



**QUESTIONS FOR EXCELLENCE:
A BOARD GUIDE TO COLLEGE AND UNIVERSITY PLANS
Essay 3**

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September 2005**

Asking About Long-Range Finances

A long-range financial plan is built from fund-raising, pricing, and investing strategies. Fund-raising and pricing policies should maximize financial support for the institution. Investing decisions, whether in endowments, programs, buildings, technologies, salaries, or residence halls, should be designed to maximize the benefit of the funds brought in. The long-range financial plan reflects, constrains, and shapes the content and direction of all other plans. The imperatives of the strategic, academic, and technology plans stretch the limits of the financial plan. The financial plan with its reflection of difficult realities constrains the other plans. A vibrant institution will foster the dynamic interplay among all plans.

The hub of a strong financial plan is a financial projection presented to the board finance committee. The investment committee is responsible for investment management and the development committee guides fund-raising. Boards often use overlapping memberships to foster communication among these committees. An effective financial projection, portraying a range of probable outcomes, is constructed from the requirements of other plans, assumptions about future revenue and expense streams, and the impact of college policies. Trustees should view the set of financial plans as a report on the financial viability of the institution. The administration is saying, “If the college or university enacts these policies and makes these assumptions, this is our view of the financial future of the college.”

Plans for fund-raising, endowment management, and pricing are part of the financial plan. Raising resources, managing investments, and setting prices have a direct bearing on the institution’s financial future.

Trustees should ask college leaders about the care taken to understand the financial implications of policies and the diligence in representing assumptions about the



future. Trustees must also probe the depth of the administration's understanding of the college's internal financial systems and the external economic environment.

The Fund-Raising Plan

One of the drivers of a financial projection is the set of assumptions made about future fund-raising success. Fund-raising plan assumptions are based on goals but with a bit of the normal fund-raising optimism removed. In the current, highly competitive world of philanthropy, sophisticated planning is required for financial success. Exhortations that board members do more "asking" are insufficient. A good plan has tangible goals, is properly funded, assigns clear responsibilities, and accounts for its use of college resources.

What is the goal of this fund-raising plan? In other words: Why are we asking for money? While all fund-raising plans have dollar goals, not all make the strategic foundation of the goals clear. In addition to a tangible list of worthwhile projects, a fund-raising plan should reflect important financial strategies. For example, an institution may need to balance a goal of increasing scholarships against a goal of increasing its "quality edge." When an institution uses a gift to replace paid tuition through a scholarship, that gift is not generally available to fund a new project. The plan should also balance the pursuit of gifts for current projects against long-term support through increased endowment, and the plan should express the strategic importance of "bricks and mortar" against less tangible goals. Building a financial strategy requires balancing these opposing priorities. The framework of the strategic plan should guide the priorities of the fund-raising plan as it expresses a preferred balance between affordability and expansion, between future strength and current program investment, and between physical quality (buildings) and academic quality (programs and salaries).

The college or university must offer donors something in return for their gifts. While "giving from the heart" is a wonderful idea, most donors give because of needs that they perceive. A good plan will show how the institutional needs and donor needs can both be met.



What resources will be necessary to achieve the goal? In other words: Is this a good time? Can we do this? Good fund-raising efforts are well timed and should begin in earnest only when resources are sufficient to assure success. Capable staff should be in place. Lead donors should be secured, and a core team of eager volunteers should have been recruited. Ramping up a strong effort requires preparation. Desire alone is insufficient. Proper preparation to implement the plan may require a major step up in the college or university's budget for fund-raising. It is risky to try and make do with meager budgets or budgets based only on hypothetical future gifts. Fund-raising efforts ought not be separately funded by speculative future gifts but should be approved as part of the formal budgeting process. Building college or university budgets on predicted annual gift levels is normal, and trustees weigh the risks involved in all revenue predictions. The formal budgeting process gives trustees a more structured opportunity to evaluate the risks, the trade-offs among investment opportunities, and the adequacy of funding to reach goals. This may not happen if fund-raising is set aside with "self-funding."

Adding difficulty to determining the right investment in fund-raising is the law of diminishing returns. Reaching each new level of success with donors requires more investment than the previous increment. The plan should accommodate these concerns and show that resources are sufficient and that the prospect base is large enough to achieve the goal.

What does this plan ask of the president and the board? In other words: Will leadership resources be used effectively? Clearer communications between the board and the administration start when mutual expectations are on the table. In most fund-raising efforts, the time and commitment of the president and board are the most precious resources. Board members and presidents are very busy. Daily, president-involving emergencies can cause a fund-raiser to become hesitant to take the time of a president, not to mention the time of a volunteer board member. A commitment to spend measured time is critical. A good plan will be specific about the number of hours that the fund-raising office will need of the president's time for priority opportunities. The board's responsibilities should also be detailed, discussed, and accepted.



At what rate are prospects moving through to donors? In other words: How good are we at converting opportunities into benefits? Most fund-raising offices are periodically rebuilt and then improve quickly. Boards should welcome measures of efficiency, not just volume. Cultivation of major donors takes time. Carefully constructed case statements, effective prospect research, and a talent for meeting donor needs will speed improvements. The board needs to see a measure of donor cultivation efficiency. This is also an opportunity for benchmarking—comparing the investment of time per dollar raised among competing, but friendly, peers. This will help the board monitor fund-raising capabilities and priorities.

How much are we raising at what expense? In other words: What is the return on investment for fund-raising? A college or university has many opportunities for investment. New academic programs, scholarships, new buildings, and even landscaping are expected to yield returns when funds are invested in them. The results of investments in fund-raising are more easily measured than most investments. Fund-raising should not be done because everyone else does it. Fund-raising must yield an attractive return.

An edifying answer will link fund-raising expenses to each area of development. The simplest model comes from the annual fund, to which yearly expenses return yearly gifts. The effectiveness of resources invested in planned giving is much harder to ascertain, but the board needs to understand the relationship between today's investments and the expectations of tomorrow. Some comparative information for benchmarking is available from national associations of development officers. Dialogues based on the preceding questions can help the board compare realizations against expectations and may help demonstrate the wisdom of additional investments.

Endowment Policies

How might the primary strategic purposes of the endowment be described: to support the budget, to support students (scholarships), to buffer against financial swings, to support important future programs, or to invest in current strategic programs? In other words: At



what level should we set endowment payout? Balancing current and future needs is difficult. The response should assist trustees in understanding the split of endowment support between scholarships and other budget items. The more an endowment supports scholarships, the more the intended growth rate of the endowment must be in line with expected tuition growth, perhaps limiting the payout rate. On the other hand, to the extent that gifts to the endowment are intended to sustain current activities, a higher rate of endowment payout may be needed to balance today's needs with tomorrow's. The stated purposes of gifts to the endowment as divided between support for new and support for continuing projects can affect the payout rate decision. The planned payout or take-down rate should sustain these strategic purposes over the long run.

A high rate of endowment gift giving can also be used to justify a higher rate of payout, if the gifts have not been designated to support new programs. New endowment meant for new programs, however, does not allow a higher payout rate—the return is “spoken for.” New endowment that can support *existing* programs will expand expected future levels of budget support. In that case, the payout rate might be raised as an offset, bringing current support strength in line with expected future support.

What do the laws of our state say about trustee responsibility for investments, and how will we be assisted in staying within these laws? In other words: What are our legal, fiduciary responsibilities? “Prudent” endowment management is widely required by law, but each state has peculiar variations and details. Institutional leaders should be ready to provide trustees with any legislative changes that pertain to trustee fiduciary requirements. In addition, the college has a duty to assist trustees in fulfilling these requirements. Trustees should be made aware of assessments of investment risk, investment staff changes, investment manager changes, relevant changes to debt covenants, and relevant additions to fiduciary law precedent. While Sarbanes-Oxley regulations do not apply to nonprofits, the rigor of their requisite search for risk has appealed to both trustees and state authorities. Trustees need to stay informed of their exposure. Investment choices that may increase investment risk for the sake of possible higher returns, for example, need to be documented and demonstrably well-informed.



College and university administrations are responsible for the support of trustee assessments of risk tolerance and prudence.

What investment options are precluded by cash flow needs or non-financial considerations? In other words: What shouldn't we invest in? Trustees advising on the endowment often have the opportunity to suggest investments with delayed cash returns, for example, certain real estate and venture capital opportunities. Many institutions have successfully invested in private ventures that do not release cash returns for many years. Other institutions have avoided illiquid investments because of the need to maintain steady returns and the difficulty of using only a portion of investment as a revenue source. In a down market, if only a portion of investments are liquid and providing revenue, a sizable proportion of the liquid investments may need to be sold under unfavorable conditions to provide the required institutional support.

The response to this question should give both the cash-need restrictions on investments and the campus climate on investment limitations. There are a variety of options for maintaining working capital beyond limiting investments to those that are liquid, for example, the use of lines of credit.

How substantially can the financial administrators of this college or university handle the management of the endowment? In other words: How much outside professional assistance do we need? Few colleges have financial staff members with a background in investing and investment analysis. An adequate presentation of the depth of preparation for in-house investment management will assist the board in setting requirements for portfolio management and other forms of investment advising.

Tuition Projections

What is the real gain of raising prices? In other words: What is the elasticity of tuition revenue? Every tuition increase leads to an increased financial burden on students. Some of this burden is met with increased financial aid. For some students, however, this increased burden becomes a reason for leaving school. To the extent that the college



increases the availability of its own funds for financial aid, it fails to realize the full potential of the tuition increase. Thus, the expected revenue gain from a tuition increase is depressed by added financial aid and by decisions made by potential students not to attend and current students not to re-enroll. (An expanded discussion of elasticity can be found in Chapter 4.)

After a student leaves this college or university, what will be his or her continuing loan burden? In other words: Are there trends in customer financing of purchases that foretell growing customer resistance? Millions of students in the United States finance all or a portion of their higher education with loans. The amounts borrowed and the numbers of borrowers are increasing every year. Evidence of resistance to an increased burden is beginning to appear, both from students and from legislators. The appropriate size of a student's debt upon separation is both a moral and a financial question. College or university leaders should be grappling with these questions and should be doing so with solid information. Trustees should be assisted in grasping trends in the indebtedness of both graduates and dropouts. Another helpful statistic is the trend in graduate debt compared against average starting salary. The ability of graduates to repay school loans may be changing in ways that indicate that the institution is becoming less affordable.

In real terms, has a family's tuition financial burden changed? In other words: Has customer ability to pay changed? Families recognize the tuition burden in three ways: the list price, the amount to be financed, and the out-of-pocket cost. Stated tuition is the list price. The amount remaining after the application of discounts, grants, and scholarships must be financed by loans or come from the student's pocket and/or her family's pocket. Answering this question requires that the institution track the amount that students and their families are financing.

Trends in an average student's annual tuition expense after grants can be compared with trends in family income. A full analysis of net tuition (average tuition after grants) can be developed by showing how this burden has changed for students with differing levels of financial preparation. The addition of trends in the expected family contribution of aid recipients calculated by federal formula will add to this response by



showing changes in student financial preparation. Also, the ratio of need-based aid recipients to all students can be used to demonstrate changes in student ability to pay. Finally, the average amount of student educational costs that are not covered by expected family, federal, state, private, or institutional sources (unmet need) can chart the changing burden on students with financial need.

Financial Projections

What are the assumptions built into these projections? In other words: What's behind these numbers? The numbers themselves are less worthy of examination than the assumptions that produce them. Policies and assumptions drive financial projections. All assumptions used to make the projections, including anticipated trends in inflation, family income, and investment market performance, should be presented to the board. The basis for making these assumptions should be explained and the sensitivity of the projected financial results to errors in these assumptions should also be included.

When will this college or university reach true equilibrium—the point at which the institution's financial position, endowment purchasing power, facility adequacy, infrastructure adequacy, human resources (as in competitive salaries), and tuition leverage no longer show signs of deterioration? In other words: Will we be in better or worse shape in the final year of the projection than we are now? True equilibrium protects all resources. The protection of financial resources as demonstrated by budget balance is only one factor in the equation. Budgets may be balanced by avoiding plant maintenance or draining investments. Budgets may also be balanced with tuition increases that may not be sustainable in a competitive market. Balancing the budget by keeping salaries below those maintained at peer institutions can prompt turnover, representing a decline in human resources. In all these cases, equilibrium has not been achieved.

The college or university's strategies should lead to financial equilibrium. Otherwise, the institution will not be moving ahead, it will only be putting off its closing.



The financial plan should make provision not only for balancing the budget in the future, but for preserving buildings, the endowment, and the people of the college.

What policy compromises are evident in the projection? In other words: How were the policy trade-offs in the projection made, and are they compatible with the mission and strategies? A coherent plan for the future requires many trade-offs among valued financial opportunities. Higher salaries may require faster tuition growth. The debt service on a new building may require slowed salary growth. A reasonable projection will highlight the administration's trade-off preferences for salary growth rates, tuition growth rate, financial aid policy, new program support, austerity rates (planned base-budget cutting), and asset maintenance for equilibrium. These compromises should be consistent with the college or university's mission, values, strategies, and vision as understood by the trustees.

All of these questions are tough. Each makes clear the difficulty of managing the finances of a college or university. Today's administrators are more professionally trained and more passionately committed to higher education than ever before. Trustees should respond to this financial management professionalism with a set of expectations for high performance. These questions are designed to bring out the best in college and university leaders.