Financing the Small Private College

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Assessment of student learning has emerged as the overriding issue in college and university accreditation over the last two decades, often overshadowing other important considerations and accreditation criteria. But colleges and universities that are not viable financially face fundamental issues that necessarily take precedence over assessment and other accreditation criteria. Two of the co-authors serve as Consultant-Evaluators on visiting team reaccreditation site visits. Our research is motivated, in part, by our first-hand observations that there is a significant group of colleges and universities, especially small private colleges and universities, facing financial challenges that are so dire that organizational survival is at stake. We believe that professional societies and organizations, including the Higher Learning Commission, should focus more attention on this problem as a first step in developing resources and support for schools facing significant financial challenges.

The fundamental premise guiding our research is that to be financially viable, a small private college or university must have either 1) an effective enrollment management strategy that guarantees a sufficiently adequate and reliable stream of net tuition revenue and/or 2) an endowment that is large enough to provide a meaningful additional source of revenue (Stimpert, 2004). Small private colleges and universities do have other sources of income including annual giving and auxiliary operations, but we assume that small private colleges and universities must meet one or both of these criteria to be guaranteed a viable financial future.

The current macroeconomic situation vividly illustrates that no college or university is completely immune from volatility in the larger economic landscape. And, there are many indications that schools with large endowments – usually seen as highly advantageous – are suffering inordinately at this time because declining endowment values will mean major reductions in the endowment income they receive. Still, we believe our basic premise is fundamentally sound, that schools must have an effective enrollment management strategy and/or a significant endowment in order to be financially viable.

Study Methodology and Sample

This paper reports the results of the first phase of a multiphase study examining the financial viability of small private colleges. This first phase of our research adopted a descriptive, quantitative methodology that examined small private colleges in light of just two variables – selectivity, chosen as a proxy to assess the effectiveness of schools' enrollment management strategies, and endowment size, which indicates whether colleges and universities have a significant additional source of revenue beyond net tuition. Future phases of the research will include more in-depth quantitative and qualitative analysis examining more detailed aspects of small colleges' budgets.

Our sample was drawn from the list of colleges and universities included in the "liberal arts colleges" category of the *US News Guide to the Best Colleges*. The original sample included 248 schools, but this was narrowed to 159 colleges and universities when we eliminated public institutions and those for which complete data were unavailable. The *US News Guide to the Best Colleges* was also the source for the study's acceptance rate data that serve as our measure of enrollment management effectiveness. We recognize that selectivity is only a very crude proxy for measuring the effectiveness of schools' enrollment management efforts, but it is an easily obtained and objective way to compare and contrast a large sample of colleges and universities. Data on college and university endowments are for 2007, and obtained from the dataset compiled annually by *The Chronicle of Higher Education*.

Our analysis involved dividing colleges and universities into three equal-size groups based on selectivity. The most selective group included those schools that accept less than 50 percent of their applicants; the second most selective group included schools that accept between 50 and 72 percent of their applicants; and the third, least selective group included schools that accept more than 72 percent of their applicants. We similarly divided the colleges and universities into three equal-size groups based on endowment size. The largest endowment group included schools with endowments larger than $270 million; the second group included schools with endowments between $99 and

$270 million; and the third group included schools with endowments of less than $99 million. We then collapsed these two sets of groupings into the 3 by 3 matrix that appears in the next section. That matrix not only indicates the number of schools falling into each of the nine resulting categories, but it also shows the mean acceptance rate and the average endowment size for the schools in each of those categories.

Findings

Findings are summarized here in the matrix and in the more detailed descriptions of the categories that follow.

SMALL PRIVATE COLLEGES GROUPED BY SELECTIVITY AND ENDOWMENT SIZE
(N = 159)

	MOST SELECTIVE Application Acceptance Rate < 50%	*MEDIUM SELECTIVITY Application Acceptance Rate 50% to 72%*	*LEAST SELECTIVE Application Acceptance Rate > 72%*
LARGEST LEVELS OF ENDOWMENT More than $270 million	"STRONGEST SCHOOLS" N = 41 Mean Acceptance Rate = 32% Mean Endowment = $721 million	"HAVES" N = 13 Mean Acceptance Rate = 59% Mean Endowment = $625 million	"OUTLIERS" N = 0
MEDIUM LEVELS OF ENDOWMENT $99 to $270 million	"HAVES" N = 9 Mean Acceptance Rate = 33% Mean Endowment = $188 million	"SOLID SCHOOLS" N = 23 Mean Acceptance Rate = 62% Mean Endowment = $168 million	"PROBLEMATIC" N = 21 Mean Acceptance Rate = 79% Mean Endowment = $144 million
SMALLEST LEVELS OF ENDOWMENT Less than $99 million	"OUTLIERS" N = 3 Mean Acceptance Rate = 43% Mean Endowment = $44 million	"PROBLEMATIC" N = 17 Mean Acceptance Rate = 64% Mean Endowment = $61 million	"AT RISK" N = 32 Mean Acceptance Rate = 81% Mean Endowment = $60 million

Colleges and universities in the "STRONGEST SCHOOLS" category enjoy the best of all worlds – highly selective enrollment management situations and the largest endowments. This group is comprised of 41 of the most prestigious small private colleges and universities in the country, including Williams, Pomona, Amherst, and Swarthmore. As a result, many of the schools in this group accept less than 30 percent of their applicants, and even schools in this group that have higher acceptance rates have very high levels of endowment. For example, Wabash College accepts 47 percent of applicants, but with an endowment of $413 million and a modest-size study body, the college has one of the highest levels of endowment per student.

Schools in the two "HAVES" groups are either selective or highly selective and so it can be inferred that they have solid enrollment management strategies, and they have large or medium-size endowments. Together these two groups include 22 schools or about 14 percent of the total sample. Some of these schools, including Grinnell, Smith, Berry, and DePauw, have very large endowments that allow them to thrive in spite of higher acceptance rates that are indicative of enrollment management challenges. Their large endowments may allow these schools to offer very attractive financial aid packages to prospective students to boost what might otherwise be less successful enrollment management strategies. Other schools in this medium selectivity/largest levels of endowment category may have more attractive enrollment management strategies than their higher acceptance rates suggest. For example, Earlham and St. Olaf have relatively higher acceptance rates (69 percent and 54 percent respectively), but their applicant pools may represent a good deal of self-selection among applicants, so even though they are accepting a proportionately higher percentage of applicants, more of their applicants may be exactly the kinds of students these schools want to recruit.

Schools in the most selective/medium levels of endowment group may not enjoy the very large endowments of the schools in the other "HAVES" group, but they are very selective, suggesting strong enrollment management programs and the ability to attract sizeable and talented applicant pools. This group of "HAVES" includes such well respected institutions as St. Lawrence, Connecticut, Harvey Mudd, and Kenyon.

The 23 schools (or about 14 percent of the sample) in the "SOLID SCHOOLS" category have neither the large endowments of the schools in the largest endowment categories nor the selectivity of the schools in the most selective categories. Nevertheless, schools in this category, which include Puget Sound, Lawrence, Centre, Illinois Wesleyan, Kalamazoo, and Ursinus, must be characterized as solidly viable.

Combined, the "STRONGEST SCHOOLS," the two "HAVES," and the "SOLID SCHOOLS" categories include 86 small private colleges and universities or approximately 54 percent of the total sample of schools included in our study. This suggests a reasonable confidence about the financial viability of more than half of all of the small private colleges and universities in our sample.

Two "OUTLIER" categories appear in the matrix. One "OUTLIER" category – least selective/highest levels of endowment – includes, as might be anticipated, no schools. The other "OUTLIER" category – most selective/lowest levels of endowment – includes just three schools. One of these, Cornell College, may benefit from a relatively larger pool of applicants who are attracted by the college's unique one-course-at-a-time academic calendar.

The matrix also includes two categories we describe as "PROBLEMATIC" – a medium selectivity/lowest levels of endowment category and a low selectivity/medium endowment category. While these schools may not face serious threats to their viability, they clearly do not enjoy the benefits and strengths of more selective enrollment management programs or larger endowments. The medium selectivity/lowest endowment category includes schools such as Millikin, Moravian, Whittier, Knox, and Lake Forest, that enjoy some recruiting advantages, perhaps due to regional or even national reputation, but all of these schools have endowments of less than $100 million.

The schools in the least selective/medium levels of endowment group include College of Wooster, Willamette, Hendrix, and Hope. These schools accept large proportions of their applicants, but they also have relatively significant endowments that compensate for weaknesses in enrollment management. For example, Illinois College, the school in this category that accepts the highest proportion of applicants (91 percent), also has a relatively large endowment of $136 million for a school of its size. No doubt these relatively large endowments are a significant source of strength even as these schools struggle to maintain effective enrollment management strategies.

Finally, the matrix includes an "AT RISK" category comprised of 32 schools that are least selective and also have the lowest endowments, including Hiram, Monmouth, Nebraska Wesleyan, and Ripon. Combined, these schools accept an average of 81 percent of their applicants and have a mean level of endowment of $60 million. Lacking more detailed research it isn't possible to state that any of the schools in this category are on the verge of failure, and again, anecdotally we know that many of the schools in this category are doing remarkably well. Some of the schools have resilient enrollment management programs in spite of their high acceptance rates. Other schools have endowments that are not far from the cut-off between the medium and lowest levels of endowment. This significant additional financial strength is no doubt quite helpful to these schools. For example, assuming a five percent payout ratio, an endowment of nearly $90 million will generate $4.5 million in endowment income. Assuming net tuition of $20,000 to $25,000 per student, this is the equivalent of 180 to 225 additional students. We also know that many small private colleges have a great deal of staying power in spite weak enrollment management situations and very low endowments. Still, for those schools that have weaknesses in their enrollment management efforts and only modest endowments, budgeting and managing day-to-day cash flow must be challenging at best.

Observations

It's important to emphasize that we are reporting here only the results of a first stage of a multiphase study of the financial challenges faced by small private colleges. The descriptive quantitative methodology we used in this first phase employed only two variables, acceptance rate and endowment size, to examine our fundamental premise that schools need effective enrollment strategies and/or meaningful endowments in order to be financially viable. With this important qualification, we offer the following observations from our research thus far:

- First, 86 of the 159 (or 54 percent) of the small private schools in our sample reside in either the "STRONGEST SCHOOLS," the two "HAVES," and the SOLID categories. These schools have both successful enrollment management strategies and medium to large, and, in many cases, very large endowments. Thus, over half of the schools in our sample appear to be financially viable.

- Another large number of schools (70 total or about 44 percent of the sample) are included in either the "PROBLEMATIC" or the "AT RISK" categories. These schools have either high or very high acceptance rates and modest or small (or very small) endowments. Many of the 32 schools that fall into the "AT RISK" category must surely face significant budgetary planning challenges.

- Anecdotal evidence suggests that residing in any one of the categories does not guarantee long-term success nor does it doom a college to an unattractive future. Schools in even very attractive positions can experience sudden reversals of fortune, and, as noted earlier, the recent sharp reversals in the stock market are making life very difficult at many small colleges that have large endowments. And, many schools in comparatively weak positions have nevertheless found ways to thrive, and some have succeeded in developing solid enrollment management strategies and/or growing their endowments significantly.

Again, it is beyond the scope of this brief paper to offer comprehensive suggestions for how schools should improve their enrollment management strategies or increase their endowments. Nevertheless, it seems safe to offer a few broad guidelines to insure the financial sustainability of the small private college or university:

- Given that the small private college is both a labor-intensive and a capital-intensive enterprise, schools need diverse revenue streams to cover their costs. Many of the schools in our sample are blessed by large endowments that provide an important additional source of revenue beyond net tuition. Other private colleges and universities have obtained a greater measure financial security by developing graduate degree programs and educational programs that serve non-traditional student populations. We are not advocating any specific ideas, which will obviously need to be consistent with each school's mission and capabilities, but rather emphasizing the need for schools to diversify their sources of revenue.

- Many of the costs and expenses in higher education tend to rise faster than revenues, so every college and university must focus on cost containment in order to live within its means. We suspect that schools in the "PROBLEMATIC" and "AT RISK" categories probably already understand this far better than schools in the other categories. The current economic climate that has done so much harm to the large endowments that some colleges and universities enjoy is now bringing home the importance of cost containment to these better endowed schools as well.

- An effective enrollment management strategy eludes many schools. Our own anecdotal experiences suggest that this often results from colleges not having a clear sense of their identity and a failure to convey a compelling mission to prospective students and their families. While concepts like marketing and branding are alien and even resisted by some small colleges, deliberate efforts to develop both a distinctive and compelling mission and an effective strategy for communicating that mission are essential.

References

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