I&P

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Don't Panic! Sustain Your School During Economic Downturns

The subprime mortgage crisis in the United States reached a critical stage in September 2008, forcing the federal government to take measures to stave off a potential economic collapse by enacting the Emergency Economic Stabilization Act of 2008, a bailout of the U.S. financial system, on October 3, 2008. This situation in the U.S., linked with similar weaknesses in some other countries, has disrupted the global economy. The ramifications of the downturn may or may not be experienced for years—economists are far from agreement. As John Kenneth Galbraith said, "The only function of economic forecasting is to make astrology look respectable."

As we continue in a period of uncertainty in our national life, private-independent school Boards may be tempted to make drastic changes during this year's budgeting process. History suggests, however, that we will eventually rebound from these tough times, and draconian measures will only compromise your school's stature and weaken its competitive edge. (For more on strategies for handling the current situation, see the following article, "Hard Economic Times: Dos and Don'ts for Private-Independent Schools.")

Looking back to historical shocks that rocked U.S. financial markets (e.g., scandals, major bankruptcies, bank failures,

Table 1: How U.S. Financial Markets Reacted to Major Financial Shocks

Event Name	Event Type	Key Month	Months to Market Improvement*
Penn Central Bankruptcy	Bankruptcy	Jun-70	7
Arab Oil Embargo	Financial Crisis	Oct-73	12
Watergate/Nixon Resignation	Political Crisis	Aug-74	2
Chrysler Loan	Near Bankruptcy	Sep-79	2
President Reagan Shot	Political Crisis	Mar-81	1
Latin American Debt Crisis	Financial Crisis	Aug-82	1
S&L Industry Crisis	Bankruptcy	Jan-87	1
U.S. Stock Market Crash of '87	Financial Crisis	Oct-87	2
Gulf War I	Political Crisis	Aug-90	4
Salomon Treasury Bond Scandal	Financial Crisis	May-91	1
Barings Bank Collapse	Bankruptcy	Feb-95	0
Asian Financial Crisis	Financial Crisis	Jul-97	2
Impeachment of President Clinton	Political Crisis	Dec-98	2
Dot Com Bubble Burst	Financial Crisis	Jan-00	30
9/11 Terrorist Attacks	Political Crisis	Sep-01	12
Enron Scandal	Bankruptcy	Oct-01	1
Collapse in Refco	Bankruptcy	Oct-05	3

*"Months to Market Improvement" indicates the approximate amount of time that elapsed until the S&P 500 Index either recovered to its level prior to the "Event," or until the S&P 500 Index began a path of sustained improvement following the Event.

Table 2: How Schools Fared After the 1987 Stock Market Crash
(Based on Porter Sargent School Profiles[1])

School	1986 Tuition[2]	1988 Tuition[2]	% Chg.[3]	1986 Enr.	1988 Enr.	% Chg.[3]	1986 Endow.	1988 Endow.	% Chg.[3]
Cincinnati CDS (OH)	$5,550	$5,950	7.2%	730	732	0.2%	$4.9M	$6.0M	22.4%
Kinkaid School (TX)	$4,825	$5,075	5.0%	1,236	1,253	1.3%	$11.0M	$21.0M	90.9%
Madeira School (VA)	$6,950	$7,700	10.8%	336	336	0.0%	$8.2M	$12.8M	56.1%
Pingree School (MA)	$6,220	$7,640	22.8%	233	232	-0.4%	n/a	n/a	n/a
Sandia Preparatory School (NM)	$3,650	$4,400	20.6%	273	287	5.1%	n/a	n/a	n/a
Savannah CDS (GA)	$3,495	$4,140	18.5%	844	793	-6.0%	$665K	$659K	-0.9%
Tatnall School (DE)	$5,825	$6,400	9.8%	729	713	-2.2%	$2.4M	$4.5M	87.5%
Wichita Collegiate School (KS)	$3,500	$3,780	8.0%	600	630	5.0%	n/a	n/a	n/a

1 See *The Handbook of Private Schools*, published annually by Porter Sargent Publishers, 11 Beacon St., Boston, MA 02108. We selected one school from each geographic region used in the handbook.
2 Where a school had more than one tuition level, the highest tuition was used for this table.
3 Percentages have been rounded.

wars, disasters), it's clear that the markets not only survived, but tended to rebound quickly and even flourish after a hardship. Consider Table 1: How U.S. Financial Markets Reacted to Major Financial Shocks, developed by the research team of Genworth Financial Wealth Management (2300 Contra Costa Blvd., Suite 600, Pleasant Hill, CA 94523).[1]

Looking back through history to past recessions, we can also see that most private-independent schools sustained their enrollment, tuition, and fund-raising levels despite economic hardships. Consider Table 2: How Schools Fared After the 1987 Stock Market Crash, showing how eight schools from regions around the nation weathered the event. All eight schools increased their tuition levels over the period, all maintained their enrollments or had only slight decreases, and all but one experienced an increase in endowment.

Enrollment and Tuition

In the midst of the current financial woes and uncertainty, many parents are likely to complain about any tuition increase and many are likely to apply for financial aid or scholarships. Before deciding not to increase tuition next year, however, recognize that most private school families will still have sufficient discretionary income but will simply have to make lifestyle choices in order to pay for tuition.[2] They may postpone an expensive vacation or keep the family SUV another year, but few will skimp on their children's education. Educate parents about why any planned tuition increases are truly needed and worth any temporary sacrifice in lifestyle that they may have to make.[3]

Charitable Giving

During the last 40 years, according to the Giving USA Foundation, charitable giving typically rebounded within a year of a national crisis. Although the education sector often suffers more than other sectors during recessions, the loss is rarely significant (1%–2%) and is rapidly recovered.[4]

Annual fund contributions to schools typically flow from a donor's discretionary income. It is uncertain how agreeable a family will be to "dig into" its discretionary funds to make additional donations—to your school and other entities—during this economic downturn. Dependence on raised funds (soft income) to cover operating expenses complicates your ability to plan for and sustain programmatic excellence over time. Cutting programs and services to balance the budget is not a prudent option. If your fund raising is now covering a significant portion of your operating expenses, moving your school to a viability position is sound stewardship. Revisit your dependence on soft income during your next planning or budget cycle and begin to increase the percent of operating expense you are covering with hard income.[5]

Strengthen your school's position to meet the future with confidence. Being prepared to weather all types of crises is the hallmark of a well-run school. Sound planning and implementation will get your school through both the short- and long-term hurdles to sustainable stability and viability. *I&P*

1 This research was published in the company's e-letter in the article, "This Too Shall Pass: Major Financial Shocks and Market Recoveries, 1970-2008."
2 ISM's recent parent survey showed clearly that 89% of all parents reported having an annual gross family income of more than $75,000 ($72,785 was the national median income for a married couple in 2007), while over 50% had a gross income of more than $175,000. See "The ISM 37-School Parent Survey: Why Families Can Afford Your School's Tuition," *Ideas & Perspectives*, 33-13-51. For more on tuition, see the ISM publication, *The Tuition Book: Theory, Implementation & Financial Aid*, available for purchase online at **isminc.com/tuitionbook**
3 See "Money Follows Performance—When Validated," *I&P*, 32-12-50.
4 To track the latest trends and research concerning philanthropy, visit the Giving USA Foundation Web site at **givingusa.org**
5 See "Hard Income Coverage and Strategic Planning," *I&P*, 32-9-37.

Hard Economic Times: Dos and Don'ts for Private-Independent Schools

The international economic crisis is, we are reliably told, unprecedented—and it may be far from over. With this in mind, what useful framework of "dos" and "don'ts" might be entertained by private-independent school leaders?

ISM suggests the following.

- **DO continue to do strategic planning/strategic financial planning.**[1] If your six-year strategic plan is in Year One or Year Two, and if the document was formulated with assumptions about the economy that appear threatened, consider moving your quadrennial planning activity forward to the spring of the current school year. Your existing plan may include assumptions that are now too optimistic regarding:
  a. your enrollment demand,
  b. your inflation projection (i.e., the "floor gradient" in your strategic plan),
  c. the yield on an endowment corpus or a cash-reserve corpus, and/or
  d. expected non-capital or capital-project fund raising.
- **DON'T violate the published and marketed tuition gradient shown by your current strategic plan/strategic financial plan.**[2] However new or old your current plan may be, you have marketed the document carefully to your parent body. Remember that the tuition gradient that was delineated at that time constitutes an informal agreement with your parents, one that you should go to great lengths not to exceed.

  But if the economic crisis forces you to alter that gradient, simply accept the fact that this will require a complete re-marketing of the strategic plan. As you did originally, you will again be certain to market your projected tuition gradient as a function of your assumptions, especially regarding enrollment and inflation.
- **DO continue to work hard on building your faculty culture, focused on professional growth.**[3] This, the critical factor in achieving and sustaining high-level student performance, satisfaction, and enthusiasm, must continue to receive full-bore academic-management attention and support. Of all the items on an academic administrator's yearly agenda, this one should be the very last to be considered for reduced emphasis, no matter what sort of financial (and other) pressure may be exerted from the outside.
- **DON'T reduce the budget line dedicated to faculty professional growth and development.**[4] This budget line—ISM's benchmark figure is 1.5%–2.0% of the school's budget—should be fully spent, even if you are trying to cut expenses in other areas. Do not allow the quality of the delivery of your core service to suffer; maintain your emphasis on faculty-culture enhancement, including full financial support for teachers' professional development proposals.
- **DO reduce staffing, if opportunities present themselves and conditions allow, by means of attrition.**[5] The effects on your faculty culture of staff reduction by attrition can be expected to be mild in comparison to reduction by dismissal. If your enrollment is dropping below your strategic plan projections, consider the wisdom of opportunistic reductions in the salary and benefits budget lines by not replacing those who leave your employ of their own volition.
- **DON'T reduce staffing by dismissal (except for cause).** Firing for cause must, of course, be undertaken under any and all circumstances.[6] However, reducing staff for budget alignment purposes will be dangerous. The decision to take good-to-excellent employees off the payroll for budget-balancing purposes will place at substantial risk the quality of the core service of the institution—delivery of the mission to the student body. Faculty anxiety and hostility can be expected to destroy what might, days before, have been a superb faculty culture.
- **DO continue to increase tuition, at a minimum, at a rate consistent with your prior estimate of inflation.** Inflation will not take a year off due to the financial crisis. The floor gradient (i.e., your inflationary assumption) that you projected and marketed to your parent body when you finished your current strategic plan may—or may not—increase during economic hard times.

  ISM's standard recommendation that your floor gradient comprise your projection of inflation plus 2% gives you some cushion, should inflation exceed your assumptions.[7] Without this determined adherence to a fundamental financial reality, you will be unable to assure your constituents that their children will experience the same instructional process and quality as was operative prior to the crisis.
- **DON'T freeze salaries.** No one goes into teaching to get rich. But it is unreasonable to assume that teachers will ungrudgingly accept a salary freeze. They understand that, given inflation, a freeze constitutes a de facto reduction in pay (i.e., in their purchasing power). They understand that this is a reduction that they did not "earn." No amount of explanation is likely to ease the ill will generated by this maneuver.
- **DO utilize your cash reserves, as needed.** The accumulation of cash reserves (ISM Stability Marker™ No. 1) provides you with an unrestricted corpus—readily accessible—to which you can turn for any legitimate purpose, including feeding more hard income (accumulated revenues) into the budget lines.[8] If you have reached and maintained ISM's recommended benchmark for reserves of an amount equal to 15%–20% of one year's operations budget, then you may find that this is the time to begin to draw on those reserves.

  Reserves should be built to the ISM benchmark level as a matter of strategic-financial due diligence, but, once you find a need for the reserves, these funds should not be hoarded. They are there to be used. If, for example, your anticipated non-capital annual fund-raising figure (in your strategic plan) falls by 10% this year, replace that money with reserves. If you anticipated endowment growth of 7% this year, and you find that usable interest in support of your operations budget will fall short of that, replace some or all of what you expected, with your reserves. If your strategic plan's enrollment projection was flat—which is

ISM's standard recommendation unless a school is still adding grades or sections—and you find that there is a decline of five students, replace some or all of that revenue with reserves.

Obviously, this process will have limits. But while your reserves are in place, they should be considered the best "bridge money" you have at your disposal to tide you over to better economic times.

- **DON'T borrow money from lending agencies.**[9] Borrowing from your own resources is preferable, even if the borrowing is from a protected endowment corpus. If you decide upon this course of action, give the transaction all the formality of borrowing from a lender: Draw up proper documents, have your attorney review them, and then sign them, witness them, and adhere rigidly to the stated repayment schedule (with interest).
- **DO keep to your (renegotiated) debt-retirement schedule.** Renegotiating loan-repayment terms is a good idea. Failing to adhere to agreed-upon terms is not. Moving money from your reserves for this purpose (keeping to a debt-service schedule) is perfectly acceptable. Borrowing money from yourself (i.e., your endowment) in order to keep to a debt service schedule is also acceptable (see previous bullet point).
- **DON'T reduce employee benefits.**[10] Your employee benefit packages are vital to your employees. This is not a place in which legitimate budget cuts can be made in an economic crisis—although, during your normal strategic planning cycle, adjustments to your benefit packages should be considered the norm, not the exception. Such adjustments constitute strategic activity, and are always appropriate.
- **DO take this opportunity to foster stewardship for your school's resources.** As everyone from governments to corporations to families is reviewing current and planned expenditures, engage the school's staff and faculty to re-examine budgets and identify cost-saving opportunities. Optimal use of the school's assets is the responsibility of every stakeholder.
- **DON'T display angst.** Calm assurance in the face of crisis is also leadership of the highest order. The value of a strategic plan/strategic financial plan is that the very fact of having this critical document permits the confident comparison of projected numbers—budget lines of revenue and expense, and, of course, enrollment assumptions—with actual numbers, and allows the display of confident pre- and re-calculations regarding adjustments to the plan in the face of this, or other, crises. (Again, note that ISM has urged flat projections always, regardless of "the times," unless your school is adding grades or sections.)
- **DO reassure teachers and parents that your school's mission will continue to be delivered at the highest level.**[11] This is leadership. While you cannot assure your parent body that "everything will be all right in the economy," you can assure them that the school will continue to deliver the mission for which they signed up and for which they pay tuition. This assurance can and should also be delivered to the faculty and staff, with the proviso that staff reduction by attrition may indeed be allowed to occur, and, if so, ripple effects should be expected throughout the employee ranks (i.e., heavier work loads in order to compensate).

All of this is an expression, in one way or another, of ISM's "levers" metaphor, i.e., strategic plans/strategic financial plans represent the calculated manipulation of three variables.[12] These "levers" are:

1. faculty/staff compensation,
2. net tuition revenue, and
3. the student/staff ratio (the ratio representing the number of those who are paying the school over the number of those who are being paid by the school).

The levers are, in strategic/financial planning, set in relationship to each other in such ways as to produce balanced budgets. The movement of any of the three levers has an effect on the others, i.e., the levers are connected to each other by gears that metaphorically link them together.

Your strategic plan/strategic financial plan operates on this basis, and, where the position of a given lever proves unsustainable in the face of economic adversity (e.g., an enrollment decline that substantially reduces the student/staff ratio), then responses may be entertained in the following order:

1. reduction of faculty/staff by attrition (thereby restoring the faculty/staff ratio by lowering the denominator);
2. transfer of cash reserves into the budget in order to supplement the revenue produced by the tuition/fees lever;
3. a formal borrowing arrangement with your own endowment; and
4. a reduction in your published (strategic plan) tuition gradient, *but only to the level of the "floor gradient" (i.e., the inflationary assumption that is built into your plan).*

Your school will almost certainly survive this (or any) economic crisis—provided it has adhered in its strategic/financial planning to ISM's Stability Markers. Ensure that the school that weathers the storm is, in fact, the school that you have worked so hard to build. Make sure that what moves into the future is the school that delivers *this* mission, at *this* level of excellence, with *this* faculty culture. Use these dos and don'ts to guide your decision-making not just during economic crises, but in all economic times. *I&P*

1 See "The Board and Your School's Strategic Financial Plan," *To The Point*, 13-8-43; "A Line-by-Line Guide to Developing a Strategic Financial Plan," 13-8-44; and "Strategic Financial Plan Checklist: Build Your Board's Financial Expertise," 14-3-17.
2 See "Hard Income Coverage and Strategic Planning," *Ideas & Perspectives*, 32-9-37.
3 See "The Faculty Culture Profile: A Tool for Assessment and Change," *TTP*, 12-4-21.
4 See "Professional Development: The Best Place to Invest," *TTP*, 13-5-26.
5 For ISM's comments on strategic downsizing, see *I&P*, 31-15-57.
6 See "Predictability, Support, and Protection: Establishing a Corrective Action Policy," *I&P*, 33-3-11.
7 See "Appropriate Tuition Adjustment: Recasting Financial Figures, 2008-09," *I&P*, 33-11-45.
8 See "The Third Iteration of ISM Stability Markers," *I&P*, 31-10-37. See also "Cash Reserves: Stability and Opportunity," 32-4-17.
9 See "Tax-Exempt Bonds: Ill-Advised Debt," *I&P*, 24-6-24.
10 See "Annual Statements Show the Value of Employee Benefits," *TTP*, 14-2-11.
11 See "Purpose and Outcome Statements: Capture the Essence of Your School," *I&P*, 31-5-17.
12 See "Your School's Financial Equilibrium: The Three 'Levers,'" *TTP*, 12-3-13.

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