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Funding for business schools begins to run dry

With limited endowments and negligible state support, less prestigious schools face a long-term squeeze, says **Adam Palin**

Although leading US business schools appear to have weathered the recession, there are real question marks about the sustainability of less prestigious US institutions, particularly those that are state-funded.

Most leading business schools saw the value of their endowment funds fall sharply during the stock market decline in 2008. Among US schools that have featured in the Financial Times Global MBA rankings since 2008*, endowment funds – savings held in perpetuity which are invested to gain returns – fell by an average of 24 per cent between 2008 and 2010.

For wealthy schools that depend upon endowment returns to cover a large share of their spending, this has come as a shock.

"There was certainly a trauma among the top schools – especially the private ones – when 30 per cent or so of our endowments were suddenly lost," says Paul Danos, dean of the private Tuck School of Business at Dartmouth College. "It gives you pause for thought when you lose almost a quarter of your revenue."

Although fund values have since rebounded to pre-crisis levels, the impact is still being keenly felt by many business schools.

Alison Davis-Blake, dean of the public University of Michigan Ross School, explains that this is because each year schools draw a percentage of their endowment fund's average market value over a set period – seven years in the case of Ross. This reduces the volatility of returns year-on-year.

The Tepper School at Carnegie Mellon University continues to face this challenge. "In terms of funding developments, this is the toughest year for us," says Bob Dammon, the dean.

Philanthropy, the main source of endowment capital, has also declined. "People were in shell-shock after the crash," says Judy Olian, dean of the UCLA Anderson School, "[donations] didn't dry up, but people held back until confidence returned."

However, following a lean period at the height of the recession, many top schools are again reporting high levels of fundraising. At both Tuck and the University of Virginia's Darden School, 2011/12 represented a record year, with Darden receiving gifts that were 17 per cent higher than in any previous year. Last year, Stanford Graduate School of Business received a gift of $150m, the largest in its history.

Strong fundraising at leading schools – particularly private institutions – combined with reserves, has supported operations through the downturn. The Darden Foundation, for example, which manages the school's endowed funds, increased its endowment draw to maintain the school's activities.

"Without question, we would not have otherwise been able to avoid faculty lay-offs", says Trip Davis, president of the foundation.

Among Financial Times-ranked schools, the endowments at public institutions average only 40 per cent of those at their private counterparts. While wealthy state schools, such as Darden and Ross, which receive negligible government contributions, have been little affected by state-level cuts, the impact has been significant among the second-tier state schools.

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"We have had a big hit in terms of state funding," says Larry Pulley, dean of the College of William and Mary's Mason School. The recent cuts are an acceleration of a long-term decline in government funding, he adds, which has fallen from 40 per cent of the school's operating budget in the 1980s to about 10 per cent today.

"If you look at the great demands on state budgets... it's hard to believe that this will turn around."

John Fernandes, president of AACSB International, the accreditation body in the US, anticipates that many state schools face serious adjustments to balance their books. "Schools are leaving faculty positions unfilled and eliminating programmes that are not delivering a positive return... Often now I hear about faculty-to-student ratios rising."

Cost-cutting measures at the administrative level – including rationalisation, sharing services and centralising procurement within universities – have been widely employed. "In the boom period of philanthropy, government support and student demand, universities haven't needed to be efficient in their management," says John Nelson, managing director of Moody's public finance group.

"Responding to the crisis, there was a lot of low-hanging fruit, [for schools to reduce costs], but this only gets you so far... reforms will have to be more structural."

Faced with declining revenue streams, most schools have increased fees significantly over the past few years. Among FT-ranked schools, private institutions increased their full-time MBA tuition fees by an average of 22 per cent in the four years between the 2007/08 and 2011/12 academic years. In the same period, state schools increased MBA fees for instate students – who are charged less – by an average of 53 per cent. Out-of-state fees have risen by 36 per cent.

"This is something that we have needed to do as state support has been drying up," says Prof Pulley.

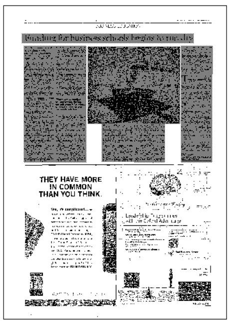
"In some cases, fee increases were a matter of catch-up," says Hugh Courtney, dean of Northeastern University's D'Amore-McKim School of Business. "There was room for manoeuvre at many state institutions."

But there is broad consensus that any underpricing has now been rectified and that tuition fees cannot continue to increase at the same rate. "There's very little ability to raise prices with such flat demand [for MBAs]," notes Prof Dammon.

"It's basic economics" says Anand Anandalingam, dean of the University of Maryland's Smith School. "Most state schools need to reassess their fee increases because the market simply will not sustain it."

At leading institutions the market for MBAs remains robust, however, with international demand ensuring they can command premium prices.

"Given the global brand of the leading schools and the quality of their programmes, pricing will retain a limited elasticity," says Mr Fernandes. "The top schools are... riding the crest of international demand, whereas lesser schools are dependent on regional demand, which is pretty stagnant," says Prof Danos.


THEY HAVE MORE IN COMMON THAN YOU THINK.

This structural problem faced by second-tier schools is compounded by inflation in teaching costs driven by competition for leading professors.

"If you want to compete at the top level – and we do – you end up paying what the market dictates," says Prof Olian.

Retention is a further issue for schools. Prof Dammon admits that he has lost academics to schools offering salaries that he was unable to match. His priority is to retain key senior professors to nurture younger teaching staff who form the school's backbone.

"We can't pay these super salaries for big names . . . so we have to do things differently."

Without the wealth of their better endowed peers, second-tier schools – public and private – will be increasingly challenged to keep pace.

"It's not like they're going out of business," says Prof Danos, "but they are facing a long-term squeeze."

And, as the number of lower-cost alternatives to full-time study grows, particularly in online programmes which in turn threatens demand for two-year programmes, Prof Olian believes that only elite institutions with brand value will continue to command a premium.

"The high-cost MBA model is not viable for the vast majority of schools," she says.

**Analysis includes data from 63 US schools ranked in the FT Global MBA Ranking, 2008 to 2012; 34 institutions are private, 29 are public. Endowment and budget data exclude six institutions where no data were available*