsible for setting the tuition decide what the market can afford, they ***then do the math to determine what programs and services should be funded***. Drucker refers to such a process as ***price-based costing***.

Stated bluntly, schools that blindly engage in cost-based pricing will – over time – learn that this is an unsustainable financial model. Stated another way, a school should not automatically hike tuitions without collecting demographic and economic data about how a given market is changing from year to year.

II. RICHARD SOGHOIAN'S COMMITMENT TO MINDING THE GAP

Columbia Grammar and Preparatory School, a prek-12, coed school in New York City, has been led for the past 36 years by Dr. Richard Soghoian. He developed a financial model that enabled him to grow the school from 400 to 1,300 students, built the largest (in terms of square footage) physical plant among the independent schools in the city, and pays the highest faculty salaries among its sister schools.

What strategy was used to contribute to the Soghoian miracle?

First, Richard Soghoian is a Ph.D. philosopher who, being an iconoclast and an independent thinker, is willing to take risks rather than automatically following conventional practice.

Second, when Dr. Soghoian picked up the leadership reins of the school in 1980, he inherited a physical plant that gave a new definition to the term "deferred maintenance," a faculty that was underpaid and underappreciated, and a location that had deteriorated so much that the students who walked to school were periodically mugged for their lunch money. Thus, foremost on his lengthy "To Do" list was to raise money for three critical purposes:

1. To buy properties contiguous to the school and in so doing contribute to the improvement of the neighborhood while enabling the school to expand;
2. To renovate properties owned by the school; and
3. To significantly improve the salaries of the faculty.

How did he secure the money to achieve these goals?

First, Dr. Soghoian convinced the Board that the school would use ***only*** the money generated from tuition for its operating budget. Therefore, unlike most Heads of School, he never had to "Mind the Gap" between what the tuition generated and what it cost to run the school. Stated another way, because there was no gap, Annual Giving could be used for other purposes.

Second, he persuaded the Board that the money that was raised annually would be used only to buy new properties or renovate existing buildings.

Third, Dr. Soghoian – ever the iconoclast – was determined that Columbia Grammar and Prep would never be accused of "administrative bloat." If any group expanded significantly, it would be the faculty, not the administration.

As a result of these practices, which have been in effect for 36 years, Columbia Grammar and Preparatory School now has a magnificent plant, a faculty that is well-paid and that appreciates the autonomy they are given, and a growing demand for the school.

III. GOVERNANCE RECOMMENDATIONS

My remarks about governance will be controversial. Nonetheless, I believe that the governance of schools must change in order to halt the continuous tuition hikes that result in many schools being ***affordable to only the top one percent*** of the families in their respective markets.

The following recommendations might be considered by Boards that are concerned about the affordability issue:

1. With respect to Peter Drucker's admonition, the budgeting process should begin with policies and directives set by the Board of Trustees that change the process currently used by many schools. For example, the Board could debate and codify a policy in which any new program or position to be established should in most cases be offset by the abolition of a current program or position, ***unless*** the new program or position is fully endowed.

2. The orientation program for new trustees should include an introduction to two important concepts. One is "Baumol's Cost Disease;" the other is "institutional ego." With respect to "Baumol's Cost Disease," schools and other service-based industries suffer from this potentially fatal disease because unlike manufacturing, salary growth in the service organizations is not offset by increases in revenues ***unless*** there are significant increases in enrollment and/or the endowment. Institutional ego is an affliction common to trustees who are more concerned with the status of their alma mater than its sustainability. To counter that affliction, trustees should focus on what will add value to the programs offered by their school as opposed to adding programs because similar programs are offered by more prestigious or affluent schools.

3. To enable Boards to make informed decisions about whether tuitions should be increased, decreased, or remain level, trustees need more and better information. To quote Richard Chait, a well-respected governance scholar, "***The Board of Trustees has to define the information they need to govern and the format in which this information should be presented.***"

Were I a governance czar, I would direct the administration of a school to provide the Board prior to the development of next year's budget with ***five years of longitudinal data*** that addressed the following:

- Tuition hikes
- Financial aid increases
- Debt service (percentage of operating budget by year)
- Endowment per student
- Annual giving
- Admission inquiries and applications
- Full-time faculty
- Adjunct faculty
- Full-time administrators
- Part-time administrators
- Part-time coaches
- Percentage of the budget allocated to salaries and benefits
- Courses with enrollments that averaged 5 or less
- Athletic offerings that have declined in participation each year over the past five years.

At the end of each academic year the Board should request a report that contains data about the aforementioned items and then target which should be ***considered for elimination or reduction*** after the next academic year. The Head of School should also be asked to identify those programs that were declining in quality or popularity and could be phased out.

Finally, and most importantly, when the Finance Committee of the Board decides that cost cutting is essential and this initiative receives the approval of the Board, the Head of School and leadership team should be charged with determining how this initiative will be managed. In so doing, the governance and management responsibilities are properly separated, but the blame for what will be perceived as a morale buster can be appropriately shared.

Jim Wickenden founded the educational consulting firm of Wickenden Associates (www.wickenden.com) in 1986. Under his direction, the firm has conducted more than 525 Head of School and other senior leadership searches for independent and charter schools located throughout the U.S. and abroad. He has also consulted with more than 200 independent schools in the areas of admissions, college counseling, governance and Board development, administrative structure, and strategic planning.