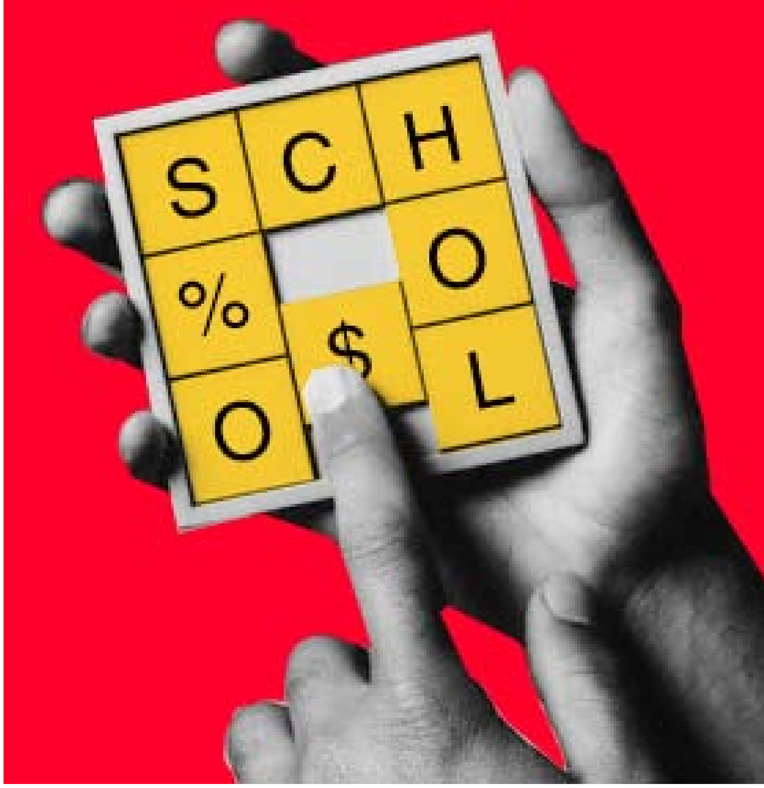

A Game-Changing Model for Financially Sustainable Schools

By Patrick F. Bassett

During the 2008–2009 school year, like a "tale of two cities," independent schools simultaneously faced the best of times and the worst of times. In this period of recession and economic uncertainty, most NAIS-member schools planned prudently and managed to open school in the fall, meeting enrollment and budget goals by expanding financial aid and trimming budgets, some finding ways to "right-size" by cutting back on program and staff in nonessential areas. It's heartening to know that most of our constituents determined that paying the tuition was not a luxury but a necessity: in many cases, everything else on the family budget was on the block, *except* the schooling, where the needs of their children were being well-met. Another "best of times" piece of good news is that independent school leaders and boards found ways to economize and increase efficiencies, by following their own instincts and by taking NAIS's challenge to "sail directly into the storm" — using the crisis to make the hard decisions that are ordinarily difficult to implement in the family-like and consensus-rooted cultures of independent schools.

Nonetheless, some schools may still face "the worst of times" because of two unprecedented factors.

1. Unsustainable Tuition Increases

First, while this year's median tuition increase is in the 4–5 percent range (one of only a few years of moderation in our 50-plus-year trend of raising tuition well beyond the Consumer Price Index), the challenge for the coming year will be setting tuition increases at anything above CPI-0, given that the economic downturn is producing very low inflation — in fact, by current calculations, negative inflation.[1]

This continued aggressive growth of tuitions cannot possibly be sustainable for much longer, given three new realities:

• Many schools had already hit their "price-break point" before the recession. Many more hit it during the recession, when the market began pushing back. This is evident by fewer inquiries, fewer applications, higher attrition, and more families applying for financial aid, including unprecedented numbers of formerly full-pay current families.

• Median inflation-adjusted incomes for families in the top 5 percent ($200,000 and above) were flat in 2007 and went *down* in 2008.[2] Also, discretionary income is probably fated to take some major hits for this income group, with tax rates and medical premiums likely to rise. The early signs of our market's "global cooling" in many regions is evident in the softness in pre-school and kindergarten admissions. Thus, the major factors that have permitted high tuition increases (parental demand for more of everything and parents' willingness and capacity to pay for subsequent programmatic additions) may become intersecting — not parallel — lines.

• The "rule of thumb" that many schools have adopted over the years of CPI+2 may become a practice no longer possible, not to mention prudent, especially since the "rule of thumb" has historically been stretched to CPI+3 (see sidebars on day and boarding schools). "Street knowledge" by savvy parents about our price increases make some increasingly wary about their capacity to pay tuitions 13 years from now, even if they can afford pre-school now.

2. Competition in the Marketplace

A second factor that may forestall high tuition increases is the growth in many markets of low- or no-cost school options, often foundation-supported, that are programmatically competitive. This includes public charter and magnet schools and consolidated, market-driven, college-prep parochial schools, online schools, and homeschool cooperatives, all of whom are now much more sophisticated in marketing not only their similarity to independent schools, but also their price advantage. The new price-setting reality can be visualized as an equation in which the perceived outcomes numerator divided by the perceived price denominator indicates the value (or the value-added) of a school[3]:

$$\text{Value} = \frac{\text{Perceived Outcomes}}{\text{Perceived Price}}$$

In the "new normal" budgeting process, the foundational assumption is that the board's key role, ultimately the primary function of the board, is to secure the future of the school.

Thus, as price goes up, unrelentingly beyond what's "normal" for most other goods and services (*i.e.*, the rate of inflation), the perceived outcomes *must* go up for perceived value to remain the same. If the market judges that perceived outcomes for homeschooling, charter schools, magnet schools, academically high-powered parochial schools, and lower-priced independent schools produce similar results to higher-priced independent schools, then the competition's value proposition exceeds that of independent schools simply by the dynamics of the equation: lower cost with similar outcomes equals higher value.

Put another way, there's been a lot more traffic in T.J. Maxx lately than in Nordstrom.

So, NAIS sees the Dickensian context some and maybe many independent schools face as "game-changing" and, in the long-run, we believe those schools whose game plan is to adapt strategically will be those that are built to last. Towards that end, NAIS recommends several options for consideration in the financial modeling and budget-planning processes, a kind of "new normal"[4] that should supersede the "old normal" (business as usual) rules of thumb.

Old Normal

To its credit, the "old normal" budgeting process has been conducted with studious diligence and effective outcomes in terms of creating and sustaining many excellent schools.[5] In the "old normal," the foundational assumption is that the board members' key role is to find the resources to move the school from "good to great" right now, serving their own children (for current-parent board members) and their children's peers. Budgeting starts with identifying the needs of the organization, after which tuition is set, predictably resulting in high tuition increases seen as the only lever to pull in order to balance the budget without sacrificing what has been deemed as "necessary." And too much of what is in the "nice to have" column has migrated over time to the "must have" column. Part of the "old normal" is the assumption that spending has no limits to it. More specifically, the "business as usual" approach to the budgeting process is rooted in the old assumptions that high tuition increases are necessary to expand program and staff while simultaneously sustaining both small classes and competitive faculty salaries. These assumptions are predicated on the belief that families in the top 5 percent income bracket will always be able and willing to pay whatever we ask.

New Normal

In the "new normal" budgeting process, the foundational assumption is that the board's key role, ultimately the primary function of the board, is to secure the future of the school. Given the expectations we've set, another assumption is that schools will continue to commit to competitive salaries and "intimate environments" where each child is known. But the starting and ending points of the new normal process are reversed.

In the new normal, budgeting *starts* with an economic assessment of the community's capacity to pay, a demographic study projecting forward how many families with children will have that capacity to pay,[6] and a realistic assessment of the school's relative strength in the market based on five-year admissions funnel trends. Based on this assessment, individual schools determine the tolerance for tuition increases, which could range from none (tuition freeze) to modest (CPI or CPI+1) to high (anything over that), based on local circumstances. Once price is set, then a strategic assessment begins on how to increase non-tuition revenues and decrease costs without sacrificing quality or core programming.

This game-changing new vision is based on the assumption that aggressive tuition increases have undermined demand (or will soon). Key to the new normal will be improved "productivity" without a decrease in quality by adopting the discipline of:

- committing to increasing enrollment without increasing staff;

- adopting a "sunset provision" of retiring an old program when introducing a new one so that no net staffing increases are required (and deciding which is which by using a value-proposition survey such as *The NAIS Parent Satisfaction Survey*);

- rightsizing to assure that mission, program, and staffing are aligned;

- re-thinking class size or workload or the number of teacher specialists and assistants; and

• setting a policy that devotes a third of each fund-raising dollar (annual giving, special events, and capital giving) to endowment — ultimately, the long-term insurance policy that guarantees the school's future existence.

In the new normal, budgeting ends not with tuition-setting (which is now a constant, rather than a variable factor in the budget formula), but with "quality engineering" a balanced and sustainable budget.

NAIS has long argued that being the value leader is more strategic and better aligned with the historic purpose of independent schools than being the price leader. Nonetheless, for that small minority of elite boarding schools and urban schools where demand far exceeds supply (Los Angeles and New York City, for example), there will remain much more price flexibility than for most of the rest of the industry. But *even for these schools*, I would argue for discipline on the expense side so that higher-than-necessary tuition increases would not be used to allow additional increased expenditures, but rather be used to invest in endowment. If these schools would adopt the same expense-side conservatism and sequencing (setting tuition first) that we are advocating, then any marginal additional percentage increase they may charge (say 2 percent) would become a budget-line transfer to reserves (quasi-endowment). By this means, over time, the higher endowment income *could and should* replace the need for higher tuition increases, if schools can resist the temptation to spend every available dollar. If not, higher endowments will correlate perversely in the future, as in the present, not with lower but higher tuitions.

Finally, the budgeting process *must* be seen as part of a larger strategic theme of "sustainability." As an NAIS board member is fond of saying, "If you are not a school *of* the future, you may not be a school *with* a future." Beyond the financial game-changing measures some schools must consider, all schools may be increasingly expected to adopt new technologies and teaching strategies to improve the outcomes for their students in the 21st century. The new professional learning communities in independent schools will teach the skills and values that will be demanded and rewarded in the future marketplace.[7] And as our schools do this, the outcomes numerator of the value proposition formula will take pressure off the price denominator.

Patrick F. Bassett is president of NAIS.

Notes

1. According to Bureau of Labor Statistics, the calendar-year inflation from December to December of last year was one tenth of one percent (0.1 percent), effectively zero. (An anomaly last year shows the full 2008 inflation to have been 3.8 percent, but most economists prefer the December to December methodology, resulting in the 0.1 percent being the figure most reported in the media, such as the *Wall Street Journal*: "Inflation Lowest Since 1954." *http://online.wsj.com/article/SB123211233305290077.html*.
2. See *www.census.gov/hhes/www/income/histinc/incfamdet.html*.
3. See NAIS's book *Affordability and Demand* where several chapters address one version or another of this basic market calculation.
4. The concept of "new normal," as it pertains to tuition setting in independent schools, is borrowed from Independent School Leadership's *Head to Head* newsletter (November, 2009), which, in turn borrows the phrase from ABC News. As the newsletter notes, "Basically, the 'New Normal' reflects an adjusted way of life predicated on the prediction that this recessionary economy will recover much slower than past recessions, thereby making it very difficult for people to recoup past losses. A slower recovery significantly reduces investment levels, prolongs high unemployment, and contributes to a lagging rate of growth, even though spending may pick up (*The Economist*, Oct. 6, 2009)." *www.nais.org/resources/article.cfm?ItemNumber=152698*.
5. James Pugh's *A Trustee's Guide to the Operating Budget* is an excellent overview of standard practice. Available at *www.nais.org*.
6. Create from the Demographics Center and StatsOnline Benchmarking (*www.nais.org*) reports to illustrate the demographic and statistical position of your school.
7. See in the Fall 2009 issue of *Independent School*, "Demonstrations of Learning for 21st-Century Schools."