Good Afternoon,

In the following report, Assessing Financial Performance in Higher Education, Hanover Research reviews the financial metrics and ratios that higher education institutions use to assess the effectiveness of their business models. The report includes profiles of specific institutions, focusing on small to mid-sized tuition-dependent colleges and universities.

## KEY FINDINGS

- **The Composite Financial Index (CFI) represents the most widely used and respected measure of institutional financial health**. Developed and refined by KPMG over almost two decades, the CFI provides a comprehensive, consistent measure based on sector-wide benchmarks, and many private institutions, in particular, use the tool to monitor their own performance. Other composite financial indicators have emerged in recent years, including those published by Bain and Company and Forbes magazine, as well as the federal government's composite score. However, experts have criticized each of these for various shortcomings, and their utility for institutional planning may be limited.

- **Experts generally consider "balance sheet" ratios to be more important than "operating statement" ratios**. In essence, an institution's wealth, as reflected on the balance sheet and through relevant ratios, may be a better indicator of its financial health than operating results, which can fluctuate from year to year. Thus, in the CFI, net operating revenues account for only 10 percent of the institutional score. Other composite indicators, such as the federal Financial Responsibility Composite Score, are similarly weighted towards retained wealth versus current income.

- **The trend in an institution's financial ratios matters more than annual results**. Although the CFI, for instance, allows for inter-institutional comparisons, KPMG suggests that the most effective use of the metric is for an institution to compare itself with itself over a period of at least five years. Similarly, Bain and Company bases its analysis of financial sustainability not on financial ratios themselves, but on their change over a five-year period.

- **Non-financial metrics provide an important complement to assessing a university's financial performance and potential**. In its review of higher education finance, for instance, Forbes magazine uses indicators such as admissions yield and percentage of students receiving merit aid, in addition to more conventional financial ratios. Drew University's financial sustainability plan incorporates metrics such as the studentfaculty ratio, and in its review of individual programs the University has used a "qualitative index" to give a numerical value to intrinsic qualities such as alignment with institutional mission.

- **Tuition-dependent private institutions are increasingly focused on diversifying their revenue streams, such as increasing endowments and private giving**. Although these institutions pay close attention to metrics such as the tuition discount rate, they are also seeking to raise funds from other sources. DeSales University, for instance, with annual revenues of around $90 million, has recently brought its annual giving levels up to almost $5 million per year. Similarly, Drew University has sustained annual giving levels of almost $10 million in recent years, one of its key strengths over an otherwise financially difficult stretch. Juniata College uses its modest endowment of $100 million strategically to support operations, seeking to strike a balance between avoiding operating deficits and preserving the value of the endowment for the long term.