International Journal of Web of Multidisciplinary Studies
(Peer-Reviewed, Open Access, Fully Refereed International Journal)
website: http://ijwos.com
Volume.03 Issue.01.
OPEN ACCESS
E-ISSN : 3049-2424
DOI: https://doi.org/10.71366/ijwos

Financial Management Strategy in Higher Education Institutions

Samir Kumar Bandyopadhyay[1]
[1] *The Bhawanipur Education Society, Kolkata 700020, India.*

Article Info

Article History:

Published:04 Jan 2026

Publication Issue:
Volume 3, Issue 01
January-2026

Page Number:
27-42

Corresponding Author:
Samir Kumar Bandyopadhyay

Abstract:

This paper examines the critical role of a robust Financial Management Strategy (FMS) in ensuring the sustainability, academic excellence, and long-term solvency of a higher education institution (HEI). The FMS is not merely an accounting function but a strategic framework that aligns fiscal resources with the college's core mission of teaching, research, and public service. The analysis focuses on key strategic pillars: effective planning and goal setting, granular budgeting and cash flow optimization, strategic savings and investment practices, fostering positive financial behaviour and literacy across the institution, and continuous monitoring and control. Through a detailed framework and a case study, the paper demonstrates how proactive financial governance, transparency, and data-driven decision-making are essential for navigating the complex and competitive landscape of modern higher education. The aim is to provide a blueprint for college administrators to transition from reactive cost management to strategic financial resource stewardship.

Keywords: Financial Management Strategy, Higher Education Finance, Institutional Sustainability, Budgeting, Cash Flow Management, Endowment Management, Financial Governance, Tuition Dependency, Fiscal Transparency.

1. Introduction

The financial landscape for colleges and universities today is characterized by increasing operational costs, intense competition for student enrolment, pressure to maintain tuition affordability, and fluctuating external funding sources (e.g., government grants, donor contributions). In this environment, an effective Financial Management Strategy (FMS) is paramount [1].

The FMS of a college is the integrated system of financial policies, processes, and decision-making structures designed to acquire, allocate, and manage the institution's resources efficiently and effectively to achieve its strategic mission. It transcends simple bookkeeping, becoming a tool for strategic resource allocation that drives academic priorities, maintains physical infrastructure, and ensures the long-term viability of the institution. This paper systematically explores the components of a comprehensive FMS, providing a framework for strategic financial stewardship in the academic sector [2].

1.1 Financial Planning & Goal Setting

This foundational stage ensures that financial resources are directly aligned with the college's academic mission and strategic plan. Financial planning is inherently a **long-term, forward-looking** activity [3-4].

1.2 Mission Alignment and Strategic Goals

- **Translating Mission into Fiscal Terms:** Every strategic priority (e.g., lowering the student-to-faculty ratio, expanding a specific research center, modernizing campus infrastructure) must be quantified and assigned a resource cost.
- **Long-Range Financial Modelling:** Developing 5- to 10-year financial forecasts that stress-test various scenarios (e.g., 5% drop in enrolment, 2% increase in endowment returns, major capital project needs). This helps identify potential funding gaps early.
- **Key Financial Goals:** Establishing clear, measurable, and time-bound objectives, such as:
  - Reducing **tuition dependency** from 80% to 70% of operating revenue within five years.
  - Achieving a balanced budget or a specific **operating surplus** target annually.
  - Maintaining an **acceptable debt-to-equity ratio** for bond ratings.
  - Building the **unrestricted quasi-endowment** to cover at least three months of operating expenses.

1.3 Resource Allocation Strategy

- **Activity-Based Costing (ABC):** Moving beyond departmental budgets to understand the true cost of core activities (e.g., cost per student in a specific major, cost per research grant administered). This informs which programs are financially viable and which require strategic subsidy.
- **Prioritization Matrix:** Developing a mechanism to rank proposed expenditures based on their alignment with strategic goals, return on investment (ROI), and urgency. Projects that score high on both mission alignment and financial return should receive priority funding.

1.4 Budgeting and Cash Flow Management

The operational heart of the FMS, effective budgeting and cash flow management ensure the college can meet its day-to-day obligations and fund its approved programs efficiently.

1.5 Budgeting Frameworks

The selection of a budgeting model significantly impacts resource allocation incentives.

- **Zero-Based Budgeting (ZBB):** Requires every department to justify every line item of expenditure from a "zero base" each period, rather than simply adjusting the previous year's budget. This drives efficiency and eliminates entrenched, non-essential spending.
- **Responsibility Center Management (RCM) or Decentralized Budgeting:** Treat major academic units (colleges/schools) as quasi-independent entities responsible for their own revenues and expenses. This incentivizes schools to generate revenue and manage costs effectively, fostering an entrepreneurial mindset.
- **Hybrid Models:** Often, a college uses a centralized model for core functions (e.g., IT, Library, Administration) and an RCM model for academic schools.

1.6 Cash Flow Optimization

Colleges experience significant seasonal fluctuations in cash due to the timing of tuition payments (often concentrated at the start of semesters) and major expenditure deadlines (e.g., capital project payments, payroll).

- **Forecasting and Modelling:** Creating rolling 13-week cash flow forecasts to predict surpluses and deficits.
- **Working Capital Management:** Strategically managing accounts receivable (tuition due), accounts payable (vendor payments), and inventory (books, supplies) to ensure liquidity. Delaying non-critical payables and aggressively pursuing receivables can free up significant working capital.
- **Short-Term Investment:** Utilizing any temporary cash surpluses in highly liquid, low-risk instruments (e.g., money market funds, short-term treasury bills) to generate incremental income.

Strategic management of non-operational funds (Endowment and Quasi-Endowment) is vital for long-term financial security and intergenerational equity.

1.7 Endowment Management

The endowment is a permanent pool of capital intended to provide a stable, perpetual stream of funding.

- **Investment Policy Statement (IPS):** A formal document outlining the investment goals (e.g., target return, real return objective), risk tolerance, asset allocation targets, spending policy, and governance structure.
- **Asset Allocation:** A diversified portfolio across asset classes (equities, fixed income, real estate, private equity, hedge funds) is essential to maximize returns while mitigating volatility. The typical time horizon for an endowment is perpetual, allowing for greater tolerance of short-term risk and a higher allocation to growth assets.
- **Spending Policy:** A rule dictating the percentage of the endowment's value that can be spent annually (typically 4% to 5%). The goal is to balance current needs with the need to preserve the principal's purchasing power (inflation-adjusted value) for future generations.

1.8 Quasi-Endowment and Reserve Funds

- **Quasi-Endowment:** Funds internally designated by the college's governing board to function as an endowment, but which can be invaded (spent) if the board deems it necessary. These funds offer flexibility while preserving capital until a strategic need arises.
- **Operational Reserves:** Maintaining specific, liquid reserves for unforeseen events (e.g., emergency campus repairs, litigation expenses, sudden enrolments decline) to avoid disrupting the operating budget.

1.9 Financial Behaviour and Literacy

An effective FMS requires a cultural shift towards financial stewardship across all levels of the institution.

Fostering a Culture of Stewardship

- **Decentralized Accountability:** Empowering department heads and principal investigators with accurate financial data and accountability for their unit's financial performance. This shifts the focus from simply *spending* the budget to *managing* resources effectively.
- **Training and Education:** Providing financial literacy training for non-financial staff and faculty (e.g., understanding fund accounting, reading a departmental budget report, managing grant funds).

Transparency and Communication

- **Open Book Management:** Regularly sharing financial performance data with the governing board, faculty, staff, and even students (in an appropriate format). This builds trust and encourages buy-in for difficult financial decisions.
- **Financial Dashboards:** Creating accessible, user-friendly dashboards that track key performance indicators (KPIs) like tuition collection rates, expenditure variances, and net assets.

Monitoring and Control

Continuous oversight is necessary to ensure the FMS remains on track, mitigates risk, and responds dynamically to external changes. Internal Control Systems composed of the following:

- **Segregation of Duties:** Ensuring no single individual has control over all aspects of a financial transaction (e.g., the person who authorizes a purchase cannot also process the payment).
- **Compliance:** Strict adherence to financial regulations (e.g., IRS tax codes, grant-specific rules, GASB/FASB accounting standards) and the college's own internal policies.

1.10 Variance Analysis and Reporting

- **Budget vs. Actuals:** Regular (monthly/quarterly) review of actual expenditures and revenues compared to the approved budget. Large **variances** (both positive and negative) should trigger an investigation and corrective action.
- **Key Performance Indicators (KPIs):** Tracking critical financial health metrics, such as:
    - **Operating Margin:** (Operating Revenue - Operating Expenses) / Operating Revenue.
    - **Primary Reserve Ratio:** Expendable Net Assets / Total Expenses.
    - **Viability Ratio:** Expendable Net Assets / Total Debt.

2. Literature Review

The academic discourse surrounding Financial Management Strategy (FMS) in higher education has shifted from a focus on administrative bookkeeping to a broader paradigm of **strategic resource stewardship**.

2.1 The Shift Toward Strategic Financial Planning

Early literature by **Meisinger (1994)** emphasized that college budgeting was primarily incremental. However, more recent scholars, such as **Goldstein (2019)**, argue that the "new normal" of dwindling state support and demographic shifts requires a transition to long-range financial modelling. This involves not just balancing books but using "What-if" scenarios to predict the impact of tuition freezes or enrolments volatility on institutional solvency [5-6].

2.2 Budgeting Models and Institutional Efficiency

The debate between **Centralized** and **Decentralized (RCM)** budgeting remains a focal point in higher education research. **Priest et al. (2002)** highlight that Responsibility Center Management (RCM) encourages entrepreneurialism among deans but warns that it can lead to "siloing," where departments compete for students solely for revenue. Conversely, **Zemsky (2013)** suggests that **Zero-Based Budgeting (ZBB)** is increasingly necessary to prune "administrative bloat," though it is often met with cultural resistance in academic settings [7].

2.3 Endowment and Investment Strategies

The "Yale Model" of endowment management, popularized by **David Swensen (2000)**, revolutionized how colleges view long-term savings. Research by **Lerner et al. (2008)** indicates that institutions moving toward alternative assets (private equity, hedge funds) generally see higher long-term returns but face significant liquidity risks during market downturns, as seen in the 2008 financial crisis. Modern literature now focuses on the **Ethical and ESG (Environmental, Social, and Governance)** dimensions of college investments, as student and faculty activism pressures boards to divest from fossil fuels.

2.4 Financial Literacy and Institutional Culture

A significant gap in the literature exists regarding the financial literacy of academic leaders. **Keeling (2006)** argues that the "silo" nature of academia often results in Deans and Department Heads having high academic expertise but low fiscal training. The literature suggests that transparency and "open book" management styles are essential to bridge the gap between faculty priorities and the financial realities of the administration.

2.5 Budgeting Frameworks in Higher Education

Budgeting in a college is a political as well as a financial exercise. It involves balancing the competing interests of academic rigor, student services, and facility maintenance. There are three predominant frameworks used by modern institutions:

Incremental Budgeting (Traditional)

This is the most common model, where the previous year's budget serves as the baseline, with "incremental" adjustments made for inflation or minor program expansions.

- **Pros:** Stability and ease of implementation.

- **Cons:** It tends to bake in historical inefficiencies and fails to re-evaluate whether a program still serves the institutional mission.

Responsibility Center Management (RCM)

RCM is a decentralized model where individual "responsibility centers" (like the School of Engineering or the College of Arts) are treated as self-sustaining businesses. They keep the revenue they generate (tuition and grants) but must pay for their own direct costs and a "tax" to support central services (the library, HR, and the President's office) [8-10].

- **Strategic Impact:** It incentivizes Deans to grow enrolments and manage costs aggressively.
- **Risk:** It can lead to "course poaching," where departments create overlapping classes to steal tuition dollars from other schools within the same university.

Zero-Based Budgeting (ZBB)

In ZBB, every department starts at zero every fiscal year. Every dollar requested must be justified based on its contribution to the current strategic plan.

- **Strategic Impact:** Highly effective for "right-sizing" an institution facing a financial crisis. It forces a move away from "we've always done it this way" thinking.
- **Constraint:** Extremely labour-intensive for faculty and staff to prepare annually.

Key Performance Indicators (KPIs) for Financial Health

To monitor the effectiveness of these budgeting frameworks, college administrators rely on specific ratios. In academic financial management, these are often grouped into the **Composite Financial Index (CFI)**.

a. **Primary Reserve Ratio**

This measures the institution's "liquidity" and financial flexibility. It compares total expendable net assets to total expenses.

b. **Benchmark:** A ratio of **0.40x** or higher is considered healthy, indicating the college could operate for roughly five months using only its reserves.

This measures the college's ability to settle its long-term debt using expendable resources. It is a critical metric for bond rating agencies.

- **Interpretation:** If the ratio is above **1.0**, the college could pay off its entire debt immediately. A falling ratio suggests the college is over-leveraged.

Net Operating Revenues Ratio

This indicates whether the college is living within its means during a specific fiscal year.

- **Benchmark:** A target of **2% to 4%** is generally sought to ensure funds are available for reinvestment in campus infrastructure.

Tuition Dependency Ratio

For private colleges especially, this is a vital risk metric.

- **Strategy:** If this exceeds **80%**, the college is highly vulnerable to enrolments fluctuations. Strategy must then focus on diversifying revenue through grants, auxiliary services (housing/dining), and endowment draws.

Strategic budgeting is useless without a rigorous control environment. This involves:

- **Monthly Variance Reporting:** Deans and Department heads should receive automated reports showing **Budget vs. Actual** spending. Any variance exceeding **5%** should require a written explanation.
- **Encumbrance Accounting:** This "earmarks" funds as soon as a purchase order is issued, rather than when the invoice is paid. This prevents departments from accidentally overspending their budget in the final months of the year.
- **The "Shadow Budget" Check:** Central finance offices often maintain a contingency reserve (usually **1-3%** of the total budget) that is not allocated to departments, serving as a buffer for emergency repairs or unexpected scholarship needs.

3.Capital Expenditure (CapEx) Planning

Capital expenditure refers to the funds used by a college to acquire, upgrade, and maintain physical assets such as buildings, laboratories, technology infrastructure, and land. Unlike operating expenses, CapEx provides benefits over a long period, usually exceeding one fiscal year.

- **The Integrated Facilities Plan (IFP)**

Strategic CapEx begins with a comprehensive assessment of the campus footprint.

- **Deferred Maintenance Backlog:** Many older colleges struggle with "hidden" debt in the form of aging HVAC systems, roof repairs, and outdated electrical grids. A strategic FMS must quantify this backlog to prevent catastrophic failures.
- **Space Utilization Analysis:** Before building new facilities, strategic management requires an audit of current space. If lecture halls are only at 40% capacity, the strategy should pivot from "new construction" to "renovation and repurposing."
- **Project Prioritization Framework**

With limited capital, colleges must use a scoring matrix to decide which projects move forward. Criteria typically include:

- **Mission Criticality:** Does the project directly support a high-growth academic program (e.g., a new Nursing lab)?
- **Regulatory Compliance:** Is the project required for ADA accessibility or safety codes?
- **Net Present Value (NPV) & ROI:** For revenue-generating projects (e.g., a new residence hall), what is the projected payback period?

Debt Management and Financing Strategies

When internal reserves and fundraising are insufficient for large-scale CapEx, colleges turn to debt. Strategic debt management is the art of balancing the need for growth with the necessity of maintaining a high credit rating.

Sources of Capital

- **Municipal Bonds:** Large public and private institutions often issue tax-exempt bonds. These require a high level of transparency and regular reporting to bondholders.
- **Bank Loans and Lines of Credit:** Useful for smaller, short-term projects or as "bridge financing" while waiting for a large donor pledge to materialize.
- **Public-Private Partnerships (P3s):** A growing trend where a college partners with a private developer to build and manage a facility (like a student apartment complex). The college avoids taking debt on its own balance sheet, though it may sacrifice some control over the asset.

Debt Capacity and Policy

A college must establish a formal **Debt Policy** to ensure it does not over-leverage itself. This policy typically sets limits on:

- **Debt Service Burden:** The annual debt payment should generally not exceed **7% to 10%** of total operating expenses.
- **Fixed vs. Variable Interest:** To mitigate risk, colleges often aim for a portfolio where at least **70-80%** of debt is at a fixed interest rate, protecting the institution from sudden market spikes.

Credit Rating Impact

The three major agencies (Moody's, S&P, and Fitch) evaluate a college's "creditworthiness." A downgrade in credit rating increases the cost of future borrowing.

- **Quantitative Factors:** The ratios discussed earlier (Viability Ratio and Primary Reserve Ratio).
- **Qualitative Factors:** Management strength, enrolments trends, and the competitive position of the college in its region.

Strategic Synthesis: Linking CapEx and Debt

The intersection of CapEx and debt is where the most significant risks lie. A strategic financial manager must ensure that the "useful life" of the asset exceeds the "term" of the debt. For example, it is fiscally irresponsible to take a 30-year bond to fund a computer lab where the technology will be obsolete in 5 years.

The Capital Reserve Fund

To reduce reliance on debt, high-performing colleges implement a "Capital Replacement Charge" (CRC). This is an internal tax on operating departments that flows into a restricted reserve fund, specifically earmarked for the future replacement of the assets they are currently using.

- **Case Study: A Regional Liberal Arts College**

The Challenge

A fictional **"Northwood College,"** a regional liberal arts institution, faced declining enrolment (5% per year) and high tuition discounting, leading to a structural operating deficit. Their primary reserve ratio was below 0.1, indicating high financial risk.

Strategic Financial Interventions

- **Planning:** Adopted a **three-year turnaround plan** focused on achieving fiscal sustainability by diversifying revenue and right sizing the academic portfolio. Goal: Balance the budget by year three.
- **Budgeting:** Implemented **Zero-Based Budgeting (ZBB)** for all administrative units. This resulted in eliminating non-essential travel budgets and consolidating overlapping administrative roles, saving 1.5 million in the first year.
- **Revenue Diversification:** Launched three **high-demand, low-cost online graduate certificate programs** in partnership with local industries, generating 800,000 in incremental, non-tuition revenue in year two.
- **Investment:** The Investment Committee revised the **Endowment Spending Policy** to a "rolling average" of the past 12 quarters' market value, smoothing the annual distribution and protecting against market volatility.
- **Control:** Introduced a **real-time financial dashboard** for all academic Deans, which tracked expenditures against budget monthly. This led to proactive identification and freezing of over-budget spending in the second half of the fiscal year.

4. **Outcomes**

By the end of the third year, Northwood College achieved a small operating surplus, and the Primary Reserve Ratio improved to 0.4. The strategic FMS successfully stabilized the college's financial health, allowing resources to be re-invested in student success initiatives.

A college's Financial Management Strategy is a continuous, dynamic process that dictates its ability to fulfil its mission. The key to long-term sustainability lies in shifting the focus from a purely accounting-driven approach to a **strategic, planning-based resource stewardship model**. Effective implementation requires:

- **Alignment:** Explicit linkage of every financial decision to the college's core academic and strategic goals.
- **Discipline:** Adopting rigorous budgeting models like ZBB or RCM and maintaining strict internal controls.
- **Foresight:** Utilizing long-range financial modelling and strategic investment (endowment management) to ensure intergenerational equity.
- **Culture:** Fostering transparency and financial literacy across the entire institution.

By integrating these elements, a college can navigate the volatility of the higher education market, secure its financial future, and ensure resources are optimally deployed to enhance the quality of teaching, research, and student life.

The financial management of a college is no longer a peripheral administrative function; it is the bedrock upon which academic innovation and student success are built. As this paper has demonstrated, a successful **Financial Management Strategy (FMS)** requires a delicate balance between the immediate operational needs of the campus and the long-term preservation of the institution's mission.

Our analysis leads to several core observations:

- **Integration is Mandatory:** Financial planning cannot exist in a vacuum. The most resilient colleges are those where the Chief Financial Officer (CFO) and the Chief Academic Officer (CAO) work in lockstep to ensure that every dollar spent is an investment in a defined strategic outcome.
- **Data-Driven Stewardship:** Moving away from incremental, "gut-feeling" budgeting toward data-informed models like RCM or ZBB allows institutions to identify inefficiencies and reallocate resources to high-growth, high-impact areas.
- **Risk Mitigation through Diversification:** High tuition dependency is a systemic vulnerability. Sustainable colleges prioritize revenue diversification through endowment growth, auxiliary services, and public-private partnerships.
- **Cultural Alignment:** Financial literacy must permeate the hierarchy. When faculty and staff understand the "why" behind fiscal constraints, the institution moves from a culture of "budget entitlement" to one of "resource stewardship."

5.Policy Recommendations for College Administrators

To operationalize the strategies discussed in this paper, the following policy recommendations are proposed for college boards, executives, and financial planners:

Establish a "Strategic Reserve" Policy

Colleges should mandate an annual operating surplus (typically 2-4%) specifically designated for a **Strategic Innovation Fund**.

- **Policy Action:** Formalize a board-approved rule that restricts these funds from being used for routine operational deficits, ensuring they are only available for "seed funding" new academic programs or emergency infrastructure needs.

Implement "Lifecycle" Capital Budgeting

To combat the crisis of deferred maintenance, the institution must adopt a lifecycle approach to all physical assets.

- **Policy Action:** Require that every proposal for a new building or major equipment purchase include a **Total Cost of Ownership (TCO)** analysis. This analysis must identify the funding source not just for the initial purchase, but for maintenance and eventual replacement 20 years down the line.

Mandate Institutional Financial Literacy Training

To bridge the gap between administration and faculty, financial transparency must be formalized.

- **Policy Action:** Develop an annual "State of the College Finances" workshop for all department heads and faculty senates. This should include training on how to read departmental dashboards and understand the impact of enrolment on the institutional bottom line.

Optimize the Debt Capacity Ratio

To protect the college's credit rating and future borrowing power, strict limits on leverage must be enforced.

- **Policy Action:** Adopt a formal Debt Policy that caps the **Debt Service Burden** at 7% of operating expenses and requires a **Viability Ratio** of at least 1.25 before any new long-term bonds are issued.

Transition to a Multi-Year Rolling Budget

The traditional one-year budget cycle is often too short to account for academic cycles and economic shifts.

- **Policy Action:** Implement a **Three-Year Rolling Budget** framework. While only the first year is "authorized" for spending, the subsequent two years serve as a mandatory forecast that forces departments to plan for long-term faculty hiring and program sunsets.

Final Thoughts

The challenges facing higher education—demographic cliffs, rising costs, and scepticism regarding the value of a degree—are formidable. However, they are not insurmountable. By adopting a rigorous, transparent, and mission-aligned Financial Management Strategy, colleges can secure the resources necessary to continue their vital work of transforming lives through education. The strategies outlined in this paper provide the structural integrity required for institutions to remain "economically viable and academically vibrant" in an uncertain future.

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This is the most common model, where the previous year's budget serves as the baseline, with "incremental" adjustments made for inflation or minor program expansions.

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Viability Ratio

This measures the college's ability to settle its long-term debt using expendable resources. It is a critical metric for bond rating agencies.

$$\text{Viability Ratio} = \frac{\text{Expendable Net Assets}}{\text{Long-Term Debt}}$$

- **Interpretation:** If the ratio is above **1.0**, the college could pay off its entire debt immediately. A falling ratio suggests the college is over-leveraged.

Net Operating Revenues Ratio

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$$\text{Net Operating Revenues Ratio} = \frac{\text{Operating Surplus (or Deficit)}}{\text{Total Operating Revenues}}$$

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$$\text{Tuition Dependency} = \frac{\text{Net Tuition and Fees}}{\text{Total Operating Revenue}}$$

- **Strategy:** If this exceeds **80%**, the college is highly vulnerable to enrolment fluctuations. Strategy must then focus on diversifying revenue through grants, auxiliary services (housing/dining), and endowment draws.

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7. Conclusions

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- Data-Driven Stewardship: Moving away from incremental, "gut-feeling" budgeting toward data-informed models like RCM or ZBB allows institutions to identify inefficiencies and reallocate resources to high-growth, high-impact areas.
- Risk Mitigation through Diversification: High tuition dependency is a systemic vulnerability. Sustainable colleges prioritize revenue diversification through endowment growth, auxiliary services, and public-private partnerships.
- Cultural Alignment: Financial literacy must permeate the hierarchy. When faculty and staff understand the "why" behind fiscal constraints, the institution moves from a culture of "budget entitlement" to one of "resource stewardship."

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