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Transformation 101: How universities can overcome financial headwinds to focus on their mission

Troubled universities can reset their financial trajectory.

by Li-Kai Chen, Claudio Brasca, Mark Hojnacki, and Charag Krishnan

Higher education institutions in the United States face starkly different prospects. Top-ranked schools turn away throngs of top applicants, while cushioned by staggering endowments. Others, including many small liberal arts colleges, are facing declining enrollment, nervously watching expenses outpace revenue, and tapping their endowments to cover shortfalls. These pressures have forced many schools to make painful choices, including cutting programs, laying off faculty, merging with other schools, and reducing student admissions. In the worst cases, some schools have lost accreditation or have shut down. There will likely be more: our review of public data suggests that at least 90 medium-size not-for-profit institutions across the country show some signs of financial pressure.

This snapshot may even understate the problem. Moody's recently predicted that growth in operating expenses will outpace revenues at most institutions of higher education. To be financially stable, most colleges need revenue growth of at least 3 percent, Moody's advised. Just 44 percent of chief financial officers of higher education institutions say they are confident their college will be financially stable over the next 10 years, down from 54 percent in 2016, according to a survey last year by Inside Higher Ed. Among the many reasons: more than two-thirds believe that their tuition discount rate is unsustainable.

At the same time, many students feel burdened by their educational debt, which suggests that schools can't continue to rely so heavily on conventional tuition as a sustainable revenue source. Americans collectively owe nearly $1.57 trillion in student debt, according to the Federal Reserve, which is a 27 percent jump since 2014. Nearly 70 percent of the class of 2018 took out student loans, graduating with an average debt of $29,800. This doesn't include the money that their parents borrowed for their education: 14 percent of parents of the 2018 class borrowed on average $35,600 in federal loans.

Despite these bleak facts, higher education still offers enormous potential for students: the average college graduate earned $1 million more than the average high-school graduate over the course of a working life, according to a 2015 study by economists at Georgetown University. Just as important, these institutions serve as one of society's pillars of progress. Enabling them to fulfill their mission to serve students through education and expanded life experiences is critical to our future. The healthier the state of our colleges and universities, the stronger the foundation for our economy and society.

So how can struggling institutions best position themselves to pursue this mission? In this article, we'll start by reviewing the unique challenges these institutions face. We'll then outline the transformational approaches that some schools are taking to improve their student outcomes by boosting enrollment, retention, and student satisfaction, and in the process resetting their financial trajectories. These efforts—which require an extraordinary commitment and a highly focused execution—have allowed them to look past their financial challenges and toward a future centered on serving students and the community.

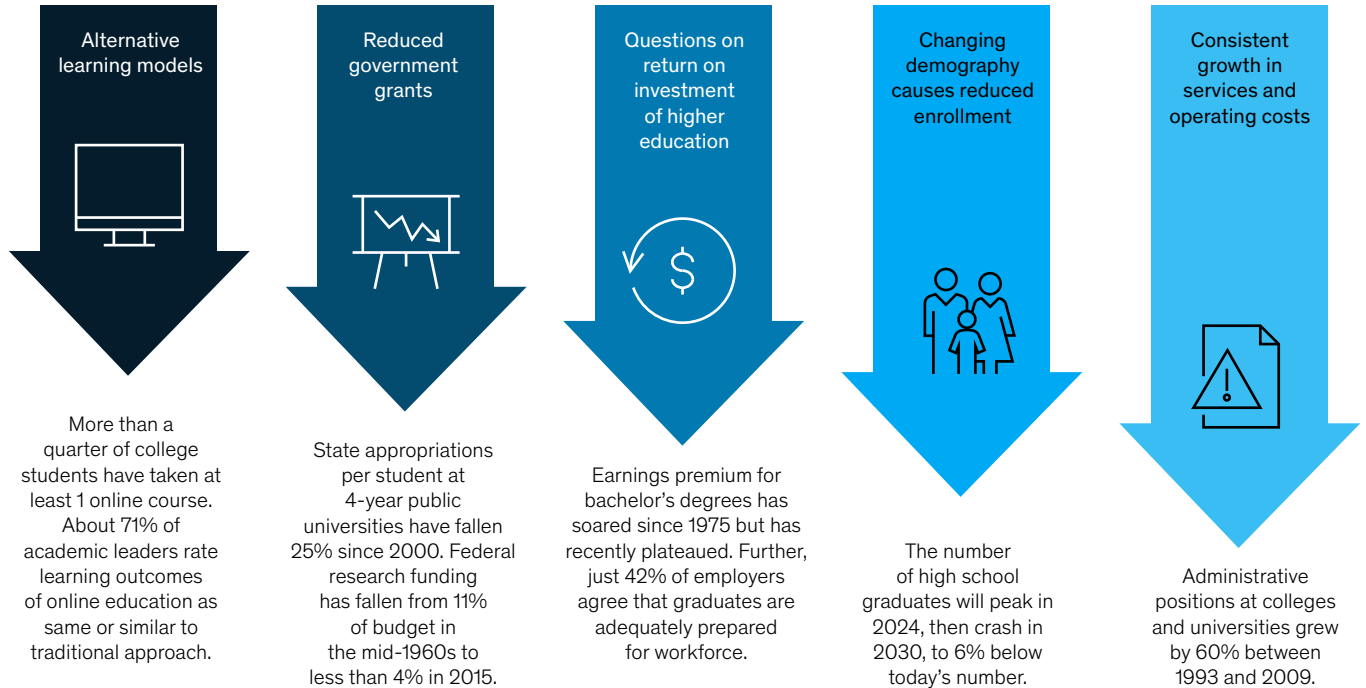## A special set of challenges

Financially troubled academic institutions have often found it difficult to right the ship. Examples of successful transformations are rare. Even when there's a success story, issues often persist, and improvements in one area, such as career services or student success and retention, do not translate into schoolwide success.

Many universities have attempted to address a wide array of challenges (Exhibit 1) through cost reductions and austerity. But it's brutally hard to attract widespread support for a plan that offers little more than budget cuts and painful choices.

A true transformation—which often raises net surplus by 20 percent or more—is challenging. It requires an intense, operations-wide program focused on improving student outcomes and

Exhibit 1

Higher education is confronting several challenges.

5 biggest challenges

Alternative learning models	Reduced government grants	Questions on return on investment of higher education	Changing demography causes reduced enrollment	Consistent growth in services and operating costs
More than a quarter of college students have taken at least 1 online course. About 71% of academic leaders rate learning outcomes of online education as same or similar to traditional approach.	State appropriations per student at 4-year public universities have fallen 25% since 2000. Federal research funding has fallen from 11% of budget in the mid-1960s to less than 4% in 2015.	Earnings premium for bachelor's degrees has soared since 1975 but has recently plateaued. Further, just 42% of employers agree that graduates are adequately prepared for workforce.	The number of high school graduates will peak in 2024, then crash in 2030, to 6% below today's number.	Administrative positions at colleges and universities grew by 60% between 1993 and 2009.

boosting organizational health and performance. It also demands an internal alignment around a common vision and strategy to deliver the full potential of what's already there.

The reported failure rate of large-scale change programs in the corporate world has hovered around 70 percent for many years. Few companies have the necessary mix of skills, mind-sets, and commitment, as their top executives are better at operating in stable environments. The best predictor of the success of a transformation is a leader who recognizes the need for a new approach and is willing to take a single self-confident leap instead of incremental steps.

University leaders face these challenges and more when attempting to transform their organizations. While they are gifted educators, researchers, fundraisers, and academics, they may have little experience leading the transformation of a large, complex enterprise. Complicating matters, stakeholders often cling to deep sentiments about their institutions and their school traditions, which impedes change. And the shared governance structures at most universities makes it even more difficult to act quickly and decisively. When leaders encounter inevitable resistance, it's not surprising that they often relent, and the project stalls, is abandoned, or becomes mired in a long implementation with poor results.

A better way

Several leading institutions of higher education have developed effective strategies to avoid these common pitfalls and improve the odds of success. A key finding of our work is that while a reasonable degree of cost management is usually necessary, it's more important to focus on improving student outcomes and identifying new ways to diversify and grow revenues.

At McKinsey, our work in enterprise-wide transformations has led to a systematic approach that enables organizations of all types to use new operational levers to improve overall health and performance. In collaboration with our work in education, we identified strategies (Exhibit 2) that can help universities reduce their dependence on the typical two largest sources of revenue—tuition and government grants.

An institution that follows these steps can generate new revenues to invest in initiatives to attract more students, deliver on the mission of student success, and drive excellence in teaching and research in a sustainable manner. These schools can focus on preparing their students to excel in the world and on planning the school's future, rather than depleting their energy by worrying about their continued existence.

Case study: A university at a crossroads

This transformational approach is illustrated by the turnaround undertaken by a midsize liberal-arts university that was facing a crisis reflecting the challenges of many small, private institutions.

In 2013, the university's entering first-year class fell nearly 30 percent and continued to shrink for the next three years. To attract students, the university offered high levels of institutional aid and scholarships well above benchmark levels for peer universities, which eroded net tuition revenue.

Exhibit 2

There are several ways to expand revenues and improve efficiency at universities.

Grow and diversify revenues

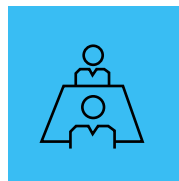| Enrollment and net tuition-revenue management | Completion and persistence | Program portfolio (new program launch) | Research funding | New business ventures (online, executive education, adult learning) | Auxiliary revenues |

Capital and investments   **Operating efficiencies**

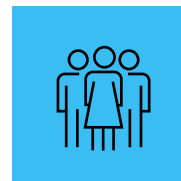| Capital productivity | Endowment returns | Faculty and instructional staff | Student support and service | Facilities utilization | Administrative efficiencies |

Exacerbating the problem, the school had trouble holding onto the students it had. Too many were dropping out or failing to complete their degrees, leading to low student-persistence and completion rates compared with peer institutions. At the same time, the quality of the educational experience suffered, as the university couldn't make needed investments in student-support services.

Significant operating deficits forced the university to double its endowment draw from 2014 to 2017. Continuing on this path would have meant depleting its unrestricted endowment in two to three years. Because of these financial concerns, the university's accreditation agency alerted it of the need for immediate action to avoid the risk of probation and possible loss of accreditation thereafter.

The university's leaders attempted to contain costs; a few administration members led the effort. But they failed to fix the problem over two attempts. The board realized that it needed a strategy tailored to the unique nature of institutions of higher education that would enable it to make rapid and significant changes without sacrificing the quality of the education.

The board takes the lead

In this new effort, the board led from the front and took responsibility for shaping the transformation goals, unifying key stakeholders, and building momentum throughout the university. (Board support is one of five critical elements; see Exhibit 3.) This required a substantial, ongoing commitment from board members. To continually reinforce its crucial role in this process, the board committed to meet biweekly to monitor progress over the entire transformation period.

As a first step, the board oversaw a short review of the school's key metrics on enrollment, retention, student satisfaction, and other student outcomes and of its overall operations. Select faculty and staff were also interviewed at length. The board then plotted a course that placed as much emphasis on student success and enrollment-driven revenue growth as cost management. Next, it had to

persuade stakeholders not just to embrace but also to play active roles in this transformation plan over a period of two years.

This was a daunting challenge. Most universities have vocal and opinionated faculty, staff, and students who aren't easily persuaded to fall in line for massive change dictated from above. Making matters more difficult here, the school's previous efforts to cut costs had left lingering anxiety and distrust. To recruit faculty, staff, and students to support this ambitious project, the school's leaders created a compelling change story to inspire people to think and behave differently. The story explained where the institution is headed, why it's changing, and why this change is vital.

The board relayed this change story through carefully planned internal and external communications. These included open town halls, meetings with faculty and staff leaders and student government bodies, as well as targeted public-relations efforts with the press.

Just as important, the board was transparent about the school's finances. By sharing this information at monthly town halls, the board made a compelling case for the urgent need for transformative change.
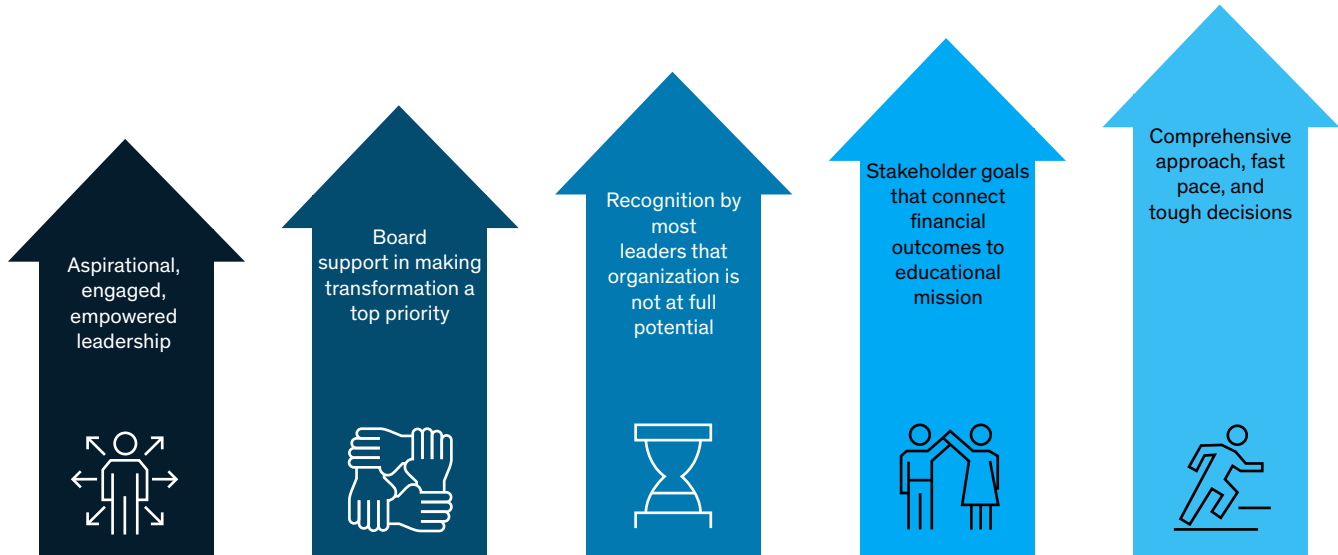
To support informed and decisive decision making, the school created a centralized governance structure that was tasked with key decisions. This group included members from across campus operations to encourage collaboration. Everyone was trained to use metric dashboards so that they could all work from the same sets of data and focus on improving student outcomes. Eventually, this governance structure and the regular use of dashboards became integrated into the university's new way of operating.

Boosting revenue by furthering the school's mission

The board also overcame initial skepticism and resistance by launching new revenue-generating initiatives that sparked excitement. As part of that plan, the school developed a multifaceted approach

Exhibit 3

Five factors are essential to successful transformations in higher education.

Top 5 factors

Aspirational, engaged, empowered leadership

Board support in making transformation a top priority

Recognition by most leaders that organization is not at full potential

Stakeholder goals that connect financial outcomes to educational mission

Comprehensive approach, fast pace, and tough decisions

to improve student recruiting and persistence and to reinvigorate its online and continuing-education programs. It also examined data on spending decisions to make more informed choices.

Enrollment was overhauled to include more targeted outreach, including materials that highlighted specific educational programs. To align the university's message with the habits and preferences of young people, the school improved its social-media presence. It also created virtual campus tours aimed at potential recruits who might not be able to visit in person or those needing more incentive to visit. Most important, everyone on campus—students, faculty, and staff—was engaged in connecting with students and sharing why they loved the university. The result: the university's first-year class increased by 30 percent in the first year of the transformation, and similar increases the following two years.

In another successful initiative, the school expanded its online and continuing-education programs. But

it first had to overcome initial concerns from faculty who worried about diluting the quality of education. Their sentiment shifted when the school translated financial goals into aspirations that resonated with them. By emphasizing the educational and societal benefits of reaching a more diverse group of students who couldn't enroll full time, the school won over most of the faculty. The school's leaders also put measures in place to ensure institutional support for the traditional programs and ensure that faculty or staff aren't concerned about online programs taking away from the value of on-ground programs.

While this initiative required a seven-figure investment, it has paid off. The online program is on track to enroll several hundred students, while continuing education is generating a new, independent revenue stream. Both are growing rapidly.

One of the most critical and galvanizing initiatives on campus centered on student success, persistence, and completion rates. A group of faculty and staff was tasked with creating and monitoring initiatives

to improve these outcomes. Just as important, the school impressed on all faculty and staff that each of them can play a role in their own way to help students succeed and to fulfill the school's mission. Creating this shared endeavor played a critical role in bringing the whole campus together to improve student success.

The university also thought creatively about other ways to increase revenue. For example, the school wasn't taking advantage of the full potential of its housing stock and other real estate. Through renovations and improved marketing, dorm rooms once left vacant were filled, leading to nearly 100 percent occupancy. These efforts, which included attracting short-term residents during summer breaks, boosted revenue in a way that the university had never considered. The school also leveraged the potential of its attractive campus by booking more conferences and attracting filmmakers to shoot on location there.

To improve the university's organizational health, the school introduced new professional-development programs for faculty and staff. To enable individuals in different departments and with differing jobs to work together more efficiently, the school introduced new collaborative norms, processes, and expectations. And to ensure successful implementation of the entire project, team members filed weekly reports that allowed visibility into performance so that any issues could be swiftly escalated to senior leadership for resolution.

Using data to make better decisions
The school learned that it could address many of its issues with better use of available data. For instance, it tapped into data on academics and behaviors—including midterm grades, class-registration data, and faculty observations—to predict students at risk of attrition.

At the beginning of the transformation, only 77 percent of first-year students returned for their next year, which was much worse than benchmarks for peer universities. This not only sapped tuition revenue but also made it difficult for the university to allocate its resources and invest further in student support. This figure also indicated that too many students were dissatisfied with their campus experience.

The school tackled this problem with several initiatives. It created a Student Success team that pulled together select counselors, administrators, students, and faculty, enabling them to work in a more coordinated way to target and help students at risk of leaving. The school also implemented more personalized one-on-one success coaching for first- and second-year students.

As a result, retention from the first to second year of school improved to 85 percent. The success flowed into the more senior classes, as persistence from the second to third years improved to 92 percent, compared with 86 percent the prior year. That meant that within two years of the transformation effort, roughly 4 percent of the student population had a better chance of graduating, a result that advances the university's mission while improving its revenues.

Another area of scrutiny was the university's high tuition-discount rate. When the school examined its discounting decisions and compared them to benchmarks, it found that it was not providing aid to students most in need and that it could reallocate financial aid in a better way.

Some cost reduction was unavoidable. The university studied faculty and staff productivity to bring the school more in line with peer benchmarks. Adjustments to student-faculty ratios and student-staff ratios freed further funds that put the school on a stronger foundation.

This approach left no room for sacred cows. For example, school leaders were persuaded that they could renegotiate contracts with the companies that provided their food service and campus maintenance, which led to substantial savings while maintaining service levels.

This transformation effort is ongoing, but the results so far have been impressive. The university's financial health has significantly improved, and for the first time since 2012 it has balanced its budget. It is now beginning to return cash from operations to grow the endowment and invest further in student-support services and growth initiatives, as well as in the development of its faculty and staff.

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We know that a successful transformation must be hugely aspirational. For this reason, it will often create tension and friction in an organization, requiring special techniques to keep progress moving forward. This approach will test a school's leaders.

But the effort will be worth it. Instead of worrying about the decline or demise of their institutions, leaders can focus on improving the well-being of individuals and society through inspired learning, growth, and change. By implementing an ambitious set of projects to inspire the entire team, foster new areas of growth, and change the trajectory at every level, these institutions can continue to influence generations of learners and their communities.

Claudio Brasca is a partner in McKinsey's San Francisco office, **Li-Kai Chen** is a partner in the Kuala Lumpur office and leads McKinsey's Education Practice, **Mark Hojnacki** is a partner in the Stamford office, and **Charag Krishnan** is an associate partner in the Washington, DC, office.