

The Net or the Noose

Develop sustainable financial aid strategies to prevent budgetary troubles.

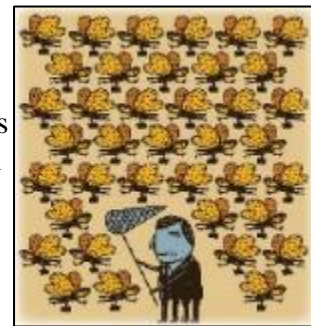
By Linda Cox Maguire

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Financial aid is one of the most powerful tools that institutions of higher education have to shape their incoming classes and achieve their strategic goals. Yet, as college and university leaders have become more aggressive in shaping their classes with various need-based and merit aid strategies, many have realized too late that they are on financially unsustainable courses. A double-edged sword, financial aid strategies can be the "net" that prevents colleges from falling into difficulties-or the "noose" that leads them inexorably into trouble.

Solution: quadruple the Aid Budget

Consider the case of one private two-year institution in New England. Enrollment at the college had been steadily declining, and tuition costs were relatively high for a two-year school. Moreover, market research determined that 89 percent of the college's students would have preferred a four-year college but were held back by low grades and test scores. As a result, the college was losing students both to less expensive community colleges and to more prestigious four-year institutions. At its low point, enrollment had fallen to 350 students and the college was facing bankruptcy.



The college desperately needed more students to survive, but its trustees were reluctant to increase the financial aid budget. They had set a maximum tuition discount rate (that is, the proportion of total tuition directed to financial aid) to keep the college within a "healthy" range. They had determined that a healthy discount needed to be under 40 percent, a ratio that was far too low to attract the student body they needed to generate adequate net revenues. By trying to keep its discount rate artificially low, the college was starving itself to death.

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At a contentious trustees meeting, we recommended that the college increase its financial aid budget by 300 percent. Our argument: The discount rate would go up, but the net revenue would increase by even more. It was the only way to fill the college's empty seats and put it on the road to recovery. The trustees were shocked, even angry, at our suggestion. They were, after all, in

deep financial trouble and unwilling to quadruple any part of their budget. However, after much discussion, they agreed to try our strategy. Crisis, in this case, was the mother of invention.

Today, that same institution is thriving. Its enrollment is up to 1,000 students, new residence halls have been built, other investments have been made in major campus projects, retention is increasing, and the endowment has quadrupled. The institution's discount rate initially spiked to the mid-50s, but after financial stability was achieved, it has been systematically brought down to the low 40s, while simultaneously balancing other important enrollment goals.

The college had tried to control its discount rate in isolation without considering the costs associated with empty seats in the class.

Chasing Prestige and Other Short-Term Strategies

Another institution we served had run into trouble by focusing entirely on achieving overly ambitious enrollment goals-what we call "chasing prestige"-and had let the discount rate run too high. ("Chasing prestige" is what gives strategic financial aid practices a bad name.)

Whether capping the discount rate or letting it float, problems are caused by a lack of coordinated institutional goal setting at the very top. Colleges that pursue strategies for tuition increases, discount rates, financial aid budgets, academic quality, diversity, and size separately

often embark on journeys that may work in the short run but have serious long-term consequences for their financial and institutional health-and their academic reputation.

For example, let's look at what happened at an unnamed university somewhere in the South. The trustees increased its tuition costs for the upcoming year by nearly 10 percent, without input from the enrollment team, and announced that it needed a significantly larger incoming class of 700 freshmen to serve a budgetary need. The Admissions staff immediately realized that these goals were unrealistic, given the pools of students that have historically applied, the strength of their position in the marketplace, and the current size of the financial aid budget. Trying desperately to meet the goals passed down from the top, they overspent their financial aid budget. The discount rate took off, but they got their class.

When the results came in, the leaders did not celebrate their enrollment success. They were dismayed at the overruns in the financial aid budget and called the enrollment team on the carpet. Moreover, as this class moved through the system, the college was committed to spending so much on financial aid that it had very little left for investments in teaching, facilities, and other critical drivers of success. Cash-strapped, the institution compromised its hard-earned academic reputation, leading to a vicious cycle of needing still more financial aid to attract a desirable class.

Even schools with the best intentions can get into trouble if they don't pay attention to the effects of aid decisions on the institution as a whole. A college in the Midwest was committed to need-based aid. Every dollar was dedicated to helping families in need-a goal rooted in its educational mission. Merit aid was looked upon as an anathema. But the college was suffering financially,

resulting in deferred maintenance and slipping admissions standards. When financial aid awards were examined closely, it was found that the policy in place was generating the highest enrollment yields among the weakest students with the greatest need.

As a result, the college didn't have sufficient operating dollars to shore up its remedial programs and invest in its students-at-risk retention program. Everyone was losing as these weak students cycled out of the college, admissions standards continued to slip, and the morale on campus plummeted due to yearly budget cuts. We urged the leadership to consider merit scholarships and a reallocation of its need-based grants to encourage more students to enroll who could pay a larger portion of the total cost. The increased revenues generated, we argued, could be reinvested in need-based aid if they chose to do so. When we last checked, these changes had not taken place and the college is still struggling.

A Holistic Approach

These problems can be avoided when colleges invite all the relevant parties-the president and trustees; the chief academic officer; the chief financial officer and budget office; and Financial Aid, Admissions, and Enrollment directors-to the decision-making process. By bringing key people into the discussion, a checks-and-balances system is created, ensuring that all strategies meet the basic reality test and that the priorities will have buy-in across the top of the institution.

Yet even when decision-making is coordinated, colleges should be wary of trying to change too quickly. It is possible, for instance, to use merit aid to attract high-quality students, raising test scores dramatically within a short period. However, if the institution is not really equipped to provide the community and learning experience these students expect, the experiment will backfire and the best students will leave. Administrators should look at managing enrollment, financial aid, and other issues like a marathon; starting out too fast may seriously compromise an institution's ability to reach its ultimate goal.

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Tuition, financial aid, and merit aid strategies have all become increasingly vital to institutional health-and increasingly controversial-creating a situation where it's doubly important to manage these issues carefully. The recent Commission on the Future of Higher Education reiterated a growing consensus among legislators and the public that college is becoming unaffordable and that educational institutions need to contain costs and make financial aid more accessible. If colleges and universities do not take action to manage their financial aid and cost issues more aggressively, the government may very well step in and do it for them.

A year ago, when Congress began agitating for caps on college tuition increases, some institutions responded by freezing costs. Others made large, last-ditch increases in their tuition rates. Only a few took a hard look at their missions, their costs, their financial aid programs, and their strategic institutional goals, and then developed financially sustainable plans for the future. We encourage colleges and universities to take a multidisciplinary approach to their tuition,

enrollment, and financial aid issues to find long-term solutions that embrace their values, meet their goals, and share their approaches openly with students and their parents.

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