

# INCAE

## INSTITUTO CENTROAMERICANO DE ADMINISTRACION DE EMPRESAS

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Ernesto Cruz  
Rector

MR/068  
09 Septiembre 1976

### MEMORANDUM

A: FACULTAD  
DE: E. CRUZ, Rector  
RE: Informe Coleman

El Dr. Alan B. Coleman, Decano de la Escuela de Administración de Negocios de Southern Methodist University, en Dallas, Texas, efectuó recientemente una evaluación general de nuestro Instituto. La evaluación fue comisionada por ROCAP con el objeto de comprobar hasta qué punto se habían cumplido los propósitos originales del préstamo AID-596-L-012 que por US\$3,9 millones nos concediera dicha entidad en el año 1972.

El Dr. Coleman reunía calificaciones muy especiales para este trabajo, pues a su experiencia como profesor de finanzas, gerente y administrador académico se unía el hecho de haber sido comisionado por la Universidad de Stanford para dirigir la fundación de la Escuela para Graduados en Administración de Negocios --mejor conocida por sus siglas, ESAN-- que funciona desde principios de los años 60's en Lima, Perú.

Adjunta copia íntegra del informe presentado por el Dr. Coleman. De los apéndices al mismo sólo se incluye una lista descriptiva, pues por tratarse de documentos en su gran mayoría conocidos de la Facultad pareció innecesario reproducirlos.

Este documento será objeto de discusión en la sesión plenaria de Facultad de los días 20 y 21 de septiembre, por lo que les agradeceré leerlo detenidamente. De más está decirles que este documento es sólo para su información.

EC/dlc  
cc: Archivos Rectoría  
Adj.-

AN OVERALL EVALUATION  
OF INCAE

Prepared for

ROCAP

Guatemala

July 12, 1976

Submitted By

Alan B. Coleman

Dean

School of Business Administration  
Southern Methodist University

## 1. INTRODUCTION

### Purpose of This Report

The purpose of this report is to provide a general evaluation of INCAE, including both its academic, administrative, and financial position. In particular, this report is intended to assess whether the original purposes of the 1972 \$3.9 million AID loan have, in fact, been accomplished. These purposes are summarized in the original loan document (green book) as follows:

- a. To strengthen the administrative, teaching, and research programs of INCAE;
- b. To improve the quality of educational programs;
- c. To expand the range of educational programs, both resident (on campus) and continuing education (on and off campus);
- d. To improve the long range-financial viability of INCAE.

Although the purpose of this report is to assess all of these factors, particular emphasis is centered on the long-range financial viability of INCAE since this was one of the crucial factors in granting the original AID loan in 1972. In addition, the financial viability of INCAE is

now perhaps the single most critical factor relative to the permanent success of this educational institution.

#### Procedure in Preparation of This Report

In order to prepare this report, advance written materials were provided to me by the ROCAP mission for study before departure to Central America. Next, several days of discussion and orientation at ROCAP were completed in preparation for the visit to INCAE. Substantial additional background and financial materials were provided for my study during the ROCAP orientation and discussions. Next, a visit to INCAE of several days duration was undertaken to inspect the physical facilities and to talk at length to faculty, staff, and administrative personnel. Several meetings were also held with the Rector, Dr. Ernesto Cruz. In addition, discussions took place with some members of the Board of Directors and several meetings were scheduled with the Chairman of the Board, Mr. Francisco de Sola. Meetings were also held with alumni of INCAE and with some governmental officials in Guatemala and in Nicaragua. Finally, various Central American business executives and other government representatives were interviewed in the course of my stay in Guatemala, El Salvador, and Nicaragua.

Upon my return to ROCAP from these visits in Nicaragua and El Salvador, there were extended discussions with ROCAP personnel based upon the written materials and field interviews, all of which then provide a basis for this report.

#### Comment and Conclusions About INCAE's Academic Performance

Academically, INCAE has made impressive progress during the past several years, and certainly during the period of the AID loan program from 1972 through 1976. The school now possesses a justified international reputation for high quality in its various educational programs. INCAE maintains a beautiful and well-planned campus facility. It has a dedicated and rigorously trained faculty. The school enjoys a loyal and supportive alumni group, although its numbers are relatively small. The academic quality of the MBA program (MAE) is excellent; the extensive and growing nature of continuing education activities provide a sound basis for the expansion of the school's educational activities and the range of its potential impact upon the Central American business community.

There is little doubt that INCAE stands today as probably the best single graduate school of business administration in Latin America. Appendices A,B,E contain considerable data confirming major progress by INCAE under

the AID loan and consistent with the loan purposes as they relate to academic activity (strengthening teaching, research, and administration; improving program quality; and extending executive and continuing education activities). In all these major academic areas, I conclude that INCAE has made excellent and substantial progress.

As illustrations of this academic progress at INCAE, the appendix material A,B, and E document the institution's development in reasonably objective and quantitative terms. For example, faculty quality at INCAE is high (see Appendix B,pp.1-4); student enrollment at the graduate level has increased (Appendix B,pp.8-12). MBA student attrition in percentage terms has dropped from over 30% in the early 1970's to approximately 15% for the most recent year; executive education and various programs of continuing education have increased substantially in number, broadened in geographical distribution, and expanded their coverage of subject matter. (see Appendix B,pp.20-23 ); new special programs have been developed in areas of agri-business management, development banking, and public management; research and case development have increased substantially; the Advisory Center has been organized and become operational. All of this

activity is entirely consistent with the purposes of the original AID loan.

Physical facilities, primarily student housing, have been expanded, although earthquake related inflation sharply reduced the amount of construction possible under the dollar amounts available for the construction portion of the loan.

The student loan fund has permitted considerable expansion in necessary financial aid, although delinquency experience has proven considerably worse than anticipated. (See Appendix C, pp. 1-3)

In summary, from an academic standpoint, INCAE has made genuine progress during the life of the AID loan agreement. The school and those responsible for this important academic accomplishment should be congratulated. It is impressive.

The same conclusions, unfortunately, cannot be reached for the final, and perhaps most critical single reason for the 1972 AID loan: to assist in the financial strengthening of INCAE for the long term. The major portion of this report discusses and analyzes the long-range financial viability of INCAE, since it is in this area, as opposed to academic performance, where major risks and problems remain.

That the school is successful academically shows clearly; but the reason for that success must be evaluated carefully in financial terms since INCAE is very costly to operate and it has required, and will continue to require, large amounts of funds if it proceeds on its present operating and conceptual basis. One important reason for INCAE's academic success, of course, relates to the very large financial investment in the school, especially in AID grant and loan funds. More than \$7 million has now been invested since the beginning of INCAE in 1964, plus at least \$2 million of additional funds from Central American sources, private and public. These funds represent a large investment for a graduate school of business administration of INCAE's size. The absolute size of this investment now poses major policy questions related to the future of the school. In my judgment, these questions must be answered soon and the problems related to them addressed promptly if the school is to avoid major financial difficulty in the period immediately ahead.



II. PROBLEMS AT THE TIME THE AID LOAN WAS WRITTEN: PURPOSES OF THE LOAN AND OTHER BACKGROUND MATERIAL

The financial analysis and the logic underlying the original 1972 AID loan are well summarized in the "green book" in the section entitled "Financial Analysis," which begins on page 51. In that section the following comments are made:

INCAE cannot survive as a quality institution without the financial support of this loan, comprising three major inter-related components designed to expand its facilities and programs. Expanding programs to an efficient size is essential if INCAE is to achieve the desired development impact and if the institution is to reach financial viability within a reasonable period.

The three major loan sections: program administration and staff development, construction and equipment, and student loan fund, are then detailed within this loan document. The interested reader should closely review the material on pages 51 through 66 of the green book for a more thorough review of the original purposes of the loan.

For this report, however, the strategy section on page 61 is particularly relevant and is quoted here:

In an effort to eliminate INCAE's annual deficits, a number of cost-saving measures have already been undertaken and others are planned. Among the more

significant of these was a reorganization of the kitchen/dining room facilities to permit them to be run on a break-even basis. Perhaps the potentially most important of the changes presently being undertaken is the implementation of a new accounting and cost control system developed during the intensive review. All expenses are now grouped under categories which correspond to INCAE's programs (MBA, AMP, seminars, etc.) or major support centers (library, dining, translations and reproduction, etc.). This system will permit better planning, budget to actual comparisons, and cost control.

While budget reductions of a small magnitude are possible, a joint INCAE-ROCAP financial review indicated that reducing costs by an amount sufficient to eliminate the current annual deficit would require severe measures which would have negative effects on the quality of the institution's programs. Deterioration of INCAE's programs would not only lessen INCAE's development impact, but would also be financially counterproductive to the extent that the institution's ability to attract students, research grants, and consulting business, and to solicit financial contributions from the private sector would also be lessened. The plan being undertaken therefore includes cost-cutting to the extent feasible without generating these negative effects, but the emphasis is placed on increasing revenue. Increasing revenue requires both a stepped-up fund raising campaign and an expansion of the revenues earned from INCAE's programs (without proportional increases in expenditures).

(Emphasis added)

Essentially there were four key strategy elements that prompted the 1972 AID loan. These key strategies were:

1. To permit INCAE to grow substantially in size so that economies of scale could be accomplished, while controlling operating expenditures.

2. To plan and develop a "profit making" consulting business which would generate additional revenues for INCAE.
3. To develop a student loan fund which, after a few years, would become a net source of cash revenue to INCAE.
4. To engage in considerably greater fund raising activities from the private sector.

After summarizing these principal strategies, there appears, on page 65, a summary section entitled "Conclusion: Capacity to Repay." The following quotations from pages 65 and 66 summarize the principal conclusions in this section of the loan paper:

The financial projections show that with the support of the \$3.9 million loan, INCAE will be able to eliminate its operating deficit, improve its working capital position, and service its long-term debt. The projections further show that by the end of the four-year disbursement period, FY 75/76, INCAE will for the first time have generated from its own revenues a reserve for contingencies and an endowment fund for a combined total of about \$267,000. Such results would not be attainable without AID's most concessionary terms and a revised repayment schedule of the CABEI loan (now being negotiated) that will permit INCAE to make repayments commensurate with "its ability to repay."

To conclude, repayment prospects of the loan at the terms recommended are favorable. The loan is timely and provides INCAE with the financing it needs to improve quality and expand. As the financial statements indicate, the programs to be developed will be sufficiently diversified so that a failure in any one will not jeopardize the overall viability

of the institution. A great deal of effort went into the preparation of the financial projections, and they look promising, as noted above. In the final analysis, of course, they are only estimates, and the true test of the program lies with INCAE itself in the ability of its management to exercise the leadership and financial discipline which will be required to make the institute truly viable. The job will be challenging and the potential for success is high. INCAE probably ranks today as the leading business school in Latin America, and has the potential of ranking with the best business schools in the United States.

Generally speaking, the above strategies have not proven effective and have not, in fact, accomplished their critical objectives, which were to help create the conditions financially needed to assure the long-run viability of INCAE. Economies of scale have proven very difficult to achieve. Expenses have proven almost as variable as revenues; annual operating deficits have continued; and, in the past three years, including the nine months of 1976, these deficits appear to be increasing--particularly sharply in Fiscal 1976. (For an example supporting these observations regarding "economies of scale" (see Appendix D, pp. 2-9, 23).

The plan to develop a "profit making consulting business" has not proven feasible in the ranges originally intended. The development of consulting revenues on the size anticipated for a school of business such as INCAE is, in fact, a difficult task to accomplish. In order

to undertake such large scale institutional consulting, additional fixed costs are necessary and, in fact, have been added. Revenues from consulting activities are notoriously uncertain and the timing is difficult to forecast and anticipate with any reasonable certainty. Moreover, there is a high degree of competition in consulting work from a variety of professional private and some governmental sources in the region and from inter-American organizations. The development of substantial annual revenues from consulting as a principal means of financing INCAE on a long-term basis is not a sound financing source for a school such as INCAE, where large fixed costs will remain a permanent operating characteristic. Again, economies of scale from consulting activities have simply not materialized.

The third strategy, the student loan fund as a net source of cash flow, also has not proven successful. The original data in the green book used delinquency rates which were quite low and probably unrealistically optimistic. Loss ratios and delinquency rates assumed in Annex 5, Exhibit E, of the green book demonstrate this point. In fact, delinquency rates have run much higher (see Appendix C, pp.1-3) and based on present cash flow estimates (see Appendix C, pp.4-6) it is doubtful that the student loan fund will ever prove a source of net

cash flow beyond the needs of the fund itself. Indeed, it may be that the cash flow generation due to delinquent loans could cause some difficulty in maintaining the level of the fund and hence cause an insufficient cash flow to finance the necessary number of new loans for future students. In any event, it does not seem appropriate to look to the student loan fund as a net source of cash flow for other INCAE operations beyond student financial aid.

Finally, fund raising from the private sector in recent years in fact has been declining after deducting the costs of raising those funds from the several countries concerned with INCAE. (See Appendix D, pp. 2, 4) The green book, on pages 64 and 65, adopts the view that progressively higher fund raising will prove possible once INCAE gains greater visibility in the Central American region and when the value of INCAE's educational programs becomes more broadly recognized. The green book also lays emphasis on the need for INCAE to devote greater institutional attention to active fund raising programs (see page 65).

The school has, in fact, devoted considerable effort and attention to annual fund raising but, as in every private institution throughout the world, this always represents a difficult task and progress can be slow and uneven, especially for a new, young institution such as INCAE.



Moreover, economic conditions in Central America caused by the recent recession together with serious setbacks in some areas due to earthquakes and their consequences undoubtedly have played an adverse role in fund raising efforts. It should be noted, however, that because of the unusual structure of INCAE (operating in six Central American countries) the cost of raising funds annually is quite high. (See Appendix D, pp.2,4). Again we find that economies of scale have not been achieved, either in larger amounts of funds raised each year or in better utilization of the cost of maintaining offices in each of the six Central American countries.

Finally, there is a question as to how much each year can actually be raised from private sector sources. There are very few business schools in the United States that raise, annually, more than \$300,000 per year. It may not be practical to expect a level that is too high for annual fund raising; and if INCAE's expense budget is geared to a high annual total of unrestricted gift income, the risk of a serious shortfall in any given year may swiftly lead to an unbalanced budget.

The financial review in the green book was not fully realistic as to the long-run financial needs for INCAE because the analysis did not penetrate to the basic concept

and structure of INCAE. It should be clear why a school with INCAE's structure and concept will always prove relatively expensive and complex to operate. The reasons supporting this conclusion will be developed in detail in the next section of this report.

The absence of any provision for permanent, dependable sources of income from funds such as endowment reflects a major problem in the original and continuing planning for INCAE. This is certainly true as to the 1972 AID INCAE loan. A school such as INCAE, given its goals, objectives, and mode of operation, simply cannot function in the long term without permanent capital. A major graduate school of business in the United States could not be fully financed solely from regular operating revenues were it to undertake the full range of services and quality which INCAE presently provides for its students, faculty, and administration.

The lack of sufficient annual revenue to finance the school is clear because:

- (1) INCAE, from the beginning in 1964, has always operated at an annual deficit, recently in the range of approximately \$200,000 per year; and that deficit has grown from \$205,000 in 1974 to \$235,000 in 1975, and to a projected deficit of more than \$350,000 in 1976. (See Appendix D, pp.2-9).



- (2) MBA, AMP, and seminar tuition revenues in 1975 (probably the most dependable sources of annual revenue) totaled only 28% of total operating expenses in 1975--too low as a total source of income for a school without endowment.
- (3) Excessive use of long-term debt has been undertaken to finance fixed assets and the school's operating expansion at the same time that annual deficits have continued. INCAE's debt position is now very heavy for a school of its size and character.
- (4) Cumulative annual operating deficits (financed by AID) from 1970 through May, 1976, total approximately \$1.5 million.

All of these factors suggest a need for a large amount of permanent capital if INCAE continues to operate under its present model.

After extensive discussions with many individuals and a close study of background documents, it is not really clear that all concerned have fully appreciated from the beginning the financial magnitude of what they were undertaking. Especially, it is not clear that the considerable complexity of the concept and structure of INCAE has been fully appreciated from a financial point of view by either AID, INCAE, the Board of Directors or other advisors.

Many of the key elements of the concept and structure of INCAE are summarized below. Taken together they represent a formidable set of operating criteria that, in the aggregate, lead to a school which is of high quality, which is costly to operate, and for which a large, permanent capital base is essential. This need for capital endowment, beyond buildings and the student loan fund, is not recognized in the AID book.

Now that regular financing to cover annual deficits is no longer available from AID, other methods must be found promptly to cover that portion of the school's expenses not covered by operating revenues.

The school now runs a risk of facing a financial crisis due to heavy negative cash flow within the next two years. Steps are outlined below which, if undertaken promptly, may resolve, or at least minimize, some of the school's financial problems. The prompt and coordinated effort of all interested parties will be required, however, to place the school on a sound financial basis.

This conclusion assumes that continuous annual AID grant and loan funds are not available and that such funds would not, in any case, constitute an appropriate method to finance INCAE's long-run financial needs.

### III. KEY FACTORS IN INCAE'S CONCEPT, MODEL, AND STRUCTURE

INCAE is a unique educational institution. Its design, its goals and objectives have provided it with an academic and financial profile which is unusual and which is capital intensive. There are summarized briefly below a series of key elements in INCAE's design which cause it to have a financial profile demanding a comparatively large capital investment and sizeable long-term operating requirements:

1. INCAE is a six-nation, multi-national school located in Nicaragua. It also maintains operational linkages to South America and particularly to the United States. This multi-national mode of operation raises operating costs substantially and makes communication, travel, and coordination more costly. A multi-national design causes INCAE to be administratively complex with greater operating expense due to this single factor than a school which serves an individual country.
2. INCAE operates a full two-year MBA program patterned almost entirely after the Harvard Business School program. This is an expensive educational

offering to operate in Latin America, especially using many North American faculty. No other business school in Latin America to my knowledge has chosen to emulate it (presumably in part due to cost).

3. Full residential accommodation is required for virtually all students. This is most expensive as a mode of operation since both single and married students live on campus. Very few United States universities can afford this and almost no business school attempts to house all graduate students, single and married.
4. It is particularly difficult for INCAE to achieve important economies of scale whereas most United States business schools can achieve some economies of scale fairly easily. Points 1-3 above and several other cost factors below cause serious difficulty in achieving economies of scale through larger student enrollments. It is critical to understand this aspect of INCAE fully since it causes a major impact on INCAE's financial requirements.
5. There is an exceptionally large physical plant relative to the number of full-time matriculated

students. By one count, there are thirty-seven buildings on campus, an unprecedented ratio for only 175 resident graduate students. Some building space is, of course, used by special academic programs, the Advisory Center, and related activities.

Even if there is some debate on the actual "definition" of the number of buildings, the investment in physical plant relative to student body size is extremely large. Costs of operating this plant and maintaining it are high and are bound to increase (e.g., utilities, maintenance, equipment replacements).

6. High proportional financial aid is needed by most students. INCAE's programs are very expensive by Latin American standards. Total cost to the student now of an MBA for single students is about \$10,000 for two years; for married students with children, about \$13,000, plus nearly two years lost salary income. Financial aid and the total cost of the program will remain critical problems to the prospective student and the school, even with the \$1 million student loan fund and the willingness of some Central American banks and other national institutions to lend money to

INCAE students. High interest costs of borrowing add to the figures cited above. A high proportion of students need some form of financial aid compared to United States schools of business.

7. The case method of instruction is probably the most expensive single technique for teaching business administration. Academically it is quite effective if delivered properly (which INCAE is doing) but it is costly. Only a few schools in the world undertake the case method as it is practiced at Harvard. Part of the reason is due to cost. INCAE should do everything possible to retain the case method--it is most valuable and appropriate in Latin America. Its cost, however, remains an important factor.
8. The total scale of INCAE is small in terms of students while the faculty is large, thus making INCAE expensive to operate. Total resident student body is approximately 170 graduate students plus annual offerings of three advanced management program seminars plus about 25 two/three day short seminars. The faculty totals 40, which represents a very generous commitment of faculty resources for this level of operation. Many

faculty members are engaged in special programs, case writing, research, consulting, and related activities. By any measure of high standards, however, the full-time teaching faculty relative to student body is too high. Even the AMP and short seminar activities do not spread the cost of faculty over a sufficiently broad base.

9. INCAE maintains a policy of delivering high quality in everything it undertakes. This is quite desirable in Latin America, where educational quality standards are not generally high. Insistence on high quality is, however, an expensive characteristic of any school, in Central America or anywhere else.
10. INCAE has a relatively large turnover of key faculty and administrators compared to high quality business schools in the United States. Turnover of key personnel is expensive (moving expense, travel, orientation, and operational effectiveness). INCAE's basic model, including the use of many North American (nearly 50%) faculty causes turnover to be a continuing expense. For example, seven new faculty will be arriving this year and approximately the same number leaving the school.



This is an unusually high turnover for a given year, but it does dramatize the cost problem, which is a continuing consideration for INCAE. At the same time there has been a high turnover of key administrative personnel which further adds to cost.

11. The cost of external fund raising in the private sector is quite expensive for INCAE compared to U.S. universities and business schools. The multi-national model, offices in each country, considerable travel and overhead expense add to the cost of raising funds annually. Some economies probably can be made, but it is, and probably will remain, expensive for INCAE to raise annual funds from the private sector--and it is very expensive by U.S. standards. Again, economies of scale in fund raising would help, but they will probably be difficult to achieve.
12. A study of INCAE's cost accounting system emphasizes that there are only a few true net cash contribution sources while there are many break even cost centers and even more net cost centers. Thus, a few real net revenue centers carry many cost centers (see Appendix D, p.10 ). Moreover, costs tend to be fixed and to increase while



revenues are more variable and can fluctuate downward fairly sharply and on short notice (e.g., in 1976; see Appendix D, pp. 3-8). This pattern of fixed and growing expense levels and fluctuating revenue characteristics makes INCAE's financial structure risky, which is doubly dangerous given its present high level of debt and continuing annual deficits.

13. The INCAE campus operates as would a small university, but with only one revenue producing school, thus emphasizing the high fixed cost characteristics of the program. INCAE is actually like a small community, with roads, grounds, recreational facilities, utility maintenance, security, etc. This high operating fixed cost base does not now relate to a broader stream of operating revenues.
14. Nicaragua itself is an expensive country in which to operate--among the most expensive in the Central American region. Moreover, the earthquake sharply raised certain costs, further complicating the normal operating expense pattern. Inflation accelerated sharply after the earthquake, although recent price increases are now much more modest. Nonetheless, inflationary pressures add an important additional dimension to INCAE's financial problems.

15. INCAE has no endowment. In fact, with \$4.5 million in long-term debt now on its balance sheet, it presently has a large negative endowment, an unusual factor which may cause trouble in later years, especially after 1982. The school is attempting to accomplish operationally what major, top quality business schools do in private U.S. universities. But those private, top quality schools virtually all have an endowment base within their respective schools or within the university, and they also enjoy greater opportunities for economy of scale in their operations.
16. INCAE receives no important financial support from Central American governments except Nicaragua (\$75,000 per year, or about 2½% of current annual budget). Hence, INCAE has neither the endowment of a private institution nor the annual financial support of a public institution. This double lack of major support is critical to the future of INCAE. The school has survived in its present model to this point only because U.S. AID grant and loan funds (plus the loan from CABEI, which in turn was provided by AID) have supplied the necessary difference between revenues,

expenses, and capital requirements. In effect AID grants and a major portion of the AID 1972 loan have acted as temporary endowment which was consumed to finance annual operations. Presumably this source of support is now coming to an end and there is no visible evidence of a replacement source of equivalent magnitude and dependability.

17. The number of faculty and staff now used to operate INCAE on its present model is excessive. In June, 1976, total faculty numbered 40 and total support staff of all kinds was 156, for a total INCAE payroll of 196 persons. This is simply too large for a school of this scale.
18. Finally, because of all the foregoing, the school is complicated and difficult to administer. Complexity always has an administrative and financial cost--sometimes a serious one. INCAE itself is a good sized management challenge and because of its diversity it is difficult to control. Similarly, it is easy to lose financial control unless great care and a constant vigilance is maintained. Finally, the school is always subject to serious factors completely outside of its control (earthquakes, political considerations, sharp swings in commodity prices such as coffee, etc.).

Summary Observations

Given these key structural factors, INCAE in its present form is not financially viable unless prompt steps are taken by the Board and the management to improve the school's financial base and to make substantial improvements in its operating efficiency, its levels of expenses and revenues, and the scope of its programs.

In the past twelve years more than \$7 million, U.S., has been invested in INCAE plus more than \$2 million from Central American private sources. Thus everyone's "investment" in INCAE is impressively large. That investment must be protected and made more secure if at all possible.

Since 1970 through May, 1976, the cumulative annual operating deficits of INCAE have totalled approximately \$1.5 million. Assuming that deficit can no longer be financed from US. AID sources as in the past, there are below a series of suggestions and recommendations as to what now might be done to resolve these problems. It is critical to remember, however, that the foregoing list of "structural factors" causes INCAE to be an unusual school--perhaps unique in the world. These structural factors will always cause INCAE to be an expensive school to operate on its present basis.

Any solution proposed that does not, in effect, provide a large amount of permanent capital to INCAE will probably only be an intermediate or relatively short term remedy. The 1972 AID loan provides a good example. That loan did not realistically assess how the school could become self-sufficient without continuing support--hence the problem the school faces today. A careful review by all key interested parties must be made to decide, either:

- (1) the present INCAE model and structure can and should be financed long-term: how, when and by whom, and in what amount; or,
- (2) the model and structure cannot be financed on a permanent basis and must be changed to prevent serious financial difficulties.

Throughout my visits in Nicaragua, Guatemala, and El Salvador I encountered many concrete illustrations of the positive and favorable impact of INCAE on Central American regional development. Its financial failure is unthinkable and to be avoided if at all possible. Nonetheless, prompt and remedial action must be taken to avoid the possibilities of severe difficulty which could develop within the next 24 months.

The extensive recommendations below are offered in the hope they will spur serious discussion and exploration,

not only of these alternatives, but presumably of others which could be generated by the Board of Directors, the management, and the faculty of the school. The recommendations below are intended to stimulate discussion and to offer some suggestions for further examination. In any case, however, a prompt and thorough exploration of these problems and various recommendations for their solution should be undertaken promptly by the Board of Directors and the management of INCAE.

#### IV. RECOMMENDATIONS TO IMPROVE FINANCIAL VIABILITY

There are summarized below four broad categories of recommendations regarding possible improvements in the financial condition of INCAE. These are: (1) reduction of costs; (2) increases in revenue sources; (3) suggestions for broadening the role of the Board of Directors; and (4) development of a long-term financial strategy.

##### A. Recommendations Regarding Operating Costs

1. There should begin immediately a program of cost reduction throughout INCAE. The faculty and staff must understand the reasons why operating costs for the school are too high and why they must be reduced. Every effort should be made to gain support and understanding by faculty and staff regarding the need to reduce costs.
2. The Rector should carefully examine INCAE's organization structure with a view to simplifying it wherever possible. Every effort should be made to reduce overlaps and duplications where they may exist. If there is a possibility to reduce the size of the organization, those steps should be taken as soon as possible.

3. The overall size of faculty and staff should be reduced. Unless material increases in student body can be achieved, there are simply too many people for the present scale of tuition and seminar revenues from all present sources.
4. Faculty teaching loads should be increased. Present teaching loads are light by any high quality standard. The present average for INCAE faculty members is approximately 2-1/4 trimester courses per year. The average for high quality schools in the United States on a trimester basis would be between five and six courses per year. Good but not outstanding schools would have heavier teaching responsibilities for faculty. Even when courses are converted to the number of class meetings per trimester, the teaching loads of the faculty are low relative to the revenue and cost base of the school.
5. The level of investment in case research and development may have to be reduced, perhaps sharply, at least until it is much more certain that financial problems can be successfully resolved.



6. Control of costs must be a top priority objective for the Rector and the Board of Directors. Both should monitor progress very carefully. Specific cost reduction goals should be established and the Board and Rector must insist that those goals be met. This step should begin promptly.
7. The possibility might be explored of reducing the number of elective courses in the MBA program as a means of further reducing faculty size. The number of total courses should be kept at a minimum level. In addition, there should be minimum class sizes before a course can be offered. For example, a course might not be offered unless there were a minimum enrollment of 15-20 students. The school should be careful about adding any additional new courses at this time.
8. Every effort should be made to keep turnover of personnel to a minimum. Such turnover is expensive for reasons outlined above. Specific turnover goals should be set and monitored. INCAE should be particularly careful about the use of North American faculty since they are expensive

and further complicate the turnover problem. In addition, INCAE should review decisions on the financing of doctoral candidates in the United States as prospective future INCAE faculty members. This is a most expensive process, and if these candidates are lost after a reasonably short time, the investment in such doctoral training is not realistic for INCAE. Great care should be exercised that faculty whose doctoral training is financed by INCAE have a long run commitment to the school.

9. INCAE should be careful about any additions to fixed costs, including plant expansion, until financial problems come under much better control. The school currently has a \$2.6 million expansion program for plant and equipment under study. No important expenditures along these lines should be made until the problems discussed in this respect have been carefully examined by the Board of Directors, and until reasonable solutions can be developed. (See Appendix F)
10. Economies of scale somehow must be achieved to spread costs. Any new activities for INCAE should produce such economies as a primary objective. Any

new programs or activities which do not make an important cash contribution should not be undertaken no matter how desirable they may appear academically, at least until long-run financial problems have been resolved.

11. It is not really clear if special programs are actually making an important financial contribution to INCAE. They certainly make a substantial academic contribution. Special programs should be studied carefully, however, to be sure they are making a financial as well as an academic contribution. At this time INCAE cannot afford to subsidize any special programs no matter how valuable they may be from an academic point of view.
12. Attitudes toward spending throughout the organization must be influenced and oriented towards cost reduction and greater efficiency. These attitudes must be influenced by example and direction from the top--specifically by actions of the Board of Directors and the Rector.
13. Cost of external fund raising somehow must be reduced. It takes too much of each dollar raised for the expense to raise it. For example,

exploration should be made whether it is absolutely necessary to maintain an Executive Secretary and related support personnel in each of the Central American countries.

14. Travel, external representation expenses, entertainment, etc. should be monitored with great care. The Rector should personally approve travel and representation expenses. Perhaps a quarterly travel cost report should be submitted to the Board of Directors or separately identified in existing reports.
15. AMP programs in the Caribbean and in South America should be reexamined closely as to their expense and actual cash contribution to overhead. They appear to be expensive and to generate a smaller contribution than do Central American AMP programs and seminars. Detailed data was not available to assess the point, but this illustrates concern about economies of scale. More dollars of contribution might come to INCAE due to greater numbers of seminars staged in Central America. Even though academically it may be desirable for INCAE to conduct such programs in the Caribbean and

South America, it may prove necessary, at least for the short to intermediate term, for the school to concentrate greater efforts on more profitable revenue generation in the Central American region.

16. The Rector and the Board of Directors should look for opportunities to simplify the school's organization and some of its activities where economically possible. Complexity does add to cost; it makes it difficult to concentrate administrative attention on key problems; complexity makes it more difficult to determine where the actual problems are and how they might be solved.

B. Recommendations On Increasing Revenues

1. It is essential for INCAE to develop additional sources of revenues as soon as possible.
2. The Institute should try particularly to explore additional opportunities for short two/three day seminars. These can be "profitable" and they are also most helpful in institutional development. Other new short seminar formats should be explored. In addition, some "in company" special programs might be considered, particularly if they

could be priced rather fully to make an important cash contribution to INCAE operations.

3. The Rector and the Board only should approve new programs after careful joint consideration of the revenue and cost implications of such programs.
4. Steps must be taken promptly to improve the effectiveness of private sector financing and the raising of more funds from private business sources. The base of revenue support from the private sector for INCAE must be expanded sharply as a means of continued financing for the Institute.
5. The Board of Directors should discuss thoroughly, as soon as possible, their attitudes towards Central American government support for INCAE. Some Board members oppose government support and in some countries it may be almost impossible to obtain. The Board should clarify its own thinking on this matter and develop a strategy: (a) to seek or not to seek more Central American government support; and (b) whether such support beyond Nicaragua is realistically available; and (c) whether such support would compromise INCAE's educational

and other objectives. At the moment there is apparently not a Board consensus on this matter.

Exploration should be made as to INCAE's capability to undertake seminar activity for the public sector. This might provide one way of raising funds from government in a manner appropriate to INCAE's mission. It might also prove a more acceptable manner for some governments to support INCAE.

7. It appears doubtful that INCAE can count on the Advisory Center for any significant net cash contribution beyond the Center's direct costs. Current INCAE financial projections for the years 1976-1980 suggest a large contribution from the Advisory Center to INCAE overhead. This projection does not appear realistic, especially with the government of Nicaragua contract expiring in December, 1977, with renewal beyond that time presently doubtful.

C. Recommendations To the Board of Directors

1. The Board of Directors must become more familiar with INCAE operations and it must monitor them in



greater detail. The Board as a whole needs to inform itself more about INCAE progress on financial problems.

2. An Executive Committee of the Board of Directors should be established, composing two/three members, including the Chairman of the Board. This committee should study INCAE finances, costs, and operating performance closely, meeting monthly, at least for the next year. The Executive Committee should insist that budget goals be met or exceeded favorably on a regular basis.

The Executive Committee and the full Board of Directors may want to receive technical assistance and advice from time to time, particularly on financial matters relating to INCAE. Nonetheless, the ultimate authority for INCAE rests with the Board of Directors and they must assume and maintain an active and vigilant role in the Institute's affairs, especially as to the school's financial situation. Any technical advice or assistance to the Board of Directors, the Executive Committee, or to the Institute itself should not be regarded as a substitute for sound, careful, and efficient management of the school. If problems



are to be solved, they must be solved by INCAE management and by the Board of Directors. Technical advice to the Board, however, might be helpful. It is most important for the full Board, and if possible the Executive Committee, to begin at once this process of greater involvement, familiarity, and understanding of the Institute's financial problems.

3. The Board of Directors must insist now, for 1976-77, on a realistically balanced budget. INCAE is now living beyond its present means and this must end. No deficit should be permitted for 1976-77 and management should be so directed. Every possible effort should be focused toward balancing the budget as soon as possible.
4. The Board must insist on realistic, conservative financial projections. In the past revenue has often been over-estimated and expenses under-estimated. This pattern must end. Management must be held fully responsible for achieving operating results consistent with financial projections.
5. The Board of Directors should plan to take enough time at each Board meeting to review fully and

carefully the quarterly financial results. An Executive Committee of the Board should assist greatly in accomplishing this regular Board financial review.

D. Development of a Long-Range Financial Strategy

1. A long-range financial strategy for INCAE must be developed, studied carefully by the Board of Directors, then adopted and monitored closely.
2. INCAE must have a permanent capital endowment, or sources of annual income that are certain and fixed for the long run.
3. A school of INCAE's magnitude cannot be safely financed on a year-to-year basis from operating revenues alone. Long-range financial planning should have started several years ago. The AID loan is really only "bridge financing" for the total needs of INCAE.
4. INCAE is attempting to emulate schools of the very highest caliber in the United States. Those schools all have either (a) large endowment or (b) large state support. INCAE has neither. In

fact, it has negative endowment due to \$4.5 million in total debt.

5. A realistic and careful estimate of long-term capital needs must be prepared. Without such an estimate it is impossible to determine the full magnitude of INCAE's financial problems. It should now be clear, however, that twelve years of continuous deficits cannot long continue. Without further AID financing, a cash crisis could swiftly develop. INCAE's long-term capital needs will be substantially influenced by (a) the amount by which operating costs can permanently be reduced, and (b) the amount of additional operating revenues which might be raised, and (c) the quality of management control which is exercised over operations.

Special Note: INCAE cannot raise prices on academic programs without running the risk of pricing itself out of the market. The Masters program is now fully priced. Executive programs could go up some, but not excessively. At the same time, debt services on the AID and the CABEI loan continue and principal plus interest payments will add heavily to negative cash flow, especially

in the future when AID loan repayments begin in 1983. Negative cash flow then from AID plus the CABEI loan principal and interest will total approximately \$300,000 per year for many years to come.

6. Even if the budget can be temporarily balanced by cutting costs and raising revenues (a possibility), INCAE will still need a large permanent capital base or it risks a financial crisis which could develop at any time, and perhaps suddenly. This is primarily the result of heavy fixed costs, uncertain fluctuating revenue sources, and INCAE's basic structure and operating format. If INCAE wants to retain its present model and operational strategy, it probably needs an endowment of at least \$3 to \$4 million, even with good expense control and some improvement in operating revenues. In addition, it will need future annual revenue sources to repay the \$4.5 million in debt over the long term. Taken together, it is clear that INCAE will need very substantial endowment in order to continue operations in its present form.
7. Continuing long-range financial planning must be a major concern of the Board of Directors for many years to come.

## ADDITIONAL ALTERNATIVES

The foregoing sections of this report have outlined a number of the principal problem areas at INCAE from a financial point of view together with some possibilities for solutions to these problems. As indicated at the outset, INCAE represents a high quality educational program which is setting a new standard for management education in Latin America. A major policy decision must soon be made whether the INCAE model, in fact, can be preserved and properly financed. If major progress along the lines of the various recommendations outlined above, or other similar kinds of recommendations, is not made within the next twelve to twenty-four months, then serious consideration should be given to changes in the basic INCAE model. I am most reluctant to make such a suggestion in view of the standards of excellence and high quality which INCAE has established within the Central American region. Nonetheless, if the model cannot be financed properly, it would be better to have a modified INCAE than no INCAE at all. I would suggest consideration of the points briefly summarized below only if it appears that proper financing cannot be secured for the present concept and structure of the school. In that event, some elements of the model presumably could be changed.

Possible Changes

- A. An 11/12 month MBA program might be offered. Four trimesters instead of the present six trimesters would be included. There are several models for this example, both in Latin America and in the United States. Substantial savings probably could be accomplished through sharp reductions in faculty size, the number of courses offered, more intensive use of physical plant, etc.
- B. More students could be obtained from certain countries with less emphasis on the Central American integration concept.
- C. Relatively more students could live "off campus." An attempt could be made to cut back the full residential campus concept. This presumably would mean raising the number of Nicaraguan students relative to students from other countries.
- D. Attempts should be made towards an extremely vigorous cost reduction program. All but absolute essentials should be eliminated. Use a much smaller faculty with almost no foreign faculty due to costs; cut back

or virtually eliminate case development and reduce or nearly eliminate translation costs. In short, convert the program to a basic minimum stressing essentials only, conducted entirely in the Spanish language.

- E. Perhaps, sell or lease some assets, for example, a portion of campus land. Possibly consider leasing some facilities to another school or explore the possibility for joint academic utilization of the campus to gain some additional revenues through sharing overhead costs.

Clearly, most of the above suggestions are drastic ones which would materially change the character of INCAE as it exists today. Any such changes should be made only after extremely careful review of all alternative financial sources and only after a clear determination that the present model cannot be financed.

#### Final Conclusions

I strongly urge all responsible parties to move forward as soon as possible in the review and examination of INCAE's financial affairs and its prospects for future survival. INCAE's financial problems have been developing for many



years. Time is now a critical factor, particularly since it may take considerable time to resolve fully some of these matters. The sooner a start is made, the sooner a successful conclusion may be reached.

INCAE is making a substantial contribution to the economic development of the Central American region. Assuring its continued favorable contribution to the region is most important. The significant effort of all concerned in time, effort, and money over many years must also be recognized and protected. The solutions will not prove easy to accomplish and they will require a high level of performance and genuine commitment by all who are concerned about INCAE's long-run institutional survival and success.

## LIST OF APPENDICES

### Appendix A:

- "INCAE: Background, Strategy, Programs & Activities" (a summary description prepared by the Rector in the Fall of 1975).
- "INCAE: Faculty Statement of Institutional Goals & Purposes" (adopted in principle by the Faculty, May 1971; edited and updated by the Rector, December 1975).
- Preliminary Staffing Plan for the MBA Program, 1976-77.

### Appendix B:

A series of statistical tables relating to the faculty and the various educational programs in recent years, included in the list of documents compiled by the Rector for the January 1976 meeting of the Advisory Board.

### Appendix C:

Current and projected data on the Student Loan Fund.

### Appendix D:

Financial information covering the last three years.

### Appendix E:

Physical Expansion Needs: Justification, Definition & Preliminary Estimate, (a document submitted by the Rector to the Board in May 1976).

### Appendix F:

"Library Annual Report, 1974-75"

### Appendix G:

- List of INCAE National Committees throughout Central America.
- Proposal of the Guatemala National Committee for the creation of an endowment fund.