Optimizing Academic Budget Models

Finding the Right Resource Allocation Model for Your Institution



Academic Affairs Forum

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June 24-25, 2014 Washington, DC

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- The Failure of Incremental Budgeting
- 2 Lessons from RCM Leaders
- 3 Budget Model Design Principles

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Sound Familiar?



Common Signs That Something Is Wrong With Your Budget Model



Inadequate Resources for Institutional Priorities

- Health Sciences lacks resources to grow despite strong demand
- Provost cannot fund new multidisciplinary research initiative
- Engineering, Business turn away qualified students due to lack of capacity
- Researchers have no funding to travel to critical conferences
- Business dean keeps trying to negotiate for additional funds



Little Transparency About Cost and Revenue Drivers

- CBO cannot answer board's questions about which departments lose money
- Department chairs demand resources while restricted funds go unspent
- Provost can't explain why
 Physics costs 8x more than
 Chemistry
- Engineering dean complains that she is subsidizing other colleges



Few Incentives for Revenue Growth or Cost Control

- A&S dean refuses to launch new revenue generating masters program
- Education keeps refilling positions despite declining student demand
- Huge increase in photocopier purchases just before end of budget cycle
- Summer enrollment well below capacity
- Biology building leaves lights on all night

Good People in a Bad System



Rational Responses to Poorly Aligned Incentives



Faculty Stereotypes

- **B** Lazy
- ß Resistant to change
- ß Oblivious to financial considerations



Administrator Stereotypes

- **B** Overpaid
- ß Obsessed with change
- ß Reduces everything to financial considerations

A Different View

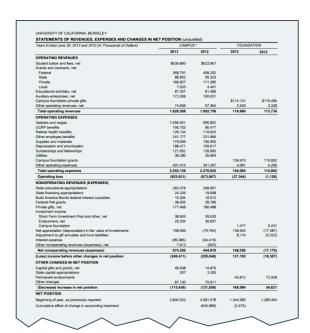
Both struggling to help students and support mission in the face of increased competition, growing responsibilities, and flat or declining budgets

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More Than Just A Flow of Funds



To many it's just dollars and cents...



...but budgets express the university's most important goals and priorities

- ß How do we strike a balance between teaching and research?
- B How much financial aid can we afford to give out this year?
- B How much should we devote to athletic programs?
- ß What is the right faculty to student ratio?
- B How many adjuncts are too many?
- B Which academic programs are our top priority?

"

"The budgets of a university are the surest single indicator of what it is committed to do and what it is stuck with... Underneath the rhetoric of leadership... is a hard logic in putting institutional funds where necessity permits."

Frederick Balderston, Managing Today's University, 1974

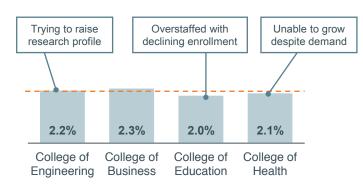
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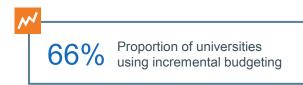
A Model That No Longer Works



Incremental Budgeting Ignores Differential Opportunities and Costs

Revenue Growth Allocated Equally Despite Different Needs and Opportunities





Advantages

/

Simple for academic leaders to understand and manage

Equitable sharing of resources reinforces campus culture

Minimal disruption from year to year minimizes political squabbling

Disadvantages



No link between investments and outputs



Creates disincentives to grow revenue or control costs



Difficult to maintain when revenues no longer growing



Tight Financial Environment Demands New Focus on Reallocation

Chief Business Officers

"New spending at my institution will come from reallocated dollars not an increase in revenue"



57% Agree or Strongly Agree

Provosts

"Most new funds for academic programs will come from reallocation rather than new revenue"



66%
Agree or
Strongly Agree



"We're not seeing the same student growth that we used to and our governor is saying that we're not going to get the tuition bump we were expecting. If we're going to do anything new, then it's got to come out of what we already have. And folks around here don't want to hear that."

Chief Business Officer, Regional Public University

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Source: Inside Higher Education "Survey of College and University Business Officers" 2013; Inside Higher Education "Survey of College & University Chief Academic Officers" 2014; EAB interview and analysis.

Fitting Your Environment

Optimal Budget Model Depends on Market Conditions





Focus: Growth

ß Resources used to support organic growth in areas of high demand



Focus: Strategic Priorities

ß Resources used to fund institutional priorities or new

growth initiatives



Focus: Stability

ß Resources used to continue existing commitments

Degree of Marketplace Disruption

- The Failure of Incremental Budgeting
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Solution or Fad?

Number of Institutions Adopting RCM Growing Rapidly



1.

1970s

University of Pennsylvania University of Southern California Washington University St. Louis

1990s

Duke University

Central Michigan University

University of Illinois Urbana

Indiana University-Bloomington

University of Michigan-Ann Arbor

2000s

Brandeis University
Ohio State University
Okanagan College
University of New Hampshire
University of Minnesota
University of Utah

2010s

McMaster University Northeastern University Ohio University Queens University Texas Tech University University of Delaware University of Florida University of Oregon Wright State University

2005s

Iowa State University Kent State University Marquette University Rutgers University Southern Oregon University Syracuse University University of Toronto

Planned for 2014 and Beyond

Auburn University

Cornell University

George Washington University

Ohio University

Portland State University

Temple University

University of Arizona

University of Kentucky

University of New Mexico

Youngstown University

University of Vermont

University of Virginia

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Source: EAB interviews and analysis

Desire for Growth and Transparency Drive Budget Model Shifts

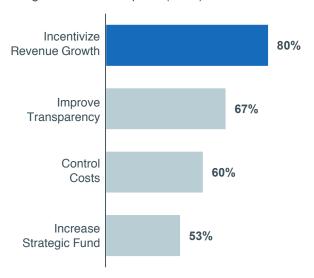


Financial Changes Motivating Most Budget Model Transitions

Taskforce Considers Budget Alternatives Pressure on Funding "As the nation's public universities receive less state support, they are finding it necessary not only to develop new sources of funding, but to adopt new budget approaches" **Rising Ambitions** "If Kent State is to become an academically and financially stronger institution, it must rethink how financial resources are allocated, transferring a greater role in these decisions to academic leaders and faculty.

Revenue and Transparency Are Leading Justifications for Moving to RCM

Budget Taskforce Reports (n=40)

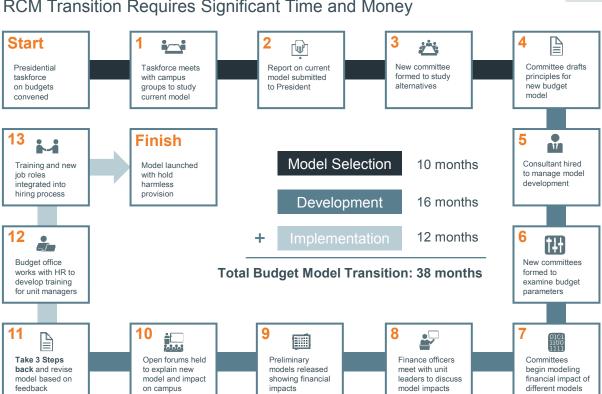


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Source: "Review of Budgetary Methods and Roles at Kent State University." 2007 Kent State; EAB interviews and analysis

The Price of Change

RCM Transition Requires Significant Time and Money



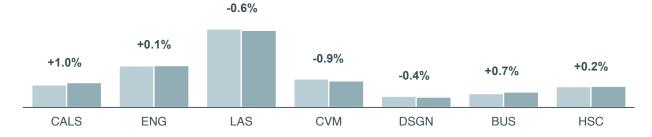
A Radical Change... in Slow Motion



RCM Requires Cultural Transformation, But Financial Changes Come Slowly

Minor Changes in College Share of Resources

Share of Academic Revenue, Iowa State University, FY09 vs FY12



Mitigating Transitional Friction



Learning Years (1 Year)

One-year data-baselining period to familiarize units with new allocation formula



Phased Implementation (4-5 Years)

Increase amount of funds subject to formula in predetermined increments



Hold Harmless Period (Indefinite)

Use reallocation to hold unit budgets to preimplementation levels



Stop-Loss Measures (Indefinite)

Set limit on how much individual units can gain or lose in a single year

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Source: Iowa State University "Report of the Resource Management Model Review Committee" 2012; EAB interviews and analysis

Current Faculty Need Not Apply

Major Budget Overhaul Requires New Administrative Skillset



A New Job With New Responsibilities

DEAN WANTED

Description: University seeks highly qualified dean for College of Arts & Sciences

Skills

- **B** Change management
- **B** Business development
- B Fund raising
- **B** Financial accounting

Qualifications

- B Five-years experience in RCM budgeting environment
- B Comfortable managing P&L for multi-million dollar organization

Proportion of Deans Replaced After Transition to RCM

Public Research University

9 of 10

Deans replaced after moving to RCM

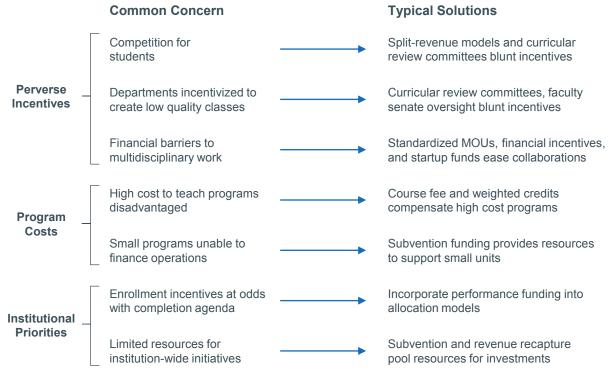
"

"RCM is a great system, but you'll need to replace all of your deans to make it work."

Provost, Public Research University

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Simple Solutions to Common Complaints About RCM



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Source: EAB interviews and analysis

The Many Meanings of RCM





RCM-Heavy



- B Large academic units
- B Distinct student markets
- B Large philanthropy and research revenue
- B Colleges employ financial support staff
- B Units possess significant financial autonomy
- B Large portion of revenue allocated to units

RCM-Hybrid



- ß Medium academic units
- B Regional student market
- B Limited discretionary funding at unit level
- B Financial support staff within central administration
- B Few units financially independent
- B Revenue allocated to units, with significant subvention

RCM-Lite

VERCER UNIVERSITY

- B Small academic units
- B Overlapping student markets
- B Most costs managed centrally
- B Colleges lack financial support staff
- B Use cost accounting to set margin targets for units
- B University overhead funded out of margin contributions

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Working on the Margins



Applying RCM Principles at a Small Institution



Assign Revenue and Costs

Revenue allocated based on credit hour production

Catalogue all direct departmental costs



Set Contribution Targets

Calculate direct contribution margin for each department

Assign targets for direct contribution at college level



Create Unit Incentives

Contributions pay for university-wide overhead

Deans retain surplus after contribution and direct costs

Universities Implementing or Considering Contribution Based Budget Systems













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Notes:

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The Periodic Table of Budget Model Elements

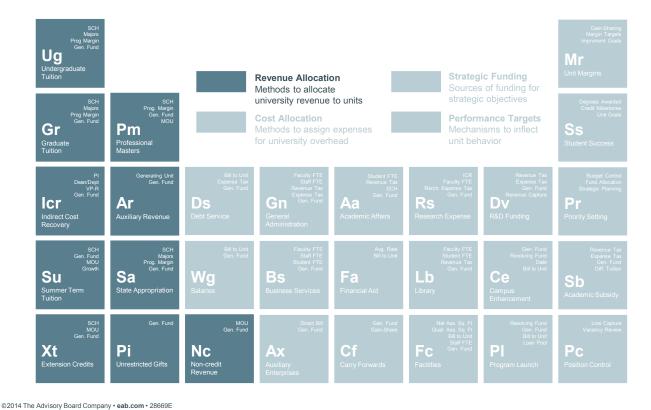


Mr **Revenue Allocation** Strategic Funding Sources of funding for Methods to allocate strategic objectives university revenue to units **Cost Allocation Performance Targets** Pm Ss Methods to assign expenses Mechanisms to inflect for university overhead unit behavior Student Success Dv Pr Icr Ar Ds Gn Aa Rs R&D Funding Wg Bs Lb Ce Fa Sb Pc Xt PΙ Nc

The Periodic Table of Budget Model Elements



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Allocating Revenue

Aligning Incentives with Targeted Growth

Incentives to Identify and Fund Professional Masters

Prog. Margin Gen. Fund MOU Pm Professional Masters



Student Credit Hours

Revenue distributed by credit hour production



Program Margin

Units own profit above pre-determined margin



4%

General Fund

Revenue pooled into university general fund





New Program Screen

- Adequate student demand
- Revenue model indicates financial viability
- Student market will not cannibalize existing BSU programs

80%

Gross Revenue Share



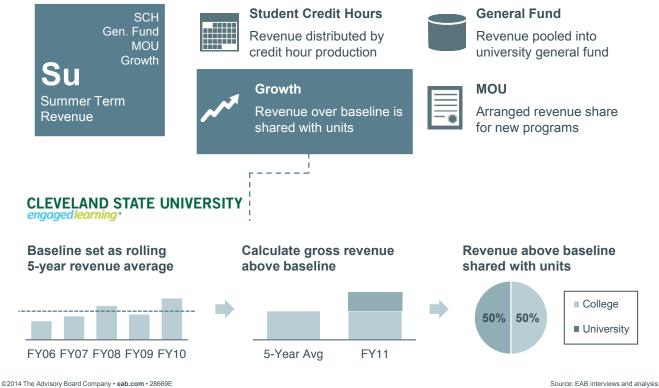
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Source: EAB interviews and analysis.

Aligning Incentives with Targeted Growth, Pt. II



Growth Incentives to Increase Summer Term Utilization



Allocating Revenue

Aligning Incentives with Targeted Growth, Pt. III

Supporting and Incentivizing Research Through ICR Allocation





PΙ

Grant revenue given to Principal Investigator



Dean/Dept

Grant revenue given to the dean or department



General Fund

Revenue pooled into university general fund



VP-R

Grant revenue given to VP-Research office

ICR Allocation Approaches Span Allocation Spectrum

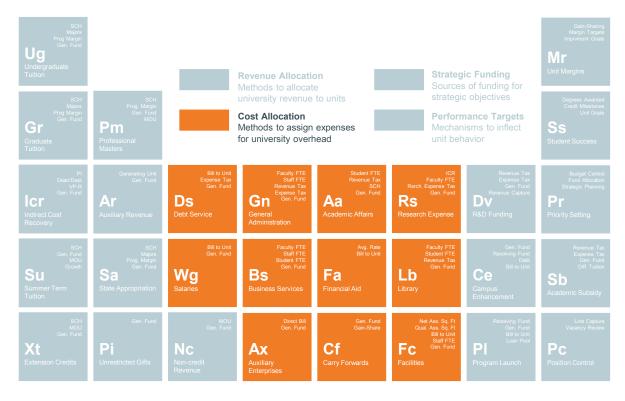


Source: EAB "Optimizing the Distribution of F&A Recovery Funds" 2008; EAB interviews and analysis.

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Allocating Costs

Diminishing Returns to Complexity



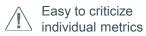
USC Sees Downside to Complicated Cost Allocation Methodology



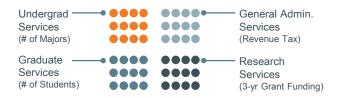








Four cost pools driven by single metric formula







Keeping It Simple



Adjusting Space Costs for Quality

Net Ass. Sq. Ft Qual. Ass. Sq. Ft Direct Bill Gen. Fund **Facilities**



Bill to Unit

Units charged for total cost of service



Quality Assigned Square Ft

Rate based on quality of space occupied



General Fund

Costs pooled and paid out of general fund revenues



Net Assigned Square Ft

Rate based on total square feet occupied



New space classified by cost of maintenance

High Cost = 1.10Average Cost = 1.00 Low Cost = 0.90



Assignable square feet calculated for each facility

> 1,220 sq. feet 15,000 sq. feet 28,000 sq. feet



Standard base rate assigned to weighted space



Facilities Cost

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Source: EAB interviews and analysis.

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Go Big or Go Home

Central Strategic Funds Increasingly Critical

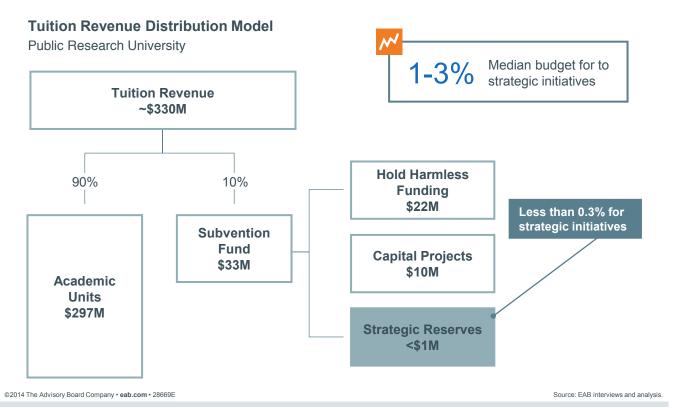


Strength in Traditional Markets

Prior Commitments



Even in an RCM Context Funding Strategic Reserves Poses Challenges



Strategic Funding

Building a War Chest in Tight Times

How to Create Centralized Funds in a Decentralized Model





Expected Return

Mission Mismatch



Budget Change Leaves Campus Poorly Aligned With University Mission

Rensselaer

Adopted RCM in 1990s with focus on revenue and enrollment growth



Majority of enrollment growth in Humanities School, not institutional priority (Engineering)

New president redesigns budget model around campus strategic plan

Central resources grown through centralizing faculty lines and revenue allocation

Academic budgets set based on unit's alignment with the institution's five strategic goals

The Other Side of the Spectrum - RPI's Annual Performance Budgeting Process

Performance plans developed by each unit

- B Activity budget tying each cost to institutional priority
- B Budget covers all funds (unit resources and new requests)

President reviews plans and sets budget allocations

- B Plans ranked according to institutional priorities
- ß Allocations based on performance ranking

Units adjust performance plans based on actual allocation

B Final budgets required to demonstrate how funding will be used to support institutional priorities

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Source: EAB interviews and analysis

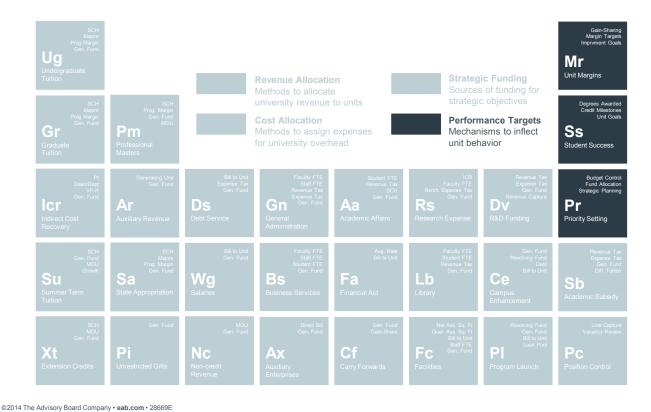
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Performance Targets

From Enrollment to Outcomes



Integrating Performance-Based Mandates Into Your Budget Model

Potential Unit Level PBF Tactics

Department Incentive Bonus funds tied to department-specific metrics	Milestone Bonus Incentive payments tied to student completion milestones
Outcome Allocations Share of college revenue for # of degrees awarded	State to School Conversion Incorporate state PBF metrics into campus allocations

?

Can performance based funding work at the college or department level?

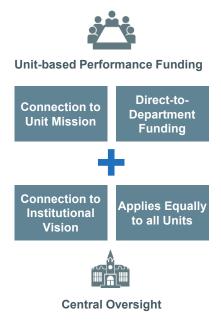
Will student success incentives change behavior?

Integrating the Institutional Mission



Institutional Priorities Inform Unit Performance Funding Targets







Strategic Accountability Matrix (SAM)

- B Institution-level collection of 25 metrics broken into nine categories:
 - Sustainability (financial)
 - Development (gifts, grants)
 - Tuition
 - Student Progression
 - Course Availability
 - Student Interest
 - Student Demographics
 - Advising
 - High-Impact Experiences
- B Metric performance connected to \$400K annual merit pool, split 80/20 between departments and colleges (avg. dept. payout ~\$9K)
- B Merit payouts connected to departmental progress towards individual & collective goals on each metric

Source: Used with permission from University of Wisconsin-Eau Claire; EAB interviews and analysis.

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Performance Targets

Breaking Down the Fundamentals

Scoring Integrates Differences in Dept. Mission, Customized Goals

Sample SAM Score Sheet

Flexible Weighting: Metrics are weighted differently for each department (0, 1, or 2) to accommodate differences in department missions

Department-Specific Goals: Deans and provost negotiate expected values for each metric – scores based off difference between goal and performance

Performance payout based on weighted sum of scores

					Tact	tical						
Strategic Accountability Matrix		Student Progression										
	S	SCH Lost Due to			WRF 30 Credits First Year			Weighted	Perform.			
Department/Program	Weight	Expected	Actual		PR	Weight	Expected	Actual	P	R	Score	Share
Department A	1.0	371	1,232	û	3.32	1.0	80.0%	62.4%	▼	0.78	0.99	3.24%
Department B	1.0	7	136	î	18.50	1.0	80.0%	16.7%	1	0.21	2.31	7.52%
Department C	1.0	294	287	_	0.98	1.0	80.0%	49.4%	~	0.62	0.85	2.77%
Department D	1.0	708	1,865	î	2.63	1.0	80.0%	50.5%	▼	0.63	1.16	3.79%
Department E	1.0	42	173	1	4.08						1.61	5.23%
Department F	1.0	471	1,086	<u> 1</u>	2.31	1.0	80.0%	53.8%	▼	0.67	0.96	3.12%
Department G	1.0	381	518	3 🗢	1.36	1.0	80.0%	47.9%	▼	0.60	1.08	3.52%
Department H	0.0	95	199	ı 🕆	2.09	0.0	80.0%	59.9%	▼	0.75	1.01	3.29%
Department I	1.0	66	473	1	7.15	1.0	80.0%	47.5%	▼	0.59	1.35	4.40%
Department J	1.0	142	560) 1	3.93	1.0	80.0%	44.3%	~	0.55	1.09	3.55%
Department K	0.0	401	134	1	0.33	0.0	80.0%	58.9%	V	0.74	1.19	3.86%
Department L	1.0	1,879	1,384		0.74	1.0	80.0%	46.4%	V	0.58	0.88	2.86%
Department M	1.0	463	869		1.88	1.0	80.0%	51.9%	▼	0.65	1.05	3.42%
Department N	1.0	265	687	1	2.60	1.0	80.0%	40.4%	~	0.51	0.98	3.18%

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Everything But the Kitchen Sink



List of Metrics Included in Strategic Accountability Matrix

High-Impact Experiences:

- ß % of majors participating in collaborative research or creative activities
- B % of majors participating in an internship
- ß % of majors participating in an intercultural immersion experience

Student Interest:

- B Share of applicants submitting ACT scores expressing interest in the department
- B Number of new freshman majors
- B Total number of majors

Citizenship:

ß SCH delivered in general education-eligible courses

Mini-Session Utilization:

- B Winter session undergraduate SCH delivered
- B Summer session undergraduate SCH delivered

Advising:

- B % of freshmen with degree plans
- ß % of NSSE respondents that approve of departmental advising

Student Progression:

- B SCH lost due to DFW
- ß % of majors earning 30 credits in their first year
- ß % of majors earning 60 credits in their first two years

Tuition:

- B Tuition paid by students for department courses
- ß Tuition paid by majors
- B Winter and summer session tuition

Development:

- B Extramural grant \$
- B Program revenue \$
- B Fundraising \$

Sustainability:

- B Total earned income
- B Direct expenditures
- B Earned income ratio (income/expenditures)

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Source: EAB interviews and analysis

Performance Targets

Early Signs of Success

Two Years In, SAM Inflecting Department Behavior



Early Lessons from SAM's Success

Incent Collective Performance: Each department's payout modified based on university-wide progress, encouraging collaboration

Give Departments Free Rein on Policy Solutions, Spending: Chairs apply their local knowledge regarding policy changes, how to distribute merit money

Provide "Hold Harmless Period": Base initial two years of payments on share of faculty FTE, not merit pool, to acclimate departments

"Green Shoots" Visible in Departmental Responsiveness to Metrics



Modifying Curriculum to Improve Transfer Success: One department saw below-target DFW and progression among transfer students, now modifying curriculum to align with 2yr partners



Investing in Quality to Attract Majors: Service department with few majors now investing more in advising and undergrad research to attract students



Increasing Support for At-Risk Groups: Finding an achievement gap between URM and white students, one department added supplemental instruction to gatekeeper courses

Source: Used with permission from University of Wisconsin-Eau Claire; EAB interviews and analysis

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