PARTHENON

Strength in numbers

Strategies for collaborating in a new era for higher education

EY

Parthenon-EY Education practice

Introduction

Since the Great Recession, a common refrain heard throughout higher education is that hundreds of colleges and universities are at risk of going out of business. The reality, of course, is that few have closed — about five a year, on average — lulling many academic leaders into believing that they are somewhat immune from the disruptive forces of change sweeping the economy.

It would be a mistake, however, for college and university officials to think that this period of financial distress and the public's unease about the value of a degree is in any way temporary. A decades-long expansion of higher education institutions — a golden era when many of today's campus leaders came of age — is over. According to our analysis, some 800 institutions face critical strategic challenges because of their inefficiencies or their small size.

Until recently, colleges and universities had enjoyed the benefits of two lengthy and successive expansion periods in the history of higher education. The first, which lasted from 1968 to 1990, witnessed the Cold War and baby boomers usher in unprecedented growth in spending and enrollments. The second era, from 1991 to 2010, saw technology transform teaching, learning, and research as well as increased demand for a degree from students of all ages.

Three eras of higher education

Growth 1968-90	Technology 1990-2010	Collaboration 2010-current
Increased federal spending because of the Cold War and baby boomers leads to a growth spurt at American colleges and universities.	The internet and technology lead to advances in teaching and learning, mostly expanding access through new technologies and offerings just as the baby boom echo reaches college at the turn of the 21st century.	A downturn in the number of high school graduates coincides with diminished state and federal spending and squeezed personal income.

Higher education is now firmly situated in a third era, which is marked by diminished state and federal spending, lagging personal incomes of college-going families, and increased accountability around outcomes, particularly the view that the role of colleges is to prepare graduates for a job.

But this new era doesn't necessarily portend the end of the road for many colleges, as some pundits argue. Rather, it demands a significant shift in strategy for institutions around the idea of collaboration and the development of much deeper partnerships than higher education has ever seen before.

We found that colleges emerged from the previous era in one of four strategic positions. As we outline below, how and when institutions partner will depend largely on where they fall into four categories based on their size and stability.

Although institutions find themselves in a wide range of financial conditions today, their reactions to the changing market need not be independent and isolated from one another. In a few cases, this period offers tremendous opportunities for universities to partner and merge with institutions that would be a strategic fit for the future.

> **What is most needed for this new era is a change in mindset among higher education leaders: they need to stop thinking that the only path forward is one that they take alone.**

This new era of cooperation goes well beyond simple agreements between colleges to share back-office operations or cross-list academic courses that often result in good publicity and not much else. Collaboration in this new era involves colleges and universities coming together as seemingly one institution to change their future direction.

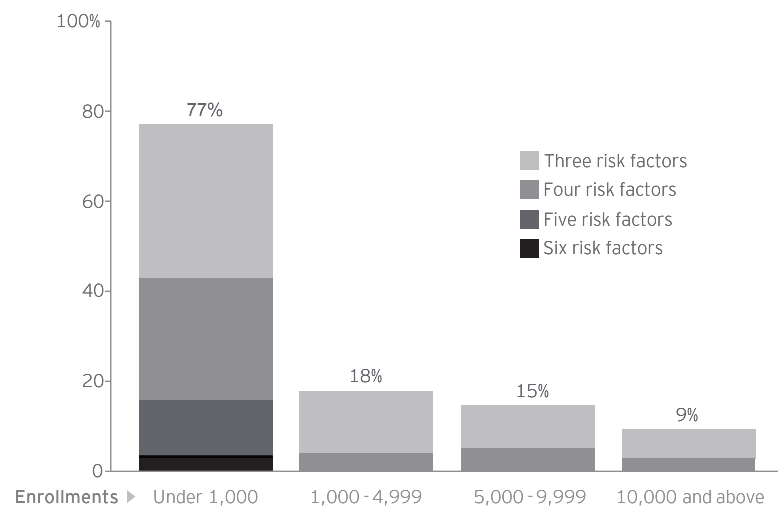
The institutions at the most risk of failure must collaborate out of necessity; those in a position of strength should work with other colleges and universities for the opportunities they present. This much is for sure: the time has come for institutions to join together because the market cannot support the number of institutions that we have today.

Developing a collaboration strategy: a test for institutional leaders

There is a set of risk factors[1] that are fairly predictive of whether a college faces the challenges that require it to consider collaboration for survival. Presidents and trustees who want to give their institution a test to determine whether it is a good candidate to partner with another college or university can refer to this list below. The more factors that describe an institution, the more it is at risk of struggling in this new era of higher education (Figure 1):

- Enrollment under 1,000 students
- No online programs
- Annual tuition increases of more than 8%
- Tuition discount rate higher than 35%
- Dependent on tuition for more than 85% of revenue
- Endowment that covers less than 33% of expenses
- Debt payments more than 10% of expenses
- Deficit spending

Figure 1: Percentage of universities exhibiting risk factors for closing by institution size, 2013; four-year, private not-for-profit and public institutions[2]



	Under 1,000	1,000 - 4,999	5,000 - 9,999	10,000 and above
Total number of institutions	738	929	254	354

Currently, 122 institutions exhibit more than four risk factors for closing.

[1] "Learning from Closed Institutions: Indicators of Risk for Small Private Colleges and Universities," Vanderbilt University, 2013.

[2] U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, Integrated Postsecondary Education Data Systems (IPEDS), *http://nces.ed.gov/ipeds*, accessed April 2015.

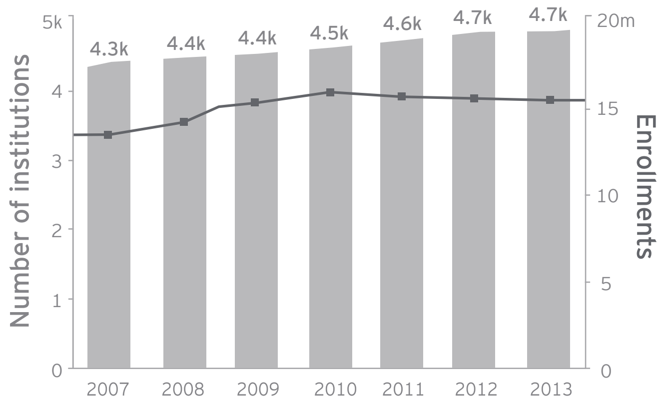
Why collaboration now?

Across higher education, revenue is squeezed while costs are rising. Net tuition revenue is lagging the inflation rate at 55% of public universities and at 40% of private universities, according to Moody's Investors Service.

The fundamental problem is that there are too many institutions chasing too few students (Figure 2). The biggest decline in enrollment has been among small colleges, those with fewer than 1,000 students, which account for some 40% of degree-granting institutions in the United States. Since 2010, their enrollment has fallen by more than 5%.

Too many institutions chasing too few students

Figure 2: Total number of degree-granting institutions vs. total enrollment, 2007–13[3]



The travails of small colleges have been well-documented, of course. But larger institutions are also grappling with dwindling student interest these days. Enrollment is down 3% at four-year private and public institutions that enroll fewer than 10,000 students, a group of colleges and universities that make up another half of the higher education market.

Falling enrollment has forced many institutions to push up their discount rate to attract students. In 2014–15, the average freshman discount rate was close to 50% among the colleges and universities surveyed by the National Association of College and University Business Officers.

Such discounts are increasingly weighing on the bottom line of institutions. About 2 out of 10 colleges are running annual budget deficits. Some of them are limping along with no realistic plan for turning around their finances, and thus a few have closed their doors. Since 2007, 72 institutions have shut down. Almost all of them had enrollments under 1,000 students.

[3] U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, Integrated Postsecondary Education Data Systems (IPEDS), *http://nces.ed.gov/ipeds*, accessed April 2015.

The current cost structure of colleges and universities cannot support an era of declining numbers of students because too many institutions are more dependent than ever on enrollment for a bulk of their revenue. Tuition dollars make up 56% of the revenue pie at private not-for-profit colleges with enrollments under 5,000 students, compared to 42% at larger universities. A small decline in enrollments at these institutions has a significant impact on their financial sustainability (Figure 3).

To counter these trends, tuition-dependent universities are faced with either increasing their value proposition to students to raise revenue or cutting costs. Collaborating with other institutions can help on both fronts. It should not be seen as just a strategy for weaker players to survive.

In this new era of higher education, the scale and scope of an institution matters to a college's ultimate success. This is a marked departure from the past, when the philosophy had always been that increased size came at the expense of academic quality and prestige.

Size alone, however, is not the sole insurance policy against the forces bearing down on higher education. Even large colleges and universities need to collaborate in this new era because the strategies often employed to boost their revenue are inherently unsustainable: they either rely on a constant supply of students (e.g., out-of-staters) or are fundamentally short-term cost savings (e.g., procurement).

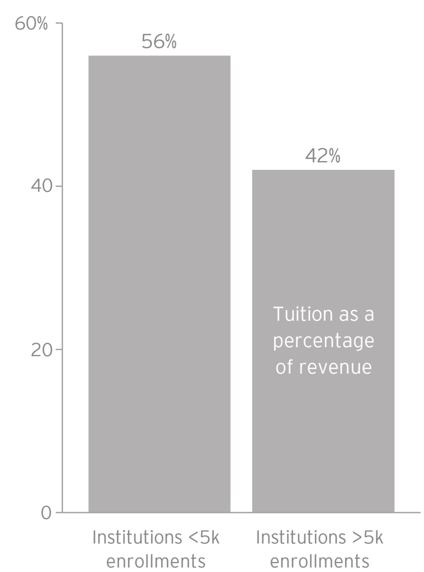
Public universities, for example, have turned to recruiting international students who pay full-freight to make up revenue shortfalls in a time of dwindling taxpayer support. But as more universities enter that game, the competition for the best students will grow more intense. At the same time, American institutions are increasingly reliant on one country for their students — China. Chinese students account for nearly 60% of the foreign-student growth at American colleges, a flow that could suddenly slow to a trickle if the Chinese economy were to falter.

This is an opportune time for universities with few risk factors to build models for collaboration and cement their position as a leader in this new era of higher education.

A small decline in enrollments at colleges with under 5,000 students has a significant impact on financial sustainability

Figure 3: Percentage of tuition at schools with enrollments <5,000 is 56%, compared with 42% at schools >5,000

Percentage of revenue from tuition, 2013
Private not-for-profit institutions[4]



[4] U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, Integrated Postsecondary Education Data Systems (IPEDS), *http://nces.ed.gov/ipeds*, accessed April 2015.

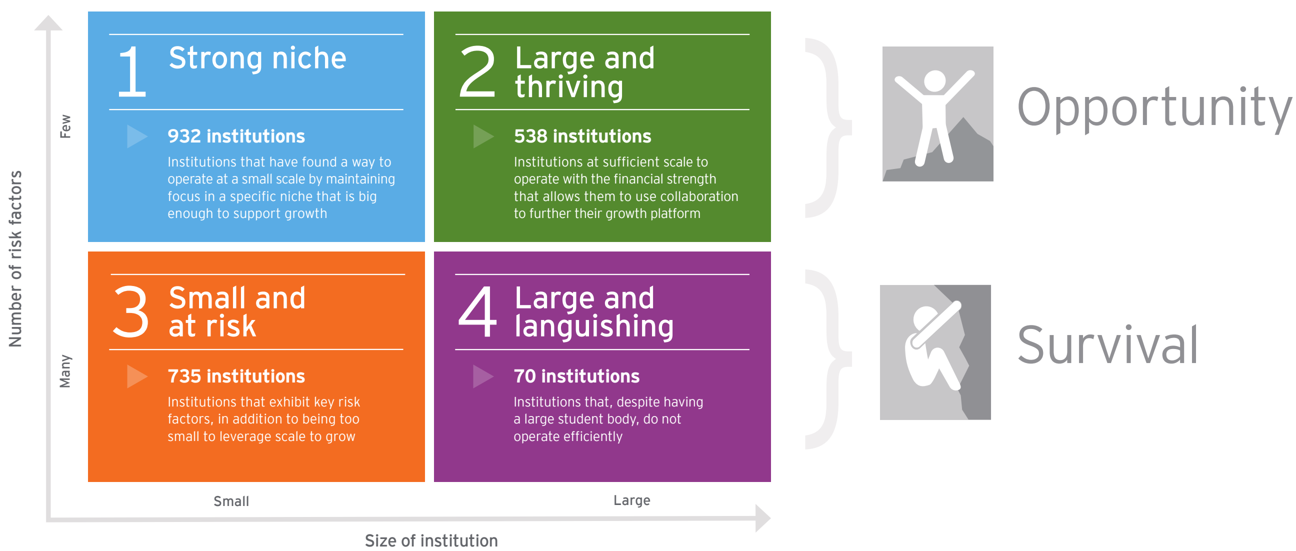
What to do

Determining how to collaborate and when to partner

There is no one ideal approach for institutions to collaborate. A range of options exist and which one your institution chooses largely depends on where it falls on our risk scale.

Our analysis divided colleges and universities into four categories based on their size and vulnerability.

Although the individual colleges and universities in each of these four categories might seem remarkably different in their selectivity and financial resources, the approach to collaboration within each group should follow a similar playbook. Institutions will take one of two pathways depending on their situation: they are either pursuing collaboration out of **survival** or taking advantage of an **opportunity**.



Opportunity

1 Strong niche

Think differentiation

Examples

- School of the Art Institute of Chicago

2 Large and thriving

Think enhancement

Examples

- George Washington University
- Yale University

Institutions that have found efficiencies operating at a large scale, *Think enhancement,* or are small but with few risk factors, *Think differentiation,* have a unique moment in this new era to strengthen their existing offerings through collaboration.

Take, for example, the integrated Keck Science Department shared among three colleges in California – Claremont McKenna, Pitzer and Scripps. The department is housed in a state-of-the-art building that is physically located at the intersection of the three institutions and allows them to offer an array of majors with top-notch faculty that none of them could have provided individually to their students.

The same is true of a collaboration among Babson College, Wellesley College and the Franklin W. Olin College of Engineering, three very different institutions in terms of their missions – entrepreneurship, liberal arts and engineering, respectively – that saw those differences as complementary and a consortium as practical given their geographic proximity. "Important goals of the collaboration include improving opportunities for students and faculty and positioning these places to be more attractive in the future," said Theodore Ducas, Professor of Physics at Wellesley.

Collaborations are no longer limited to colleges in close proximity. Advances in technology can now link together institutions that are separated by hundreds or thousands of miles. In Pennsylvania, 10 liberal arts colleges, including Haverford, Gettysburg, Franklin & Marshall, and Swarthmore, have moved a step beyond the normal course sharing that has usually marked collaborative agreements and are partnering on faculty development, study abroad, and compliance and risk management.

Of course, neighboring colleges have long teamed up on nonacademic operations, sharing police forces or purchasing offices. We have athletic conferences, but there has been little cooperation, if any, on the academic side when it comes to degree programs or entire departments, like Keck.

Survival

3 Small and at risk

Think new strategy

Examples

- Sweet Briar College

4 Large and languishing

Think efficiency

Examples

- Alabama A&M University
- University of South Florida

Institutions with many risk factors, *Think new strategy*, or that are large and inefficient, *Think efficiency*, need partners to quickly cut their costs. Our analysis found more than 800 institutions in those two categories. They include both small colleges that rely heavily on tuition for the bulk of their revenue and large universities that are running budget deficits.

Finding savings in the proverbial low-hanging fruit through traditional cost cutting in peripheral budget areas is no longer an option for most of these campuses if they have any chance of surviving into the next decade. The small colleges in survival mode are unable to draw additional students even as they come to depend more on them to provide needed revenue. The large universities in survival mode have consistently raised their tuition rates above the national averages in recent years but still find themselves in a hole financially.

The time has come for both sets of institutions to find partners. Neither group can move forward alone.

That's what the University of Maine determined in 2015 when it found itself staring at the possibility of a $90 million budget shortfall within five years. Leaders at the 30,000-student system determined that working together would be the only way they could keep operating seven campuses statewide, six of which were in the red in 2014. By running the far-flung campuses more collaboratively as one institution and consolidating administrative functions, the system expected to save about $6 million annually.[5]

[5] "UMaine System passes $518 million budget, prepares for structure, oversight changes," http://bangordailynews.com/2015/05/18/news/state/umaine-system-passes-518-million-budget-prepares-for-structure-oversight-changes, 18 May 2015.

Proposals to merge public colleges have become more common in recent years but have often run into strong opposition from lawmakers and higher education officials. In Georgia, where universities were suffering from years of budget cuts, higher education leaders attempted to head off controversy by making their consolidation process as transparent as possible and following a set of six principles that guided their work.

The consolidation was also framed as a way to free up funds for student success initiatives, not simply to cut spending. As a result, over the course of three years beginning in 2011, leaders of the University System of Georgia approved six campus mergers.[6]

Indeed, our interviews with leaders from institutions nationwide who successfully navigated mergers and other collaborative efforts all pointed to improving quality and access for students as the key driver.

> The small colleges in survival mode are unable to draw additional students even as they come to depend more on them to provide needed revenue.

Not all institutions that need to pursue a survival strategy are struggling. Sometimes this approach is appropriate for universities that are inefficient as stand-alone entities. In 2013, the Texas A&M Health Science Center merged with the much larger Texas A&M University to better leverage the university's research prowess. Before the merger, the Health Science faculty conducted about $80 million in research annually, while the main university had $700 million in research grants. The hope was that if researchers worked more closely together under the umbrella of one university, the institution as a whole could bring in more money overall.[7]

If survival is your strategy, surprisingly, finding a suitable partner is not the biggest obstacle to collaboration, according to a survey Parthenon-EY conducted of 38 institutional leaders. The toughest barrier to overcome? Pushback from internal stakeholders in the process. So as you begin to lay the groundwork for collaboration, be sure your internal priorities realigned and your various constituencies (trustees, faculty, alumni) understand the need to collaborate before you offer up potential models and partners.

[6] Interviews: Theodore Ducas, Professor of Physics, Wellesley College, 4 November 2015; Patrick Norton, VP for Finance and Treasurer, Middlebury College, 3 November 2015; Steve Wrigley, Executive Vice Chancellor, and Shelley Nickel, Vice Chancellor of Planning, Georgia State University, 2 November 2015.

[7] "A&M merger approved," http://www.theeagle.com/news/local/a-m-merger-approved/article_1eb29316-d837-588e-90cb-47d8e297e042.html, 4 August 2012.

A combination of approaches

In some cases, collaboration will mean the marriage of unequal partners. In the business world, the prevailing wisdom has long been that companies grow by merging or acquiring weaker players. But such mergers and acquisitions have been uncommon in higher education until relatively recently.

Now university leaders view linking up with another institution, even sometimes a weaker partner, as a way to build a platform for future growth. That's particularly the case when a university with a relatively narrow focus — in the health professions or art, for instance — joins forces with a comprehensive institution.

Case study #1

When George Washington University was approached with the opportunity to take over the struggling Corcoran Gallery of Art in 2014, the university was interested in the gallery's 120-year-old art and design school and its historic buildings but not in maintaining its extensive art collection. Under an unusual agreement that was forged with the National Gallery of Art, the museum absorbed most of the art, while the university took over the art school, giving it a much-needed academic foothold in art and design without the expense and marketing challenge of building its own.

Our interviews with various constituencies involved in higher education mergers uncovered that financial considerations alone should not drive initial discussions about an affiliation. Starting from the perspective of providing students with increased access to academic programs and improving the overall quality of both institutions in the transaction is paramount.

Case study #2

Such was the case when the Monterey Institute of International Studies approached Middlebury College about a possible affiliation in 2005. Monterey, which offered master's degrees only in international affairs, had run deficits in two of the previous three years and was enrolling several hundred students under its capacity.

Previous merger discussions with larger partners — the the California State University System and the University of the Pacific — fell apart. That's when Monterey went looking for a smaller partner in Middlebury, given the college's historical strength in language instruction and international studies. "The synergies were startling," said Patrick Norton, Vice President for Finance and Treasurer at Middlebury College.

In 2005, the two institutions signed an affiliation agreement, and five years later, the institute turned into a graduate school of Middlebury College, allowing for new degrees, team-taught classes and joint research efforts.

The lengthy period toward integration, however, meant that officials didn't fully merge the finance, HR and IT functions of both institutions as quickly as they should have to realize immediate financial savings. While the motivation for a merger or acquisition should be programmatic, administrative integration should be deliberately pursued as soon as possible in any affiliation.

What's next?

The three-step plan: identify, structure and sustain

The history of higher education is filled with examples of institutions copying competitors by starting new programs, schools or branch campuses. Call it Harvard envy. Driven by the proliferation of the rankings, every college or university wanted to be like another institution that they were competing with or wanted to be more like someone a few rungs up the ladder. What's more, academics often think they can build something better themselves rather than buy it elsewhere. Take as just one example the explosion of open-source course management systems that were created after Blackboard was introduced in the late 1990s.

But in this new era, colleges can no longer afford the time and expense of building their own platforms. Mergers and acquisitions offer the chance for institutions to enter new markets or grow faster than competitors do, oftentimes with less risk and expense than trying to do it themselves.

Collaboration and consolidation have a long history in higher education, of course. According to our own survey, 85% of campus leaders report that they have engaged in some type of collaboration — although with numerous challenges and varying levels of success.

What's different now is that this new era of higher education calls for deeper alliances between institutions, whether it be for survival or expansion. Working with others is likely to improve the financial position and offerings of any individual institution. While collaboration is a natural strategy for large public systems or small private colleges with similar missions located near each other, the path forward for institutions without obvious partners is less clear.

Our conversations with campus leaders at a wide range of institutions suggest a three-step process to consider as you weigh options for partnerships.

In this new era, colleges can no longer afford the time and expense of building their own platforms. Mergers and acquisitions offer institutions new growth opportunities.

The three-step plan

Step one

Identify areas for collaboration

Collaboration can take many different forms and doesn't always need to be seen as resulting in a merger or acquisition. Based on our survey of campus leaders, the most common type of alliance is around academics. Collaboration on administrative and services functions is also common. In both cases, leaders said they chose partners based on complementary strengths.

As you begin to identify areas where partnerships might be possible, here are some key questions to consider:

- What type of collaboration is most useful for your institution?
- To what extent is collaboration necessary to stay financially viable? Is there an opportunity to improve value to students or cut costs?
- What administrative, service and academic departments would benefit most from collaboration, and how deep should those collaborations go?

Step two

Structure potential partnership opportunities

Institutions choose collaborating partners based less on proximity and more on the importance of shared vision. In our survey, college leaders who engaged in academic collaborations said the largest challenge was internal resistance as they attempted to structure the partnership. When colleges partnered on administrative functions and services, the biggest hurdles were around implementing the agreement, specifically on determining matters of control.

As you begin to prepare to structure a deal with a partner, here are some key questions to consider:

- What factors should be used to evaluate the feasibility and attractiveness of a potential partner (e.g., geography, shared vision)?
- Which institution is the best strategic, operational and financial fit for the type of collaboration being sought? What additional collaboration opportunities could we pursue with existing partners?
- How will the collaboration work? Who has to sign off on decisions? How can the two institutions work together operationally?

Step three

Sustain the benefits of a partnership

Forging a partnership might be the easy task; sustaining the benefits of a partnership over the long term could prove more difficult. In our survey, campus leaders said students were the biggest beneficiaries of partnerships because they improve the value of an education. While cost savings were less commonly cited as an important concern for academic collaboration, such partnerships are often an opportunity to "save costs" that would otherwise have been required to build out those capabilities.

As you search for strategies to sustain the benefits of a partnership, here are some key questions to consider:

- How do we realize the full potential benefits of all cost-cutting opportunities identified in the first two phases (e.g., systems integration, real estate optimization)?
- How do we leverage collaboration to enhance value to students through expansion of services and academic offerings?

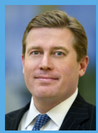
Conclusion

Today's failures of colleges and universities that are heavily publicized in the press are not without precedent in higher education. In the period before the American Civil War, more than 700 colleges closed. In this new era of higher education, collaboration is a strategy that many institutions will need to follow simply to survive.

But partnerships are also a winning approach for colleges operating from a position of relative strength right now. Collaboration can provide a much-needed boost – and quickly – in academic and co-curricular offerings for institutions without strengths in certain areas.

By emphasizing collaboration, we can define this new era of higher education as one of growth through cooperation rather than retrenchment.

Parthenon-EY Education practice contributors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