The board's contribution to and oversight of strategy at colleges and universities

Along with selecting or replacing the CEO, involvement with and oversight of strategy is generally recognized as a chief responsibility of governance. Despite that recognition, governing boards have acknowledged challenges to fulfilling this critical role. While management typically develops the strategic plan (preferably with board involvement), the role of a board is to understand, discuss, and when appropriate, challenge underlying assumptions or other aspects of the plan. While governing the institution for the present, helping guide it into the future calls for board members to provide oversight, insight, and foresight.

Since the start of 2018, we have engaged in conversations with a few colleges and universities around a common theme—the board's oversight of strategy, particularly during a period of challenge and change for higher education.

That presidents and board members have raised the issue is not surprising and is, in fact, consistent with views expressed by public company directors. In his NACD Directorship article *Public Company Board Priorities for 2018* summarizing responses to the *2017–2018 NACD Public Company Governance Survey*, Friso van der Oord, Director of Research, National Association of Corporate Directors (NACD) noted that the survey queried board members regarding opportunities for improving board performance, and the most frequently cited area was the board's contribution to strategy. He added that "71 percent of directors indicate that their boards must better understand the risks and opportunities that affect performance and drive strategic choices … many boards still struggle to move from a traditional review-and-concur approach to deep and continual engagement with strategy."

Before providing a view into the NACD's recommendations, let's consider a few thoughts about the importance of the board understanding the strategic choices that likely have been discussed by senior management. The following was excerpted from an article in the April 2018 McKinsey Quarterly: "The goal of most strategy discussions is to approve or reject a single proposal…suggesting different options, or questioning the plan's premise is often unwelcome…choices are the essence of real strategy, and the planning process should be geared to shining a spotlight on them." Our experience with many colleges and universities supports the notion that more often than not it is a particular path forward that is brought to the board while management's deep and thoughtful deliberations of alternate paths go unpresented. Almost all of the time, this is based on a desire to use the board's time effectively rather than to keep them from considering other options. We encourage the development of a meeting agenda that allows significant time for strategy discussion, including sufficient time to cover the road(s) not taken.

Returning to the NACD's recommendations—Mr. van der Oord explains them as "among the concrete actions directors should consider: develop a more intimate understanding of your changing business and industry…engage with management on strategy issues…evaluate strategy options and underlying assumptions…and not be afraid to ask difficult questions about the viability of the business."

For colleges and universities, it is important that mission drive strategy and inspire all decisions made by institutional stewards to accomplish their vision. In the November/December 2017 issue of AGB's Trusteeship magazine, Dr. Ellen Chaffee, Senior Fellow for the Association of Governing Boards of Universities and Colleges (AGB), asserted "we need to start where we are and think about the future, focus on purpose and why we exist, and ask why anyone should care if we exist. That's very fundamental, and it's an area in which trustees can be very helpful in terms of giving us some perspective...they come to us with fewer assumptions and more experiences in other settings...people who will challenge the way we've been doing things, who will bring new ideas to how things could be done, who can enrich our sense of purpose and our direction..."

Perhaps belatedly, let's raise the question: What is strategy? There are many dictionary definitions, media articles and even YouTube videos. The 2014 *Report of the NACD Blue Ribbon Commission on Strategy Development* offers the following: "strategy is the means to create economic value by gaining competitive advantage through a unique value proposition." In an April 2018 Harvard Business Review article *Your Strategic Plans Probably Aren't Strategic, or Even Plans*, Graham Kenny says "[strategy is] a scarily misunderstood concept in management and board circles. The most basic mix-up is between 'objective,' 'strategy,' and 'action'… The key to strategy is that it's the positioning of one business against others."

Recognizing that competition and competitive positioning are critical elements of strategy, the higher education challenge frequently comes down to how to gain (or perhaps maintain) market share in an industry that is overpopulated. Depending on the institution, the most pressing competitive battles may be for students, faculty, researchers and research dollars, or even state funding. Often, the competitive landscape can shift so quickly that institutional response is challenged to keep up with the pace of change amid considerable uncertainty. For example, New York State's Excelsior Scholarship program and its offer of free tuition to residents meeting family income criteria and other conditions became effective so quickly after being announced as a legislative priority that many private colleges and universities in the state—and many outside the state seeking to enroll students from New York—were faced with enrollment uncertainty and financial vulnerability.

Earlier this year, AGB issued its biennial edition (2018–2019) of *Top Strategic Issues for Boards,* which it designed to help boards with their work "that concentrates on strategy rather than management and on long-range issues instead of day to day concerns." The issues highlighted—Educational Quality, Financial Stability, Freedom of Speech, Innovation, Presidential Leadership, and Relevance—are each covered in depth, including proposed "Questions for Boards to Consider."

We will focus our attention on Financial Stability. With respect to this issue, AGB notes that various "financial trends combine to put severe pressure on the traditional higher education business model".

Once again we see the overlap of risks facing higher education and corporations, as business model pressures confront all industries. The top two risks identified in the Protiviti and NC State issued *Executive Perspectives on Top Risks for 2018* were:

- Rapid speed of disruptive innovations and/or new technologies…may outpace our organization's ability to compete…without making significant changes to our business model; and
- Resistance to change may restrict our organization from making necessary adjustments to the business model and core operations.

These risks identified by corporate executives could have come from a survey of higher education leaders. In fact, a United Educators survey in 2017 found the business model, including enrollment trends, staffing levels, and fiscal and tuition management, ranked as the top reputational risk confronting colleges and universities over the next three years. Also, in a survey of board members as reported in *The AGB 2017 Trustee Index* "58% say business models need to change moderately, and 34% say they need to change drastically…when asked to identify the biggest barrier to changing a higher education institution's business model, board members are most likely to cite lack of support from faculty (28%), followed by a lack of confidence among institutional leaders to make changes (19%)…".

Corporate executives cite resistance to change as a top risk. In meeting their oversight responsibilities, college and university board members face unique challenges with respect to the long-standing traditions of tenure (a challenge exacerbated by no mandatory retirement age) and shared governance. Many trustees believe their institutions need to consider significant changes to academic offerings—not only additions, but subtractions as well—and may have been led to believe that such changes, especially program closures, are nearly impossible, particularly for institutions that are currently in reasonably good financial condition.

In a May 2018 Forbes opinion piece *Is Tenure Dying? Does it Matter?* Richard Vedder, Distinguished Professor of Economics Emeritus at Ohio University, wrote, "Tenure emboldens faculty members to be feisty, argumentative, and protective of their property rights in certain courses, office space, and even parking…. That is a huge problem if, as is increasingly the case, enrollment decline, changing student interests, or debilitating faculty performance make dismissal of the faculty member advisable…. Decision making in universities thus often becomes costly, time consuming, and is filled with dubious compromises to minimize brutal academic wars. Shared governance is expensive and often leads to non-optimal decisions." The 2017 issued *AGB Board of Directors' Statement on Shared Governance* acknowledges the challenges noting "Boards, faculty, and presidents…continue to struggle with its value and its effectiveness," but asserted "In higher education's volatile environment, shared governance is essential." AGB has also recommended that institutions regularly review their shared governance practices for potential improvements, and notes that "perhaps the best indicator of how well shared governance is working on any campus is whether it enables, rather than constrains, thoughtful decisions to enhance student success, institutional health, and innovation."

Although the NACD advised public company directors to better understand their business and industry, the *AGB 2017 Trustee Index* concluded that "board members seem to be well aware of the challenges facing the sector." Our own experience with college and university audit committees and boards supports AGB's conclusion that issues and trends, including rating agency views (e.g., Moody's current negative outlook for the sector), struggles to reach enrollment goals, rising discount rates, declining or modestly increasing state funding, demographic changes, public questioning of higher education's value proposition, student debt, and rising costs are generally well understood. That said, we see opportunity for board members to deepen the conversation regarding their institutions, without crossing the line into management. Board retreats, which are increasingly common in the industry and take place away from the more routine business of committee agendas, may provide such an opportunity. With respect to the financial stability and business model issue, AGB's Questions for Boards to Consider are presented below.

Financial stability

QUESTIONS FOR BOARDS TO CONSIDER

- Does your board include members with the skills, knowledge, and background needed to plan for the financial future of your institution? How can your board best achieve collective "financial literacy," while recognizing that not all board members need to be financial experts?
- Do recent fiscal results and future financial and demographic trends point to a need to rethink or reform your institution's current business model? What changes would lead to greater financial stability and long-term sustainability?
- Has your board taken a close look at your institution's cost structure to identify the potential for reductions that would not negatively affect the mission or educational quality and student success? Are there any programs that could be consolidated, costs that could be cut, or economies that could be taken advantage of in order to increase productivity and efficiency?
- What are the key factors affecting net tuition revenue at your institution? Is financial aid being used effectively?
- Could your institution gain a competitive advantage by diversifying its educational offerings or launching new programs that attract new types of students and increase enrollments? What efforts are underway to promote student retention and completion?
- Does your board have a system for tracking key financial metrics that provides data relevant to long-term financial decision making?

Excerpted from AGB's *Top Strategic Issues for Boards* (2018–2019)

We recognize that deeper dives into net tuition revenue and financial aid may lead to some sensitive conversations, but the criticality of these business model components for most institutions warrants the discussion. Additional questions that may be considered include: Are aid policies consistent with our mission? Is aid used strategically to build the desired student population? How is aid allocated between merit-based and need-based awards? What controls are in place to mitigate the risk of over-awarding institutional aid? and What is the debt burden being taken on by our students? Also, the percentage of students receiving Pell Grants—a metric widely used to measure the enrollment of low income students—may be of interest to board members at many institutions and perhaps particularly important for elite schools or those whose missions promote socio-economic diversity and access.

For those institutions with significant research enterprises, board members may want to consider the following questions: How are the direct and indirect costs of our research efforts, including compliance, funded (i.e., federal, corporate, foundation or other external sources vs. internally)? Is the institution's research enterprise supported by an appropriate infrastructure? Is the intellectual property associated with our research understood, leveraged, and protected? What is the level of annual royalties earned from our research and how are those royalties shared? For those schools which seek to raise their research profile, questions surrounding the return on investment should be, and likely are being, discussed.

Strategic plans need a means, such as milestones and performance metrics, to enable the board to monitor progress and timely determine whether revision is needed. Revision is by no means failure, as strategy must be dynamic because of the pace of change. To help guide the institution toward achievement of strategic goals, beyond internal information including analysis of financial and operational data, board members need information with respect to industry trends, forward-looking indicators, and competitors.

Not only is involvement with strategy a top responsibility of governance, but active involvement from formation to ultimate achievement offers opportunity to truly lead, add value, and advance institutional mission.

Contact us

KPMG's Higher Education, Research & Other Not-for-Profits Audit Practice

David Gagnon
National Industry Leader
T: 617-988-1326
E: dgagnon@kpmg.com

Rosemary Meyer
Deputy National Industry Leader
T: 410-949-8425
E: rameyer@kpmg.com

Regional Leaders

Renee Bourget-Place
Northeast
T: 802-651-5634
E: rbourgetplace@kpmg.com

Jamie Klein
Metro New York and New Jersey
T: 212-872-6708
E: jhklein@kpmg.com

Rosemary Meyer
Mid-Atlantic
T: 410-949-8425
E: rameyer@kpmg.com

Eileen McGinn
Southeast
T: 615-248-5619
E: emcginn@kpmg.com

Kurt Gabouer
Midwest
T: 312-665-3308
E: kgabouer@kpmg.com

Drew Corrigan
Pacific Northwest
T: 503-820-6629
E: dcorrigan@kpmg.com

Mark Thomas
West
T: 949-885-5630
E: mtthomas@kpmg.com

Travis Hunter, Jr.
Southwest
T: 214-840-2117
E: thunterjr@kpmg.com

kpmg.com/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. The effective dates included herein relate to annual periods for June and other fiscal year-end not-for-profit institutions. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

©2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in the U.S.A. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 798525