Assessing Independence & Strategic Options for Higher Education Institutions

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This article offers board members and executive teams of universities and colleges guidance in weighing alternatives to best position their organizations for future success. As the landscape of higher education evolves, leaders are increasingly taking proactive steps to review their strategic positions to ensure their universities' long-term vitality. While this process is critical for institutions facing fiscal stressors that can limit alternatives, it is also prudent for colleges and universities seeking growth and sustainability.

As a starting point, we will review the reasons boards are studying their independence, the approaches that they are taking, the role of governance, and common missteps that boards and leadership teams can avoid.

Why Assess Partnerships

The reasons for considering independence vary depending on the institution's position. Financially strong and academically robust organizations might want to extend their reach, while distressed organizations might seek financial stability, with many scenarios in between. Pursuit of this topic has gone from a sign of weakness by a relatively few financially-challenged colleges and universities, to a widely accepted and pragmatic approach being conducted by boards regardless of solvency or near-term merger plans.

In addition to financial drivers, institutions of higher learning pursue partnerships to meet a broad range of objectives. These include expanding academic programs, broadening student demographics, creating new opportunities for faculty, geographic and campus expansion, accessing new sources of capital and realizing scale efficiencies, among others. In addition, evolving student preferences and expectations are placing new burdens on organizations that had successfully served a specialized niche for decades.

Approaches to Assessing Partnerships

There are two ways for organizations to assess their positions and make determinations about how to best meet their objectives: secondary research and primary research.

Secondary research involves a review of one's financial circumstance and market position. It does not seek input from market participants, i.e., primary sources. Non-profit university boards have historically relied exclusively on secondary research as they considered their independence. Generally, this is the first inclination of management, boards, consultants and attorneys. Secondary research is a very worthwhile approach and almost a necessity. However, if conducted in a vacuum or in the wrong hands, the results can be imprecise and even misleading.

Secondary research is done from the board room and assumptions take the place of actionable facts. Particularly troubling are decisions based upon forecasts of sharply improved operating results, notwithstanding obvious recruitment, operating and financial challenges. This approach is sometimes used merely to substantiate the original inclination of boards rather than openly explore alternatives; more on this as we discuss 'missteps' later in this article.

Primary research is an alternative that centers on receiving market input as a component of a board's diligence in considering independence. It has only recently become an alternative, perhaps because of the greater social acceptance of considering independence. By seeking real input from market participants, more ideas and a greater understanding of reality can be achieved. It can also be a very useful tool for boards to gauge the market's relative willingness to provide sought-after objectives under affiliations, where no ownership or control is exchanged, *versus* business combinations, where some or all of ownership and control is exchanged. While the idea of gauging market receptiveness by engaging with potential partners can seem daunting, little actual risk is involved.

Together secondary and primary research offer boards the tools they need to make good decisions. Secondary research provides a baseline understanding of the organization's position, allows for the development of objectives and educates the board on what structural alternatives *may* exist to advance those objectives. Primary research tests these assumptions and provides actionable information, allowing the board to make a fully informed decision.

Governance

There are important differences in the approaches that non-profit boards and corporate boards take to the topic of independence that should be noted. Non-profit boards are typically made up of volunteers, and the composition of the board is self-perpetuating. Most notably, board members are *not elected by owners*. As a result, while there is no lack of sincerity and purposefulness, there is no direct accountability in non-profit boardrooms. Additionally, attorneys general focus primarily on conversions, i.e., combinations between non-profit and for-profit companies. Taken together, these factors create circumstances under which well-intended and earnest board members participate in major decisions in an environment where change is avoided and equated with risk. This is corroborated by boards of failed institutions who invariably express regret for not having "acted sooner".

In considering independence at non-profit organizations, the relationship between management and boards differs dramatically from the corporate setting. Boards of many publicly-held corporations exclude CEOs from discussions and decisions regarding change-in-ownership due to the potential for conflict. In non-profit boards, just the opposite occurs as management usually initiates and leads consideration of this topic. This seems appropriate given the make-up of non-profit boards and the complexity of modern universities. It is, however, a point of which boards should be aware and engaged.

Higher education boards also often emphasize philanthropy, leaning towards alumni and donors. Understandably, their focus often centers on avoiding change. Alumni can be nostalgic to a fault and donors can seek to solve systemic issues with short term donations. As a result, management must initiate discussion of this topic in most cases.

Avoiding Transaction Missteps

Missteps are increasing as more university boards consider independence. These occur both publicly and privately. In either case, they usually lead to a decline in outcomes, value, stability for students, security for faculty and missed opportunity.

Public missteps often involve entering into exclusivity arrangements either prematurely or with an overly confident public announcement that does not accurately reflect the status of ongoing conversations. These are occurring frequently. For example, while writing this article a northeastern university with 5,000 students announced that merger talks had failed when it released enrollment estimates *after* announcing the transaction. The same university had called off another partnership just two years earlier. These types of false starts under public scrutiny need *never* happen; they are harmful to the school, the students, the faculty, the alumni, the staff and the entire community.

Private missteps are more difficult to detect, but we hear of them frequently in our work. These have also been occurring at a surprising rate, perhaps as high as 20% of announced agreed-to combinations, in our estimation. They are often an outcome of management and boards relying on forecasted dramatic improvements before appropriate due diligence is complete. This, too, can lead to poor decisions and decline in value. In other cases, illogical transaction structures are attempted. These usually reflect well-intended but fruitless efforts by boards to retain governance independence or significant participation in future governance of the combined enterprise. These frequently occur when the "most-logical" partner is identified from the board room and the organization only engages that partner in discussions, putting all eggs in one basket and giving up the ability to make a fully informed decision based on comparison of alternatives. Once it comes time to consummate a transaction, the parties may find distinct differences in culture or go-forward strategy.

Missteps lead to loss of value, opportunity, and a whole host of operating challenges. They generally result from the complexity and external nature of the merger market and are often preceded by faulty assessments of independence or poorly designed processes regarding partner selection. Management, boards, and consultants with little experience in this market often engage in time consuming, expensive, and meandering reviews. Group decision-making dynamics and ideology, coupled with barriers to institutional change, only act to compound the challenges.

From a broader view, such missteps are reflective of early stages of change in a fragmented and tradition-bound field like higher education. They rarely occur in corporate industries where there is greater familiarity with the merger market, comfort with change, and accountability to ownership.

Final Thoughts

Even before the global COVID-19 pandemic, higher education was transforming dramatically. Changing student populations and priorities, academic financial models, and teaching structures have been driving institutions of higher education to reevaluate their operations in recent years. The pandemic has accelerated this evolution with advancements in e-learning and continued financial pressures on students and universities alike.

However, these challenges bear new opportunities for higher education institutions. At this critical juncture, boards and leadership teams have a unique opportunity to reassess their strategic imperatives and explore new opportunities for growth. Partnerships between colleges and universities are still in a nascent stage yet hold tremendous promise. We believe this topic deserves more attention and discussion and hope that this article might serve as a beginning.

For more information about how higher education institutions are positioning themselves for the future, please contact Casey Webb, Executive Director, 312.506.3010 or cwebb@juniperadvisory.com.