"The bottom fell out of the stock market: a cow worth £20 in the spring of 1640 fetched but £8 in December and £4 in June…

Corn paid to the Harvard building committee at 4s a bushel fetched only 2s"

—EARLY *HARVARD JOURNAL*

"…a financial crisis in 1903-1904, when the University ran a deficit of $43,000"

—*HARVARD OBSERVED*

"Of course the University has not been exempt from the effects of the depression…realizing the value of having a safe margin for an unknown future, the University, and its several departments, had laid aside some surplus that is invaluable now"

—PRESIDENT ABBOTT LAWRENCE LOWELL, 1932

FINANCIAL RESILIENCE AT HARVARD: *A Recession Playbook*

(October 2019)

"The prospects for the future were grim: private giving to the University had plummeted from an average of $10 million a year in the prosperous 20's to $3.8 million…"

—*MAN OF THE HOUR*, JAMES CONANT

"The task before us is clear: to bring our style of operations more in line with income while preserving the quality of our activities. This must be our guiding principle"

—PRESIDENT DEREK BOK, 1974

"…the new President is likely to face severe financial difficulties. Relative to widely felt needs, money has been scarce all along. It is likely to become scarcer"

—*THE DUNLOP REPORT*, 1970

"The balance of its [Central resources] books shrank from $1.3 million on July 1, 1945, to $148,931 five years later"

—*MAKING HARVARD MODERN*

"I guarantee you there will be a recession, I don't know when it is coming, but it's important to think about it in advance"

—PRESIDENT LARRY BACOW, 2018

"You don't survive 400 years if there's not resilience in your DNA"

—HARVARD SCHOOL DEAN, 2019

The severity of the Great Recession of 2007-09 took the world by surprise, and Harvard was no exception. The University experienced a perfect storm: free-falling financial markets, sharply declining endowment distributions, and illiquidity at Harvard Management Company (HMC) and the University. After years of abundance and a feeling of invulnerability, the effects were a shock to the Harvard community.

At the University level, revenues declined 3% in fiscal year 2010 – the first drop in operating revenues since 1945. Once it was clear in late Fall 2008 that the endowment would be impacted, leaders across the University mobilized. Responses ranged from University-wide (e.g., a Voluntary Early Retirement Program and salary freeze for faculty and exempt staff) to School- and Unit-based reductions in programs and reductions in force. Construction of the first science building in Allston was paused, and the University issued $1.5B in debt to ease liquidity constraints. Across the higher education industry, other institutions were engaged in similar actions with the market crash and the subsequent recession as an impetus for sudden, unexpected, and painful action.

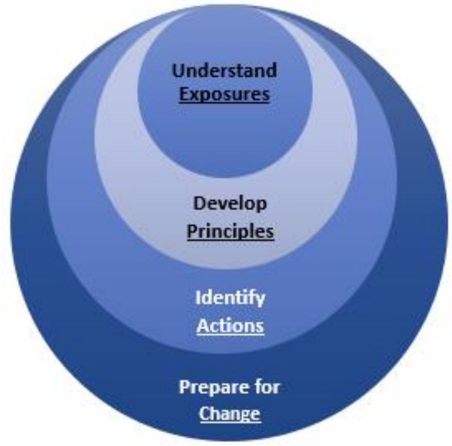
From a financial planning and management perspective, the events of Fall 2008 caught the University largely unprepared – and served as a catalyst for meaningful change. Since that time, Harvard's financial processes, enterprise risk management protocols, and University planning capabilities are much improved. In addition to a thorough annual budgeting process, the integrated multi-year capital and financial planning process provides a five-year look at both baseline operating budgets and desired investments. At the University level, having more rigorous policies around liquidity and debt management, as well as improved communication and transparency with Harvard Management Company (HMC), reduces Harvard's exposure to the same type of challenges faced in Fall 2008. And, the Corporation ushered in governance changes that have led to more informed and focused oversight through its Finance and Facilities committees.

As planning continues for the next recession, the University can take some comfort in the progress made over the past decade with respect to financial information, financial planning, liquidity levels, and coordination between the University and HMC. At the same time, Harvard – and higher education more broadly – remains vulnerable to both near-term macroeconomic risks as well as more systemic changes to the industry. Developing a culture of financial resilience will better position the University to manage successfully in variable economic conditions.

Financial Resilience

Resilience is the capacity to manage through difficult times and emerge stronger on the other side. **For Harvard, financial resilience means stewarding resources to support and maintain excellence in teaching, research, and scholarship in perpetuity.** It means developing coordinated academic and financial planning roadmaps that can help guide Schools and Units toward financial sustainability and includes proactive and adaptive responses that can be implemented during times of financial stress. At an institution with distributed resources, leadership, and governance, financial resilience is the responsibility of all University stakeholders – faculty and staff included.

There are structural elements in higher education that make taking action in response to a change in financial circumstances difficult. For example, fund restrictions limit where and how resources can be allocated. The inherent structure of the organization, designed to exist in perpetuity, makes changes to the status quo challenging. Additionally, the ability of the private sector to quickly reallocate resources in response to financial pressures is not readily available within the higher education sector.



For all these reasons, advanced planning and preparedness become even more important to support a timely and coherent response. Given Harvard's diverse revenue models and operating structures, most of that response will and should be local. **At the same time, having a consistent framework across the University, and identifying in advance the areas where coordination can improve outcomes, will better position the Harvard to manage through financial constraint.**

1. Understand Exposures

There is no consensus about what the next economic downturn might look like or when it might occur. However, even absent the specifics of how, what, when or why, it is helpful to analyze, understand, and anticipate how revenues might respond under different conditions. Recognizing the unique exposures of your School, Unit, or department is an important step toward preparedness.

An economic downturn could take many different forms. Pressure on the University's economic model can come from many different sources and have widely varying impacts. While some sources are obviously financial and broad-reaching, such as an economic recession, other pressures could have a narrower scope. For example, a change in the political climate could impact federal sponsored funding for previously well-supported research initiatives. An epidemic or a natural disaster could also precipitate a difficult financial situation. Risk planning for these crises should consider the potential financial impact and response.

During the Great Recession, the University's primary exposure was through the endowment – financial markets crashed quickly and steeply, followed by a relatively quick recovery. A different scenario could have the University managing through several years of no growth in the capital markets, as experienced in the 1960's, or sub-inflationary growth, as in the 1970's. In all of these different scenarios, revenues could end at the same level. However, the response may look significantly different in each case.

The impact of a changing operating model…and world. As the University's priorities and focus evolve over time, it is helpful to understand how those changes may increase or decrease financial exposure. For example, continuing and executive education programs have grown dramatically since the last recession, both in terms of the volume of students and associated revenue. Because many of these programs are relatively new, it may be difficult to predict how they will respond in an economic downturn. This is also true for recent advances in non-federal sponsored funding. Increased investments in financial aid – while critically important to the University's mission – also add additional financial exposure, as student need is likely to increase during a financial downturn.

Similarly, we should examine how broader changes to the way Harvard relates to the world may impact our planning and response. As an industry, higher education is currently under intense scrutiny for a variety of matters ranging from the cost of tuition to free speech issues to debate on the underlying value of a liberal arts education. With diminished public support, Harvard may be more vulnerable to increasing regulatory control and expanding tax obligations. Some economists have suggested that student debt could be a precipitating factor in the next recession, which would place higher education in the awkward position of being vulnerable to and potentially blamed for the financial crisis.

2. Develop Principles

Strategic decision making can be especially difficult and consequential during a downturn. How can we begin thinking about making choices and trade-offs and balancing priorities in advance of an urgent need to act? Having a set of established principles and a clear governance model can make it easier to make choices when the time comes.

Protect your core priorities and keep your mission central. A primary opportunity – in advance of a crisis – is to identify the essential mission activities of your organization that should be maintained at all costs. What are the priorities, and what operational considerations need to be kept at the forefront to keep the engine running and ensure current and future excellence? Are there items "off the table" for action?

Make strategic cuts. During downside planning, it is easy to model a consistent haircut across all departments or activities. While there is value in this exercise, during an actual downturn this approach to cost savings distributes the pain and the dollars evenly without consideration of priorities. A more strategic approach is to look across the organization and distribute programs and activities into three buckets: areas to invest, areas to maintain, and areas that can be reduced or eliminated. This framework for decision making and the subsequent allocation of resources can be helpful in times of crisis, but also a powerful tool for changing and invigorating focus during annual planning cycles.

Questioning and examining the correlation between size and excellence should be a key element of Harvard's ongoing strategic considerations at all levels and parts of the organization. As one outside observer commented: "Harvard can do anything, but it cannot do everything."

Think globally, act locally. Harvard's decentralized structure means that priorities are set and resource allocation decisions are typically made at the local level. This version of "responsibility center management" where units are wholly responsible for managing their own revenues and expenses distributes financial problem solving throughout the organization – an advantage during times of financial constraint. At the same time, it often leads individual Schools and Units to build their operating models – and financial downside preparations – in isolation.

Financial resilience planning should consider opportunities where coordination across the University, or within School departments, can lead to improved outcomes. Administratively, there may be opportunities to partner with neighboring units to share like-kind services or to examine vacant positions for job-sharing opportunities instead of reflexively filling requisitions. On the academic side, opportunities for collaboration in concert with other departments or other institutions may be the most effective way to advance knowledge in certain fields.

Look for opportunities to strengthen the enterprise. Finally, it is just as important to identify both areas to be deprioritized as well as areas for investment and growth. Creating capacity – dry powder – in advance of a downturn can enable the organization to make investments or "play offense" during times of constraint. The ability to hire faculty or invest in emerging fields of study can better position Harvard for future success.

3. Identify Actions

A key element of financial resilience planning is identifying what to do if a downturn were to occur. This kind of planning should occur across the organization, identifying opportunities to increase revenues, contain or cut costs, manage the physical plant, and seek efficiencies in the operating model. There is also an opportunity to take proactive measures in order to strengthen the institution's financial footing before a crisis hits. The checklist below offers a starting point for advanced planning possibilities.

Recession Readiness: Advanced Planning Possibilities

Revenue
- ❑ Identify and anticipate economic exposures
- ❑ Pre-plan countercyclical opportunities in donor management, executive education offerings, and sponsored research grant strategies and other revenue sources

Expenses
- ❑ Undertake the strategic exercise of dividing all programs and activities within categories of investment, maintenance or reduction / elimination
- ❑ Identify areas for consolidation of like-type services
- ❑ Examine manager spans of control
- ❑ Create off-ramp budget flexibility
- ❑ Employ line-item scrutiny to all non-personnel costs to determine what activities are necessary for excellence and where there may be inefficiencies or low-hanging fruit

Assets and Liabilities
- ❑ Build cash reserves to have a liquidity cushion against shortfalls and take proactive advantage of counter-cyclical investment opportunities
- ❑ Proactively pay down debt
- ❑ Review restricted gift terms for opportunities for more expansive use of funds
- ❑ Clarify and enforce "the first dollar principle" on the use of restricted funds

Space
- ❑ Design capital plans with a phased or modular approach so they can be stopped if necessary
- ❑ In addition to current cross-University effort under the EVP, conduct a local space utilization survey in order to assess potential improvements and efficiencies

Organizational Efficiencies
- ❑ Actively utilize Strategic Procurement's contract offerings and category purchase programs, and support the soon-to-be-launched Buy-to-Pay system
- ❑ Identify areas for functional clustering of like services to increase efficiencies and reduce space use
- ❑ Re-engineer unnecessarily complex or inefficient processes

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4. Prepare for Change

The final piece of the framework is arguably both the hardest and the most important. Change is difficult in higher education. At some point, though, planning must pivot into action. Preparing Harvard to be ready to act – to make thoughtful decisions and effect change – requires its own proactive planning.

Once a clear vision has been set and priorities identified, there are several tools that can be helpful to build momentum and make progress. For example, the active sharing of data and metrics, utilization of pilots, implementation of technology solutions, and emphasis of small wins can all be successful approaches for effecting change, particularly in an organization as large and complex as Harvard. Capitalizing on opportunities for a bright future will require collaboration between academic and administrative community members at every level, both within the Schools and across the University.

The wisest thing Harvard can do with its financial resources is to allocate them to maximize excellence in its teaching, research, and scholarship. This should be an act of everyday stewardship, as times and priorities continuously change, and developing the habit of reallocating resources is a successful strategy in both good times and times of constraint. Periods of economic hardship are often unavoidable and always painful, but managing successfully through them is best accomplished when contingency plans are in place and actions are based on a clear sense of organizational purpose.

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In September 2019, a resource called "Financial Resilience at Harvard: A Recession Playbook" was distributed to School and Unit leaders for use as a downside planning toolkit. If we – the Office of Financial Strategy and Planning – can be helpful as you engage with the materials and have questions or would appreciate a thought partner, please do not hesitate to reach out.