



# Full Steam Ahead

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## Full Steam Ahead!

In the Spring 2010 edition of *Independent School*, NAIS, writes persuasively and interestingly in the article, “A Game-Changing Model for Financially Sustainable Schools.” ISM has written the following commentary concerning the issue of sustainability and the points that NAIS makes. An immediate caveat is that ISM’s database and research, while including NAIS member schools, reflects a far wider group of schools nationwide. The taxonomy of schools that ISM has developed (Price/Product/Process) provides a way to distinguish the subtle, yet complex differences that defines schools as they establish their market niches.

Before getting to the substance of the NAIS article and argument, however, ISM concurs that there *is* a “game changer” in private education and that this game changer will be evidenced in the finances of schools—but *the finances of schools are the wrong focus for understanding what the change is*.

In the last paragraph of the NAIS article, we get a glimpse of the real issues at stake here: “All schools may be increasingly expected to adopt new technologies and teaching strategies to improve the outcomes of their students.” In the “value proposition formula,” the game changer is:

- ***not*** money, but the move from 20<sup>th</sup> Century Schools to 21<sup>st</sup> Century Schools—not in “teaching the skills and values” (great schools have always taught and adapted to new eras), but in the whole architecture and technology of teaching itself, enabling the individualization of teaching to a degree that has never been possible. Schools that do not understand this will see enormous pressure on enrollment in a competitive marketplace. It

will not be their financial structure per se that causes this pressure, but rather the failure to transition from a factory model of schooling to an individualized model of schooling;

- **not** a tuition break-point that will destroy schools, but the inability to move away from the 20<sup>th</sup> century factory paradigm of education;
- **not** flat incomes, but the static leadership failure to strategically plan for the future;
- **not** the local demographic, but the lack of vision for an extended demographic;
- **not** CPI plus 2%, but failing to attract the great faculty of the future who are able to teach, be the experts and mentors, and be compensated appropriately;
- **not** the lack of endowment, but the lack of attending to the needs of students and families in a way that truly recognizes their situations; and
- **not** market/budget versus mission, but mission infused with market/budget. (ISM is exploring this in a current series of articles in *Ideas & Perspectives*, its research-based advisory letter.)

What of the other issues that NAIS persuasively and articulately raises? The past two years have been filled with angst and suspense as we've watched our economy fall into the worst recession in recent memory. Private-independent school leaders have bombarded ISM with questions like "Are the fundamental reasons parents buy private education changing? Are we pricing out the middle class? Do we need to fear that we're pricing ourselves out of the market?" and so on. These are reasonable questions in our

difficult times. ISM's overall answer is that *there is no persuasive, verifiable evidence that schools are pricing themselves into extinction*. Let's look at parent motivation, for example.

In January 2009, ISM conducted a large parent survey; over 13,000 independent school parents participated. Our intent was to find out if the game was really changing: Were parents planning to leave independent schools because of the recession? The results were encouraging. In January 2009:

- 84% of those surveyed said that their children will or probably will remain in their current school until its last grade,
- 9% were not sure, and
- 8% probably will not or will not remain.

These results were consistent with past year's survey results.

When asked about the perceived value of the education their children were receiving, parents responded:

- 85%, excellent or good;
- 11%, average; and
- 2%, below average or poor.

Again, these results were consistent with past year's survey results.

When asked to indicate the top five reasons they chose to enroll their children, parents cited:

- safety of my child,
- faculty care and concern,
- character education,
- faculty expertise, and
- academic rigor.

Parents who rated the perceived value as “average” or “below average/poor” were then asked to cite what areas their school needed to improve. The top responses were:

- academic rigor,
- some faculty’s subject expertise, and
- some faculty’s care and concern.

What parents were clearly communicating in this survey, taken at the height of the recession, was exactly what ISM has held fast to for 35 years: Schools are primarily mission-driven organizations, and parents choose schools for a variety of reasons including academic, social, and character-building aspects. They leave for primarily ONE reason—the quality of the faculty’s work with “MY child.” To parents, at least, it seems that the game hasn’t changed.

Another complicated aspect of understanding private schools is tuition increases. To consistently deliver value, private schools must adequately fund faculty salaries, staff salaries, employee benefits, academic and cocurricular programs, physical plant, fund raising, marketing, reserves, and the like. Because independent schools are primarily lean fiscal mechanisms in the sense that they do not have complicated or multiple revenue streams and few cost centers in which to adjust (downward), they must look at tuition as their primary revenue source. Understanding this fact is the key to understanding why schools cannot use the CPI as the primary justification for tuition increases.

William J. Baumol, an NYU economist, describes a phenomenon known as Baumol’s Cost Disease. He explains that there are sectors that cannot use the CPI as the primary determiner of inflationary costs because they are not able to increase efficiency. Classical economics states that wage increases are always closely tied to labor

productivity changes. Baumol argues that labor-intensive sectors that rely upon a high degree of human interaction (nursing, education, and the performing arts) have no ability to become more efficient.

Because the Consumer Price Index includes a wide basket of manufactured goods, it naturally includes provisions in its calculation for increased labor efficiency. That allowance must be removed for schools to understand their true inflationary costs. Historically, increasing costs approximately 2% above the CPI has accounted for the efficiency quotient buried with the CPI. This is why schools must raise tuition 2% higher than the CPI. And while it may be a distressing or unpopular idea, ISM has long held to this because it is the only way a school can continue to deliver value. A private-independent school education may carry a certain cache within the marketplace, but that cache must be backed by solid proof of value. Value is a complex concept and includes things such as outstanding academics, high quality cocurriculas, opportunities for every child to participate, a faith/values orientation, safety, etc. Clearly parents leave when they perceive the value offered is not worth the price. As NAIS says, “being the value leader is more strategic and better aligned ... than being the price leader.”

So, can schools price themselves out of today’s market? ISM’s answer, as it was long before the current economic crisis, is: “Not if you understand and act on the relationships among pricing, customer service, marketing, and strategic planning.” The two core errors made by planners, in the past and now, remain the same: (1) setting tuition annually rather than multi-year (based on a strategic financial plan); and (2) basing tuition increases on the question: “What can parents tolerate?” Doing the first

thing ensures the absence of a strategic focus in the budgeting process. Doing the second is a poor method of funding a school's mission and program.

If you ask 100 parents how they feel about a tuition increase of X, most of them, most of the time, will shake their heads and tell you that it is too much. In contrast, if you ask the same parents how they feel about a tuition increase of X in the context of expense increases Y, and if you are careful to show how Y will materially strengthen your institution for the short and long haul—and how Y will therefore be of great benefit to their children and to future families—then most of them, most of the time, will nod their heads and tell you that they suppose they will manage. (ISM surveys conducted for individual schools over the years have shown that schools typically *underestimate* parent capacity to pay. A February 2010 study by the Center for Labor Market Studies, Northeastern University, indicated that unemployment for those earning \$150,000 and over is currently 3.2%, and for those earning over \$100,000, 4%.)

The ISM-developed strategic planning method addresses many of the issues that NAIS raises. It is as effective in tough and unpredictable times as it is in more seemingly prosperous times. It entails collecting all your data—demographic, comparative, and other—and, with data in hand, delineating the school that your intended Purpose and Outcome statements imply, six years into the future. ISM would therefore advocate that, when there is financial pressure as many have experienced, every reasonable precaution be taken. Examine your local demographic, consider your school's own data trends, and evaluate the competition. But each school's primary responsibility concerning sustainability involves the answers to the following questions.

- Do we have cash reserves equivalent to 20% of expenses?

- Do we have and follow an actionable strategic plan/strategic financial plan?
- How does our executive leadership foster the kind of faculty culture that acts as a student magnet?
- Do we cover our expenses with our tuition and fees incomes?
- Is our Board rich in its leadership capacity?
- Is our Board profiled such that its members can deliver on the strategic plan?
- What are the faculty characteristics in areas of commitment to professional growth and renewal?
- What is the school's commitment in terms of compensation including benefits, and in the support it is given for professional development?
- Are the facilities appropriate to mission delivery? Do we have the ability to maintain the facilities as they should be?
- Does the Development Office have the organizational capacity to identify, cultivate, solicit, recognize, and steward donors?
- Does the school as a community recognize its total commitment to internal marketing—the re-recruitment of its current clients?
- Is there an appropriate management structure?

These research-based questions, called Stability Markers by ISM, establish a proactive place for a school to begin its examination of market pressure.

ISM agrees with NAIS's profound and useful contentions about "discipline on the expense side" and the tendency in some schools to move "nice to have" to "must have," distorting the budget. ISM cautions schools against increasing the management side of the expense line; there is a limit to how much top-level management is needed. This is

not the same, however, as the NAIS stance that schools need to “increase non-tuition revenues and decrease costs without sacrificing quality or core programming.” The only non-tuition revenue mentioned in the NAIS article is endowment; for most schools, endowment is and will continue to be irrelevant. Cost containment suggestions—resisting constant increase in program, rightsizing, rethinking how many specialists are needed—are sensible and always bear consideration.

The final issue here is budgeting. Why do schools prepare budgets? The answer is really quite simple—*the budget is a numeric expression of the mission of the school.* NAIS proposes that, to be sustainable, schools must look at demographics first and then determine their budgets. ISM might indeed congratulate that school for creative thinking, but give the school a failing grade in accomplishing the Board’s primary role—to provide for the long-term mission of the school. The basic mission does not usually change much over the life of a school. The Board’s job is to serve multiple and successive generations of students (not the current generation) by providing resources (approving appropriate budgets; support capital campaigns, and the like) that ensure a strong future for the school. Budgeting doesn’t start with demographics; even as giving medicine to a child doesn’t start with the preferred flavor of the medication. Budgeting begins by doing what is best for the school to ever-enhance the excellence offered by the school’s mission. It is *critical* that schools fulfill their missions, keep their costs in line with their student body size, and constantly evaluate their needs.

What if the buying public no longer values a particular school because of its mission? Of course, the Board may think prudently and make a decision to relocate the school (which has recently happened in North Carolina and Tennessee) to be near a

demographic that values the school's mission, or to even be draconian and change the mission. Ultimately, the best decision the Board may make is to close the school. There is no shame in a school closing.

So, yes, the game is changing. But, it would be changing even if our GDP were growing at 10% a year. It is not the recession that has changed the game, but the very nature of schooling itself. The game change is not for reasons of price, but for reasons of pedagogy and methodology. (In this light, ISM is now writing about the 21<sup>st</sup> Century School, on topics such as evolving programs, scheduling, faculty load, faculty compensation, social media, and technology.) Tuitions are no more or less sustainable than they have ever been. Competition in the marketplace is certainly fiercer than it has ever been, but the difference-makers are not about pricing schools out of the market, inflation, and family incomes. The changing nature of schooling—not price—is the controversial element of sustainability. That's what we, as education leaders, should be debating.