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## “Through-Cycle” Planning and Management in Higher Education

The Forum for the Future of Higher Education and McKinsey & Company have undertaken a multiyear collaboration focused on the factors that will drive the evolution of the higher education sector, for better or worse, going forward. Phase III of the McKinsey Project on Global Higher Education focuses on the impact of the recession on colleges and universities and strategies for responding to it. Paul Jansen, a Director Emeritus of McKinsey & Company whose most recent responsibilities included director of the McKinsey Global Nonprofit Practice, noted that even as signs indicate a possible economic recovery, tremendous residual uncertainty about how the future will unfold persists. Unpredictability concerning the point at which the financial markets and the economy will correct, and the shape of the “new normal,” deepens that uncertainty. Building on previous McKinsey research on which companies perform best over the course of recessions, Jansen discusses how the recession is affecting the higher education sector and outlines strategies for responding to it. He encourages campus leaders to adopt a *through-cycle* mindset so as to capitalize on opportunities presented by the crisis and to best position their institutions for recovery as we emerge from recession.

### IMPACT OF RECESSION ON HIGHER EDUCATION

Generally, higher education weathers recessions well. Student demand for higher education flattens or falls slightly, but then emerges at a higher level post recession. While endowments have plummeted, giving to higher education has grown through two of the last three recessions and in all cases was at a higher level post recession than before. Federal research funding, moreover, is benefitting from allocations in the economic stimulus package passed in early 2009.

More specifically, the impact of the recession varies widely across higher education’s segments and institutional types. Institutions feeling the most pressure are those that had large endowments

■ A through-cycle mindset calls for consideration of stressful scenarios, modeling revenue drivers, prioritizing, cost cutting, and long-term thinking that strategically positions the institution for success post-recession.

■ Given the tremendous residual uncertainty about how the future will unfold, three principles should underpin any organiza-

tion’s strategic response to the recession: flexibility, awareness and resiliency.

■ Flexibility calls for developing and testing scenarios that previously would have unthinkable, and applying high-level stress tests. When typical five and ten-year plans are simply not possible anymore, strategy shifts to a more dynamic and opportunistic mode.

■ Awareness means increasing your business intelligence: identify the signs and early indicators that would suggest in which direction events are unfolding, and then use pre-determined trigger points to set into motion a planned set of actions.

■ Increasing your institution’s resilience will enable you to better respond to uncertainties. Resilience requires reducing fixed

costs and creating options.

■ The academic arena presents a rich set of opportunities to favorably position institutions with a through-cycle mindset, as they make strategic moves in light of the game-changing, long-term trends affecting the traditional higher education model and the very future of higher education.

with significant losses (e.g., Harvard and Yale); public institutions dependent upon funds from their state if it's in financial trouble (e.g., University of California); and those lower-tier schools heavily dependent upon tuition revenues whose demand is most at risk. Institutions feeling the least pain are those that are dependent on tuition dollars, but are able to sustain or increase demand (e.g., University of Southern California, NYU); and strong research institutions that can take advantage of the increased allocation of federal research dollars (e.g., MIT and Caltech).

## FLEXIBILITY, AWARENESS AND RESILIENCY

The future is uncertain. No one knows which of the many scenarios as to how the recession and recovery could play out will indeed occur. Given the unpredictable environment, three principles should underpin any organization's strategic response to the recession: flexibility, awareness and resiliency.

Flexibility calls for planning for a wider range of possible futures, including more stress tests than in the past, developing and testing scenarios that previously would have unthinkable. More options need to be considered and efforts must be made to create options for use depending on how the various scenarios play out. In an era when five and ten-year plans with predictable growth rates don't reflect underlying volatility, strategy shifts to a more dynamic, shorter cycle set of practices.

Awareness requires understanding how the components of your business model respond to various scenarios and monitoring those drivers constantly. The key is to increase your business intelligence: identify the early indicators that would suggest in which direction events are unfolding, and then establish triggers that set into motion a planned set of actions should those triggers be met.

Finally, increasing your institution's resilience will enable you to better respond to uncertainties. Reducing fixed costs increases resilience, as do identifying clear priorities and reducing marginal activities and their associated costs. Resiliency requires acting quickly since hunkering down usually reduces options and delays, rather than restructures, costs.

## STRATEGIES FOR RESPONDING TO THE RECESSION

Although there are many variants, the primary strategies for responding to recessions fall into one of three categories:

- Bridging
- "Don't Waste a Good Crisis"
- Through-Cycle Mindset

### *Bridging*

Briefly, *bridging* is the approach taken by institutions that, given their wealth, high demand and previously liberal spending policies (aka fat), can make it through the recession without having to make either deep spending cuts or take on the toughest issues. Cuts are often made across all expenditure areas equally. Prudent bridgers acknowledge that it is often unclear how long the bridge will need to be, and so they also have some contingency plans ready in case the recession lasts for an extended period. Bridging is not transformative, but in the right circumstances it is a reasonable approach and results in much lower pain.

### *Don't Waste a Good Crisis*

The "*don't waste a good crisis*" strategy seizes the opportunity to reduce and reset costs at significantly lower levels, and to go after sacred cows—those cost areas that in better times have been considerable untouchable. This strategy involves being aggressive early on, since the opportunity created by broadly-felt pressure may not last long. If the economy turns around sooner than anticipated, then the institution has lower costs to move forward with; if the recession is prolonged, then the aggressive early cuts help to insure survival and avoid the terribly painful process of ongoing small cuts.

### MAPPING STRATEGIES TO RESPOND TO THE RECESSION

#### Managerial Mindset

#### Bridging

- We don't need to make deep cuts and fat/flexibility let us do so without having to take on the toughest issues
- If we have to extend the bridge, we have some contingency plans

#### Don't Waste a Good Crisis

- We can use this opportunity to "reset" some of our costs at significantly lower levels and take on some sacred cows
- We don't know how long the crisis will last so we will be aggressive early

#### Through Cycle

- We will not waste the crisis in terms of resetting our internal costs and will use our aggressive approach to shift resources to strategic priorities
- We will exploit weaknesses in competitors to acquire new customers, talent and competitors

## Through-Cycle

The *through-cycle* strategy combines the don't-waste-a-crisis approach with shifting resources to support institutional priorities. That is, cuts are not made across the board, but rather are based on a prioritization that shifts incremental resources from low to high priority activities. Institutions with a through-cycle mindset could experiment with ways to increase academic productivity, combine subscale departments, and perhaps consider establishing centers or new initiatives in strategically important research areas. Through-cyclists strengthen themselves vis-à-vis their competitors by, for example, recruiting top faculty (while the costs of doing so are lower), acquiring assets at lower costs, and expanding recruitment of desirable students.

The through-cycle mindset requires institutional leaders to wear three hats in a difficult environment:

- *The Planner.* The need to model various scenarios was addressed above relating to flexibility, yet bears repeating: the truly scary scenario should be planned for, with trigger points along the way to kick in agreed-upon action plans.
- *The Cost Cutter.* Costs need to be reduced, using the crisis to address previously off-limits topics. Also focus on generating short-term revenues.
- *The Long-Term Thinker.* Position your institution for recovery by actively upgrading faculty and students, investing in priority areas, and acquiring land or buildings while costs are lower.

## STRATEGIES IN ACTION

Campus leaders have been busy responding to the recession. Based on research and discussions with leadership, it appears that a range of responses addressing administration and academic costs as well as revenue enhancement have been taken, and can be described within the strategic framework outlined above. Out of respect for our interviewees, specific steps by institutions are not identified.

### *Administrative and Support Services*

In the realm of administrative and support services, institutions using a bridging strategy are likely to have made several of these moves: freezing salaries for the current year; freezing hiring and not filling open positions; consolidating purchasing that had been allowed to become distributed in order to capture volume savings; renegotiating vendor contracts; and cutting travel, entertainment, and non-essential spending such as retreats and banquets.

Institutions using the crisis have made more aggressive cuts in the same areas as those addressed by bridging, but

### KEY QUESTIONS IN DESIGNING A THROUGH-CYCLE STRATEGY

- What wide range of scenarios are possible for your institution given your revenue drivers? What will be the "new normal" when we emerge from the recession?
- Where can we cut to take advantage of the current crisis without hurting our core academic mission or priority research? Where might we experiment with high value approaches that would otherwise be off the table?
  - Administration costs
  - Academic costs
  - Other costs
- What priorities need additional investment to position the institution for greater success once the recovery begins?
- Where will the recession create opportunities for us to acquire desirable students, competitors or talent at a much lower cost than normally available to us?

have established differential targets for cutting based on institutional priorities (as opposed to across-the-board cuts, which are more common for bridging). Further, some functions identified for future enhancement, such as development, have been subject to targeted layoffs of staff not considered highly productive in order to free resources for hiring more talent. Some student services have been consolidated or eliminated, such as counselors or support for different student groups. Finally, some employee benefits have been reduced to reset their cost level for the institution.

Forward-looking moves that an institution with a through-cycle mindset could take with regard to administrative and support services are not as obvious as they are in other areas, but could include outsourcing to or consolidating services with another nearby institution that may be able to provide a higher level of support than can be offered internally, or investing resources to shift recruiting to attractive geographies. Another possibility is to make investments in IT that would pay back in administrative cost savings over time. Some systems have even gone so far as to consolidate administration across multiple locations. Realistically, though, while valuable, these moves may not in the end rise up to the level of offering a real source of competitive advantage when the economy recovers.

### *Academics*

In the academic realm, institutions using a bridging strategy are, not surprisingly, freezing salaries for the current year, and freezing hiring and not filling open positions. They are also offering voluntary retirement incentives.

Institutions using the crisis have done all that and more, including seizing the opportunity to consolidate some selected departments, such as modern languages, which may not each need their own separate leadership. The use of adjuncts has been reduced in some institutions in return for receiving increases in productivity of tenured faculty, whereas other institutions have increased their use of adjuncts and lecturers. Finally, the crisis has been used as an opportunity to carefully review, prioritize, and then cut or consolidate institutes and centers that may have proliferated in good economic times.

The academic arena offers a rich set of opportunities to favorably position institutions with a through-cycle mindset. These institutions are doing all that the others are, plus thinking hard about where they are going to start to invest the incremental resources they have created. Some are making faculty hires from institutions they know are not in a position to defend against their offers, others are opening new centers or launching initiatives designed to attract new Federal research funding. They are also experimenting with ways to shorten the time to graduation and increase productivity by, for example, mandating a summer session or offering three-year degree programs. Additional efforts include experiments to increase class sizes and reconfiguring faculty across departments to increase productivity.

### **Revenue Enhancement and Other Areas**

In the realm of revenue enhancement and areas such as capital expenditures, institutions using a bridging strategy have raised tuition and fees, made special appeals to donors for help to get them through the crisis, and rethought aspects of financial aid such as merit aid, or the mix of grants and loans they offer to meet students' needs. Bridging institutions frequently have deferred capital projects.

Institutions using the crisis have taken the opportunity to renegotiate capital project budgets, sometimes resulting in tremendous savings that have allowed them to complete their projects and in some cases free up resources to reallocate to priority areas. With regard to financial aid, some have moved away from being fully need blind in freshmen admissions or more often, transfers.

Institutions with a through-cycle mindset have expanded their academic programming to increase the utilization of their facilities by targeting lifelong learners, extension students, and commuters (none of whom strain often limited residential facilities). Others are starting or expanding online offerings either to generate incremental revenues or to increase their capacity. Some through-cycle institutions are funding growth investments that will pay off in the longer term with temporary increases in their endowment payouts, while others are acquiring land for future expansion at a far lower cost than normal.

## **CONCLUSION**

McKinsey & Co. analysis of more than 1,000 industrial companies in the United States between 1998 and 2002—that is, before and after the tech bubble burst and the economy went into recession in early 2000—found an enormous amount of churn in the leadership of many sectors: Forty percent of the leaders prior to the recession had fallen out of the post-recession leadership group. Our analysis of the winners and losers<sup>1</sup> suggests that the winners frequently displayed a through-cycle mindset. They were far more likely to differentially invest in capital expenditures, research and development, advertising, people, and mergers and acquisitions than the companies that fell out of the top tier. Some of the laggards also exhibited these characteristics and still failed to thrive, so the importance of continuing to invest shouldn't be overemphasized—although it clearly is an important part of the puzzle as to how to position for recovery.

Higher education today is not only facing the worst recession since World War II, but is also subject to considerable, game-changing forces and shocks that have been felt since well before the financial crisis began, including the growth of digital and non-traditional students; the price-cost-productivity squeeze; new paradigm competitors, which are largely for-profits; globalization; and the evolving social contract that is demanding more access and accountability from higher education.<sup>2</sup> Institutions with a through-cycle mindset that anticipate the future and make strategic moves informed by these trends will be in a strong position to not only recover from the recession, but to lead higher education into the future.

## **ENDNOTES**

- 1 Dobbs, Karaolev, Malige. "Learning to love recessions". 2002 McKinsey *Quarterly Special Edition: Risk and Resilience*
- 2 These trends and shocks were discussed in detail during Phase II of the McKinsey Project on Global Higher Education and are summarized in *Forum Futures 2009*, available at [www.educause.edu/forum](http://www.educause.edu/forum).

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