SeaChange

NAVIGATING THE STORMS

A PRIMER FOR PRIVATE COLLEGE TRUSTEES

APRIL 2020

OUR EXPERIENCE

SeaChange has been working for more than a decade to support nonprofit organizations facing complex challenges. We've helped organizations put processes in place to manage risk, made grants and loans to encourage and support mergers, joint ventures, divestments and other types of reorganizations, and have even helped to wind down a number of institutions. In total, we've looked at more than 1,000 situations and engaged deeply in close to 250 as a grant-maker, lender, or pro-bono adviser.[1]

Although SeaChange has not traditionally considered nonprofit colleges to be part of our remit, recent discussions with those involved in higher education—presidents, trustees, accreditors, state associations, consultants, funders—suggest that our decade of experience working with other types of nonprofits may be relevant to college trustees and executive officers grappling with similar issues.[2]

This brief note—intended as a primer for trustees of nonprofit colleges—summarizes what we have learned and offers some tentative suggestions for where this might be relevant given the unique challenges faced by colleges.

COVID-19: AN ACCELERANT FOR ACTION AND CHANGE

This note was written in late 2019, before the onslaught of the COVID-19 pandemic buffeted planning and magnified financial pressures for every institution of higher education. Most institutions are now projecting serious to severe threats to revenue from enrollment declines (among both new and returning students), lower contributions and grants, and declines in everything from executive education to summer camps. Expense side burdens loom across the board: increased aid to support students with higher need due to widespread employment disruption; return of this spring's room and board funds; downward pressure on tuition, and higher costs for instructional design and technology, facilities cleaning and employee health insurance.

Boards are challenged as never before to be clear about their mission and priorities and candid in their assessment of their institutions' situation and options. The speed of the changes, the number of unknowns at play, and the potential for waves of changes reinforces the importance of taking the steps and considering recommendations described in this note both during the immediate COVID-19 crisis and in its aftermath.

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1 SeaChange's advisory work is almost always pro bono to the nonprofit as our costs are covered by foundations interested in the health of the sector.

2 Beginning in 2014, SeaChange began receiving inbound calls from leaders involved in higher education; the volume of inquiries has increased steadily over the last two years.

CONTEXT: STRUCTURAL CHALLENGES[3]

Even before COVID-19, the 1,700 private nonprofit colleges in the United States faced a complex set of demographic, social, cultural, technological and political challenges that are only likely to intensify over the next decade.[4] A number of institutions have already failed. Many others are expected to follow.[5]

In response, many college trustees are—or should be—asking new questions about the institutions they govern.[6] What risks do we face? How risky are we relative to our peers? Are we doing the right things to understand and mitigate our risks? What role might an institutional reorganization—a joint venture, a merger, the divestment of certain programs or assets—play in helping us address these challenges? Under what circumstances would a deliberate, proactive dissolution be the most responsible option?

Very few private colleges have experience in dealing with these issues. We believe that they have something to learn from the deeper experience of other types of nonprofits that have faced similar issues.

Private nonprofit colleges ("colleges") might appear to have little in common with traditional nonprofits ("nonprofits").[7] In fact, many nonprofit leaders look with envy at private colleges which are, in general, larger, more financially sophisticated, and benefit from a built-in base of active or potential alumni donors. While these advantages are real, colleges and nonprofits share a number of structural challenges, and both operate in environments that are far more difficult than many trustees appreciate:

1. Cost-Minus Funding: The primary revenue source for colleges—tuition—virtually guarantees a deficit which needs to be made up with philanthropy or government support.[8] Students and their families simply cannot pay the fully-loaded cost of a traditional college education. Even at full enrollment, colleges require both government and philanthropic support.

2. Cost Disease: The traditional education model offered by colleges continues to rely primarily on face-to-face, labor-intensive services. The real cost of these services has risen substantially over time and is likely to do so in the future.[9]

3. Zero-Sum Revenue: The total supply of college-bound high school students—the traditional source of students and revenue—is largely fixed at any given moment. While some individual colleges may be successful in boosting enrollment from this pool, this comes at the expense of other colleges since

3 For more information, see Risk Management For Nonprofits.

4 Public institutions also face considerable challenges but they are not addressed in this report given their different political, economic and governance characteristics.

5 Here is an updated list of all college failures.

6 Many other stakeholders—State Departments of Education, Accreditors, State Attorney Generals, the Federal Department of Education— are also actively considering how best to address these issues. However, this note is addressed only to trustees whose duties of care, obedience, and loyalty pertain to a single institution.

7 By "nonprofit" we mean the more than 225,000 organizations exempt from taxes under Section 501(c3) of the US Internal Revenue Code. See the Financial Health of the US Nonprofit Sector for more information.

8 In the case of private nonprofit colleges this government support is in the form of student aid.

9 See Baumol's Cost Disease although there is some debate about this.

aggregate enrollment is driven by exogenous demographic and economic factors over which colleges have no control.

4. Run On The Bank: Colleges can be subject to a "run on the bank" if they lose the confidence of students, families, donors, or regulators. It is very difficult for them to recover from even a brief period of financial distress, or even rumors of distress, let alone bankruptcy.[10]

Colleges also have unique characteristics that make them more complex than other nonprofits:

1. Competitive Market: Colleges operate in a uniquely competitive market environment compared with other nonprofits. They compete with one another for students on the basis of price, location, programs and services, quality (real and perceived), as well as with subsidized public university systems, for-profit organizations, and emerging players offering nontraditional degree programs.[11]

2. Shared Governance: They are committed to some form of shared governance between trustees, administration and faculty. Although staff—particularly collectively organized staff—play an important role in many nonprofits, they are seldom viewed as "partners" in governance. While shared governance is appropriate given the centrality of teaching in a college's educational mission, it complicates the tough-minded assessment required to act in the face of adversity on a timely basis particularly given the heavy emphasis on "process."

3. Alumni: Although alumni can be a source of great strength, they are seldom informed or realistic about the current operating environment. They represent a strong and vocal stakeholder group that present management and communication challenges unique to eductional institutions.[12]

4. Centrality of Location: Colleges are often tied—both financially and in terms of identity—to a particular place and its associated real estate. Outside of the major metropolitan areas, even small and struggling colleges are often vital economic centers in the local community. They cannot easily relocate to areas where the demand for education is higher.

5. Complex Regulatory Framework: Colleges are subject to multiple layers of regulation and oversight that is not always coordinated. These regulatory bodies include the institution's accreditor, the State Board of Education, the federal Department of Education, and the State Attorney General.

Given these challenges it is no surprise that most colleges—like other nonprofits—have limited resources to tide them through in the event of a crisis (e.g. COVID-19). After all, the institutions exist to pursue their educational missions,

10 Colleges in distress also face communications obligations that can quickly become public: financial exigency notices under contracts, notice requirements under bond indentures, etc. Reporting to naïve internal constituencies who do not agree to be bound by duties of confidentiality can create similar problems.

11 For example, see Southern New Hampshire University or Minerva.

12 Clients, important funders and other stakeholders may wield power with respect to particular nonprofits but no group regularly wields the power of alumni nor is a prone to nostalgia.

not to build up internal resources. However, this makes it imperative that they have prudent risk management processes in place.

THE TRACK RECORD: DEALING WITH RISK

SeaChange has interviewed or worked directly with dozens of executive directors, trustees, and other stakeholders of nonprofits that have struggled. Some of these institutions had gone bankrupt. Others were rescued at the 11th hour by other organizations or "saw the writing on the wall" early enough to pursue an orderly dissolution. Across these situations, several consistent themes emerge as do some "worst practices" leading to distress.

1. The institutions are fragile to begin with. Before the crisis hits they have limited resources and several years of deficits have eroded whatever resources had once been in place.[13]
2. The crisis is precipitated by a discrete event. The failure to renew an important grant, the discovery of a large unfunded deferred maintenance expense, the resignation of the president, unexpectedly low-enrollment, a scandal, [14]etc.
3. The institutions have failed to do explicit scenario planning despite facing inherently uncertain situations. They have not paid enough attention to contingencies and milestones. They are surprised by things that could have been foreseen.
4. Trustees are not made fully aware of important long-term trends in financial performance or the operating environment. Important trends have been masked by an exclusive focus on current year results, year-ahead budgets, and year-over-year "rearview mirror" comparisons. Trustees focus too much on the strengths and weaknesses of individuals—the CEO, the CFO, the Enrollment Manager—rather than the broader structural issues.
5. Trustees do not get timely, actionable information at the appropriate level of detail before or during the early stages of the crisis.
6. Trustees take too long to realize that there is a problem and then delay taking action even after they decide it is necessary. Trustees suffer from magical thinking.[15]

Our discussions with college presidents, trustees, and others within higher education suggest that these "worst practices" are relevant for colleges.[16] They also figure prominently in the "post-mortems" done by the state Offices of the Attorney General with respect to the Mount Ida and Cooper Union crises.[17]

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13 The resources used to fund deficits include board-reserved funds, over-draws on endowments, one-time asset sales and unrepeatable capital campaigns.

14 See Daniel Kahneman's "inside view vs. outside view" for a general discussion of this bias.

15 The belief that thinking about something or wanting it to happen can make it happen.

16 While it is difficult to get the inside story regarding particular college failures, publicly available reports suggest that many of these "worst practices" were involved.

17 The state attorney general letters with respect to Mount Ida College and The Cooper Union should be mandatory reading for all college trustees. For traditional nonprofits, fundraising dominates magical thinking in the college context it's concentrated in enrollment, new programs, and technology.

ELEMENTS OF ROBUST RISK MANAGEMENT[18]

Enterprise Risk Management in for-profit companies and our interviews with nonprofit leaders suggest a set of best practices that well-governed nonprofit institutions should have in place and revisit regularly:

1. Governance and Accountability for Risk Management: Oversight for risk management is part of the board's legal duties of care, loyalty, and obedience. It should be an explicit responsibility of the audit or finance committee, with an appropriate dedication of time to the task.[19] The committee responsible for risk must have direct communication with the financial leadership and with staff who have time to ask "What if?" It should report to and elicit input from the board as a whole. It should ensure that the board sets the right tone by communicating a commitment to risk management throughout the organization.

2. Risk Tolerance Statement: Institutions should develop an explicit risk tolerance statement. This is similar to a mission or vision statement. It needs to indicate the limits for risk-taking. A thoughtful risk tolerance statement will reduce the likelihood that an institution is either cavalier about risk or paralyzed by excessive risk aversion.

3. Scenario Planning: Institutions should keep a running list of the major risks they face. For each, they should indicate the likelihood and expected impact were it to occur. They should consider actions to reduce the likelihood of occurrence and mitigate the damage if it does. The list may include a wide range of possible risks depending on the institution.[20]

4. Recovery and Program Continuity Planning: Institutions should develop detailed plans for how to maintain services in the event of a financial disaster. Large institutions should develop "living wills" to expedite program transfers. These living wills should be discussed in advance during stable times with regulators and partners so everyone is prepared to act quickly in the event of a crisis.[21]

5. Environmental Scan: On an annual basis, institutions should brief trustees about longer-term trends in the operating environment. They should consider the potential benefits of exploring various forms of institutional reorganization as a matter of ongoing strategy, not only in reaction to an imminent crisis.

6. Benchmarking and Self-Rating: Institutions should compare their financial and operating performance to peers on an annual basis using the best publicly available data.

7. Financial Stability Targets: Institutions should have targets for operating results based on minimum and long-term needs. An example might be not having two consecutive years of deficits or not having a net tuition discount of greater than X%, or enrollment of less than Y. Trustees should develop contingency plans in advance for when minimum targets are not met. Organizations should have monitoring and governance processes in place to ensure that reserves, or other one-time sources of funds, are not used to fund operating deficits.[22]

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18 For more information see Risk Management for Nonprofits.

19 Large nonprofits that have set up standalone "risk committees" (similar to those of large financial institutions) have generally found that they do not have enough to do and that risk is better handled as part of audit or finance.

20 Some institutions have incorporated this into a "risk model." See Grinnell College.

21 For many traditional nonprofits, "living wills" may not be appropriate but given the importance of ensuring that students have a fully funded, and well planned bridge to degree completion they should be in place at all private nonprofit colleges.

22 Here is an example of certain metrics for consideration.

8. Reporting and Disclosure: Institutions should summarize their financial and programmatic results in a short, plain-English report similar to the management discussion and analysis section of the SEC's Form 10-K. This report should also cover opportunities and risks in the context of internal and external conditions.[23]

9. Board Composition, Qualifications, and Engagement: Risk management requires a functioning partnership between capable management, informed faculty, and a critical mass of experienced, informed, and engaged trustees. Institutions serious about risk management must redouble their efforts to recruit trustees with a wide range of experience. They need to empower high-functioning committees. They also need to ensure ongoing education for both new and existing trustees to ensure that they truly understand the "business" model of the institution and the mechanisms of shared governance. Many institutions would benefit from having an experienced executive on their board from a peer organization.[24]

Given the importance of higher education culturally, politically and economically—the 1,700 colleges educate 3.4 million students and employ 750,000 people—colleges face greater scrutiny from third parties than other nonprofits of similar size. As a result, colleges unwilling or unable to put robust risk management processes in place should expect to come under increasing pressure from outside stakeholders. In fact, new laws recently introduced in response to college closures—e.g. the Financial Stability in Higher Education Act in Massachusetts—essentially mandate that certain of these practices be implemented, including plain English disclosure, scenario planning, trustee training, and living wills.[25]

In the case of traditional nonprofits that fail, board members are very seldom subject to costly or time-consuming lawsuits or investigations other than in those rare cases where there is a suspicion of fraud or gross negligence. Private colleges are different. They have many more interested parties—staff and faculty, students and families, bondholders and lenders, alumni—and multiple regulators. Private college trustees should assume that a "bad failure" will result in multiple, time-consuming actions by those who feel aggrieved.

EXPLORING REORGANIZATION: THE IMPORTANCE OF PROCESS[26]

A well-governed institution with appropriate risk management processes may still conclude that it might better fulfill its mission through some type of institutional reorganization. This might involve a joint venture, merger, program collaboration, divestment of certain programs, conversion to a foundation, or even a deliberate, proactive dissolution. The potential benefits of a reorganization include a mix of lower costs, better utilization of real estate assets, strengthened leadership, improved governance, reduced duplication of efforts, more (or more diversified) funding, and programmatic improvements from breadth, depth, or quality.

While the range of reorganizations included under this definition may appear to span very dissimilar things (e.g., a merger vs. a dissolution), in our experience the good-faith exploration

23 This letter to the Oberlin community from its leadership is a good example.

24 The challenge of building a strong, skills and experience-based board can be difficult in private institutions if trustees are selected because they are large donors. Public institutions face a similar challenge if board members are political appointees.

25 The financial review and risk monitoring regulations enabled by the Massachusetts law are here.

26 Outside of higher education we prefer the term "merger and sustainable collaboration" but we are using "reorganization" here because it is more familiar within higher education.

of any type of reorganization presents a similar governance challenge because it requires an acknowledgement *that the status quo is untenable (or at least not ideal) and a commitment to action.*[27]

Given the range of potential benefits, reorganization is an option that should be regularly considered as a proactive strategic rather than only in a reaction to a looming crisis. While each situation is different, successful explorations tend to follow a process with nine vital elements.[28]

1. A Foundation of Shared Understanding

The process of exploring a reorganization must not start in a vacuum. Trustees involved in higher education vary enormously in terms of their knowledge, experience and engagement. A reorganization (or potential reorganization) is a strategy for responding to circumstances in light of the institution's mission, operating environment, strengths, weaknesses, and business model. The necessary first step—which often takes a minimum of 6-12 months—is to build consensus among the trustees around these issues. (In the COVID-19 crisis, institutional leadership must work hard to bring trustees up to speed more quickly since they don't have the luxury of this time.) All too often trustees are unwittingly ignorant of the background context since nonprofits—including colleges—often lack the indicators of organizational health that reach the directors of for-profit businesses, such as stock prices, credit spreads, or market share. They also lack outside parties like activist investors, rating agencies, stock market analysts, and short-sellers to encourage them to step back and take an objective view of their situation.[29] In addition, most trustees have never worked at an institution similar to the one they govern nor have they served on a similar board. In most cases, presidents need to actively and explicitly bring information to trustees, taking care to present data in a way that highlights the real issues. While it can be a fraught with risk for presidents to bear bad news, third parties (e.g. consultants, membership associations, etc.) can be helpful in validating this information.

2. Active, Empowered Leadership

Many institutions, even those with seemingly well-functioning boards of apparently clear-thinking trustees, find themselves under great financial pressure with few degrees of freedom and very little time. This happens because most institutions have less margin for error (i.e. time and money) than many trustees recognize and the exploration or implementation of a reorganization takes far longer than expected. Institutions often start too late without even knowing it.

Compelling reorganizations—in particular mergers—can gestate for years in some form or other before "getting serious." Working through the due diligence, legal, and regulatory processes is time consuming. In our experience, it takes an average of 18 months for things to evolve from the start of discussions to legal close, with very few under six months and over 45% taking two years or more. Given their additional complexity, transactions involving private colleges will likely take significantly longer.[30]

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27 The process of exploring one type of reorganization may lead to the implementation of another.

28 For a more detailed discussion of "process" with respect to higher education see Strategic Mergers in Higher Education.

29 For colleges with traded bonds, the bond price, yield to maturity or rating may serve as a signal. Trends in applications and admission yields can serve a similar function. Colleges have more information than other types of nonprofits but far less than publicly-traded companies. This is particularly true for smaller colleges.

30 All the figures and estimates in this section are from SeaChange's experience with over 200 nonprofit reorganizations since 2009. Although some of this is based on self-reports by nonprofits, we are confident that all the figures are directionally correct enough to be useful for college trustees.

Starting too late is the single biggest cause of failure. Moving pro-actively in the absence of a crisis requires strong leadership because trustees—particularly those with for-profit M&A experience—seldom appreciate how long the process takes. Our research suggests that while more than 60% of discussions are initiated by the president, both the president and the trustees have a veto. It often takes strong leadership from the president and at least a critical mass of supportive trustees (sometimes one is enough) to pull the others along as inaction remains the path of least resistance. A common motivating factor—though perhaps less relevant in higher education—is a change (or impending change) in leadership. Sometimes a leader who is "on the way out" anyway is more willing to push reluctant trustees. In other cases, the departure (or impending departure) of a leader who was reluctant, or viewed as reluctant, can make it easier for the trustees to take action. A new leader may also see the situation with "fresh eyes" and feel less constrained by the past.

Starting early not only improves the likelihood that the exploration ends successfully, it also increases the range of possible partners and improves the "terms of trade" that a partner might consider. It makes it more likely that an organization can enter into discussions from a position of some strength rather than under duress.

3. Mission Alignment

Nothing should be discussed in any detail unless and until there is confidence that the potential reorganization would further the mission(s) of the organization(s). Mission provides the energy required to fuel the exploration. It is to the mission— not to the continued existence of the institution as a standalone entity in its current form—that the trustees owe their fiduciary duties of care, loyalty, and obedience. A joint focus on mission has the best chance of keeping negotiations moving through the tough issues that will inevitably arise. Unless the potential mission-related benefits are significant, mutually acknowledged, and constantly communicated, the process is unlikely to reach a successful conclusion.

"Mission" is a notoriously slippery word that gets used in lots of different highly abstract ways and can overlap with terms like "values" and "vision." In the context of a reorganization there are four mission-related questions that provide a sense of the alignment between two institutions: What do we do? Why do we do it? What assumptions do we make about the "way the world works" and the ecosystem/environment in which we operate? How do we judge success? Mission alignment comes if there is significant overlap in the last three.

Unfortunately, serious consideration of a potential reorganization often reveals unstated but important differences of opinion about the real mission of the institution. For some trustees, a particular program may be the "core" of the mission, for others it may be staying in a particular location, or serving a particular type of client (i.e., student). Important questions around mission often go unexamined for years.[31]

The high stakes exploration of a reorganization also requires a high level of confidence and coordination between the trustees and the president, and among the trustees themselves. In the absence of this, the institution will appear chaotic, disorganized, and "of two minds" in discussions with potential partners. In this situation, the institution should pause and seek to address the

31 Mission issues can be particularly fraught for HBCUs, religiously-affiliated or single-sex schools. Trustees may differ on whether these aspects are "non-negotiable" or are open to discussion.

discord before starting (or resuming) the exploration.

Trustees must also recognize that the consensus-at-all-costs board culture of many institutions can hinder clear, decisive, and timely decision-making that reorganization often requires. Reaching unanimous agreement on the mission simply may not be possible. This can provide a healthy opportunity for the institution to clarify and reaffirm its mission with the believers staying involved while the dissenters respectfully move on.

The primacy of mission often allows an institution to quickly identify one or two "preferred" partners. In very few cases does an organization need to do exhaustive research to identify its potential partners. In fact, most partners already know each other well and are already on one another's "short list."[32] In a meaningful minority of cases (~30%), a successful reorganization comes the "second time around" after unsuccessful discussions between the parties in the past.

Many trustees are uncomfortable "putting all their eggs" in one basket by limiting detailed discussions to one potential partner. However, very few institutions have the internal capacity to pursue multiple discussions in parallel or to maintain enthusiasm and trust with multiple parties while doing so. In for-profit transactions, it can be risky or naïve to narrow discussions to one party who can then press their advantage when negotiating terms (e.g. their price). However, this makes little sense in the nonprofit context because mission and trust, not price, undergird discussions.

4. Cultural Compatibility

The most important asset of most nonprofits—including colleges—is their people. A reorganization which leaves people deeply demoralized will generally be unsuccessful when judged in retrospect. While nonprofit staff are seldom enthusiastic about a reorganization, even when the status quo is dire, strong leadership in support of a mission-aligned transaction can usually bring them along provided the reorganization has been well thought through and the institutions share similar cultures.

It is much harder to bridge different institutional cultures.[33] In mergers and other similar transactions, cultural integration is consistently reported as the biggest challenge to successful implementation over the following two to four years. Though these challenges are not insurmountable, detailed planning, positive messaging from executive leadership, and measurable expectations, can make cultural integration easier. However, institutions with widely different cultures—or identities—should be very wary of entering into discussions regardless of the other potential merits. Historically Black Colleges and Universities, religiously-affiliated and single-sex schools can face particularly thorny issues of cultural compatibility.

5. Sensitivity Around Language

Language often becomes a source of confusion and needless friction, particularly if one institution is smaller or perceived as "weaker," unless care is taken to agree upfront on the right words and a commitment is made to stick with them. "Acquisition," "takeover," and "merger" can be loaded terms. "Union," "integration," "combination," "partnership," or "collaboration," although less legally descriptive, should take their place and will do a lot to build trust. To the full extent possible, the

32 For example, Presscott (Arizona) College and Green Mountain (Vermont) College's "Preferred Teach-out Partnership" was possible because they knew each other well through the Eco League.

33 Trustees must be careful not to confuse board culture with institutional culture.

legal structure of a reorganization should not dictate the language used to describe it in non-legal settings. Even something as simple as using "we" in place of "you and us" can be helpful. It is also important to emphasize the unique or compatible assets that each institution brings rather than seeing the discussion as zero-sum.

6. Financially Aware, Not Financially Dominated

Trustees, particularly those with corporate backgrounds, often believe that reorganizations are principally about finances; in particular, real estate, debt, and cost savings. On the other hand, other stakeholders often feel that "mere money" should not even be part of the analysis. The truth is somewhere in between. While financial considerations are generally not a sufficient reason to pursue a reorganization in the absence of mission alignment, they may be very important at the margin and will often come from a reduction in identifiable redundancies in overhead functions (like senior leadership, HR, accounting, and development) as well as in areas like real estate, insurance, or technology.[34]

A reorganization can also make it easier to do things—close a department, sell a building—that might be difficult in the normal course. These are not so much cost savings as simply a change in what the institution does, but they can serve to improve the financial profile.

In the nonprofit world, there is no real analogy to purchase price as money very rarely changes hands when transactions happen. Even in the extreme situation where an observer might rightly conclude that a strong "buyer" is acquiring (or "taking over") a terrific program from a "selling" organization that needs the cash, it's a mistake to assume the "buyer" is going to pay upfront for the privilege.[35] From a purely financial standpoint, even the best nonprofit program is a liability. Furthermore, the charitable net assets of an organization cannot be "purchased" at a discount since the law requires that they continue to be used in furtherance of the mission.[36]

7. Outside Support

Very few institutions have been through the process of exploring or implementing a reorganization. However, experienced practitioners can help provide legal, consulting, communication and facilitation services to help navigate the process.[37]

Legal help can be vital to getting sensible transactions done. Lawyers with the right experience can make the difference between success and failure. However, a premature focus on the legal aspects—both transactional and due diligence related—of a potential reorganization runs the risk of distracting organizations and their trustees from the mission-related (and other) issues likely to determine whether a given transaction makes sense to begin exploring in earnest (it also creates a needless waste of time and money).

Although it is uncommon in the for-profit context, many nonprofit-to-nonprofit discussions benefit greatly if the parties jointly select and retain an independent facilitator/project manager to

34 While the cost savings should not be the driver of discussions they often involve—in the form of potential job losses—the handful of senior leaders who are vital for progressing the discussions. Trustees must handle this issue upfront rather than pretending it will go away.

35 Even if cash does change hands, for example for real estate, the net asset value cannot—under nonprofit law—be used other than for mission-related purposes nor can assets be sold for less than fair-market value. If this were not the case, profit-minded "vulture" investors would be actively targeting struggling private nonprofit colleges. Although they have been "sniffing around" in certain situations this is not a widespread phenomenon.

36 For example, they could be used to support students who have transferred to another institution as part of a teachout.

37 We have gathered a resources that may be helpful to colleges here. We welcome your suggestions for additions..

help move the process forward. We believe this to be true in higher education as well.[38]

8. Appropriate Pace

Exploring a reorganization takes time. Protracted discussions can be exhausting for all parties and potentially destabilizing as word gets around that something is afoot. The passage of time also reduces degrees of freedom and resources if it turns out that the original reorganization does not pan out. Organizations must push themselves to go "as fast as they can but as slow as they must."

9. Commitment to Celebration

Even at the end of an exhausting reorganization process, the institution(s) must be able to celebrate the outcome. A reorganization that could never be celebrated—even if trustees were able to put aside their purely personal and emotional considerations—should be reconsidered in light of other options. The ability to celebrate is not only a proxy for the mission-fit of the reorganization. It is also a crucial step to closing one chapter of an institution's life while getting the next one off to a solid start.

INSTITUTIONAL REORGANIZATION: JUDGING SUCCESS

There has been limited research with respect to the overall success of nonprofit reorganizations though a number of books and articles have recently been published in the area of higher education. Generally speaking, reorganization remains a "criminalized" idea perhaps because of a visceral feeling that things like "mergers" (and the associated language) are part of the objectionable corporatization of the nonprofit and higher education sectors and that any decision not to continue "as is" reflects failure. The literature tends to focus on definitions and taxonomies rather than on the practical, real-time issues that institutions face. Methodologically there is no counter-factual with which to compare a given reorganization. In addition, while research can at times be helpful in identifying base rates and highlighting risk factors, every situation is different.

In our experience, the vast majority (89%) of organizations that get the process right believe—when asked two+ years after their reorganization has been completed—that the reorganization met (62%) or exceeded (27%) their expectations. There is no reason to believe that the situation in higher education should be any different. A full 20% of institutions further report that the type of reorganization they, while successful, was different than initially expected.

Unfortunately, some commentators suggest that an exploration that does not lead to a completed transaction is by definition a failure. This is exactly backwards. Many institutions report that the process of exploring a reorganization—even one that was not ultimately pursued—gave them a new perspective on their strengths and weakness, improved their understanding of the external environment, and strengthened the relationship between management and the board. Provided that the process is disciplined (i.e., without undue waste of time and resources), the exploration of a reorganization can be a very efficient form of strategic planning and self-assessment. It must be started early enough to permit the institution to pursue other options.

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38 Even in the for-profit sector, mediators are often jointly retained since their role is to explore common interests rather than defend seperate ones. This, in addition to project management, is the essence of nonprofit faciliation.

THE WILL TO ACT

In any competitive industry with overcapacity, fixed assets (e.g., campuses) and semi-fixed costs (e.g., staff), institutions can quickly face hard choices and difficult finances. In an attempt to attract the shrinking pool of students, colleges are already cutting prices, spending more on enrollment strategies, investing in new facilities, and chasing "in-demand" programs (for example, coding and healthcare). While these decisions may be rational for individual schools, they are not collectively sustainable. In light of the shrinking population of college-bound high school students, this competition is expected to intensify over the next decade even before consideration of the COVID-19 impact. To avoid magical thinking, college leadership at all levels must understand their pricing power (the connection between tuition, net tuition and enrollment), their cost structure, and their contingent liabilities associated (e.g. deferred maintenance, teach out costs).

They must also accept the even strong leadership and discipline risk management does not guarantee survival. Institutional reorganizations—consolidation, mergers and acquisitions, divestments, and even orderly wind-downs—are a necessary part of a vibrant higher education sector. However, it is tragic when distress causes an institution to lose the capacity to make wise choices and the time to act on them. This can result in exposing students to unacceptable risk unless a fully funded plan has been put in place, allowing them to complete their degrees elsewhere. It can mean needless damage to small towns and rural communities where even a small or struggling college represents a critical, perhaps irreplaceable, part of the social and economic fabric. It can create difficult moral dilemmas as struggling institutions balance their need to attract new students with the possibility that they may not be able to serve those students through to graduation. It can expose trustees to liability. In bankruptcy, everybody loses as scarce charitable assets are squandered on legal and transaction costs.

Similarly tragic are "zombie" institutions that—though limping along—are too weak to offer effective or efficient educational programs and use whatever resources they can muster for mere survival. This can mean hollowing out student services, staffing, class size, the mix of programs, or composition of the student body.

Fortunately, there is still time for courageous, mission-driven trustees to avoid letting the institutions they govern fall into distressed or zombie states. Ideally, other stakeholders can help them in this work.

- Policymakers and accrediting bodies must enforce a regulatory framework that encourages and supports good governance and responsible self-determination. This might include a higher-education equivalent of the FDIC to support otherwise-stranded students or of the Resolution Trust Corporation to act as a trusteeship for failed institutions. Economic development funds might be earmarked to encourage and support the transformation of colleges that are vital economic actors in small towns and rural areas. Policymakers must also consider public and private institutions as one ecosystem. Expanding public institutions in the face of system-wide overcapacity is not the most cost-effective way to meet the needs of students.[39]

39 There are challenges to treating the system as one; the capacity within private colleges often come in small clusters versus the level required to reduce over-crowding at state institutions; the programs may also be different or there may be a faith overlay.

- Prospective students and their families should investigate the financial condition and governance quality of the institutions they are considering. Colleges that are transparent and well-governed should stand the best chance of gaining higher application and matriculation rates.
- Alumni must realize that while trying to preserve the best of the past, their alma mater must, above all, fulfill its duty to current and future students. Alumni who object when a college decides to make changes usually only delay the inevitable, discouraging courageous decision-making, and putting current and future students at risk by wasting precious time and resources.
- The associations that serve and represent private colleges and universities must not shy away from the uncomfortable role of encouraging frank discussion among their members. They should actively support the process of institutional transformation.

Leaders involved in higher education have long promised students—particularly first-generation and low-income students—that college is important, an investment that will pay off, and a ticket to the American Dream. They owe it to those students to keep that promise front and center as they make tough decisions over the coming years.

ABOUT SEACHANGE

SeaChange champions nonprofits facing complex challenges and is a partner of choice for those seeking to help. We've helped organizations put processes in place to manage risk, made grants and loans to encourage and support mergers, joint-ventures, divestments and other types of reorganizations, and have even helped to wind-down a number of organizations. Since 2008, we've looked at more than 1,000 situations and engaged deeply in close to 250 as a grant-maker, lender, or pro-bono/low-bono adviser.

This primer draws on our first-hand experience as well as on discussions with a number of college presidents, trustees, accreditors, lawyers, and membership organizations. We also benefited greatly from the two MAPS meetings hosted in fall 2019 at the Sorenson Impact Center at David Eccles School of Business at the University of Utah. We wish to thank everyone who participated in these interviews and discussions, as well as those who provided feedback on earlier drafts of the report.

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This work is motivated by our belief that private nonprofit colleges play a critical role in American society and that we must do all we can to help them navigate the complex environment they face. All of us are indebted to those trustees who take seriously their duties of care, loyalty and obedience to govern their institutions well. We hope that this primer will prove useful to at least a few of them.

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SeaChange champions nonprofits facing complex challenges and a partner of choice for funders seeking to help. **SeaChange** has been active over many years in the financial analysis of the nonprofit sector. This briefing note is based on these reports which include:

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