Optimizing Academic Budget Models

Finding the Right Resource Allocation Model for Your Institution
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Road Map

1 The Failure of Incremental Budgeting

2 Lessons from RCM Leaders

3 Budget Model Design Principles

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
- Lazy
- Resistant to change
- Oblivious to financial considerations

Administrator Stereotypes
- Overpaid
- Obsessed with change
- 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

More Than Just A Flow of Funds
Budget Models Support (or Don’t) Institutional Priorities

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

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

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

A Model That No Longer Works

Incremental Budgeting Ignores Differential Opportunities and Costs

Revenue Growth Allocated Equally Despite Different Needs and Opportunities

<table>
<thead>
<tr>
<th></th>
<th>College of Engineering</th>
<th>College of Business</th>
<th>College of Education</th>
<th>College of Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trying to raise research profile</td>
<td>2.2%</td>
<td>2.3%</td>
<td>2.0%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Overstaffed with declining enrollment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unable to grow despite demand</td>
<td></td>
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</tr>
</tbody>
</table>

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

66% Proportion of universities using incremental budgeting

Source: “IHE Survey of College & University Business Officers” 2011
Seek Within You

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”

Provosts
“Most new funds for academic programs will come from reallocation rather than new revenue”

“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

Fitting Your Environment
Optimal Budget Model Depends on Market Conditions

Performance Based Budgeting
Focus: Strategic Priorities
β Resources used to fund institutional priorities or new growth initiatives

Responsibility Center Management
Focus: Growth
β Resources used to support organic growth in areas of high demand

Incremental Budgeting
Focus: Stability
β Resources used to continue existing commitments
Road Map

1 | The Failure of Incremental Budgeting

2 | Lessons from RCM Leaders

3 | Budget Model Design Principles

Solution or Fad?
Number of Institutions Adopting RCM Growing Rapidly

1970s
University of Pennsylvania
University of Southern California
Washington University St. Louis

1990s
Central Michigan University
Duke University
Indiana University-Bloomington
University of Illinois Urbana
University of Michigan-Ann Arbor

2000s
Brandeis University
Ohio State University
Okanagan College
University of New Hampshire
University of Minnesota
University of Utah

2005s
Iowa State University
Kent State University
Marquette University
Rutgers University
Southern Oregon University
Syracuse University
University of Toronto

2010s
McMaster University
Northeastern University
Ohio University
Queens University
Texas Tech University
University of Delaware
University of Florida
University of Oregon
Wright State University

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

Source: EAB interviews and analysis
Why Change?

Desire for Growth and Transparency Drive Budget Model Shifts

Financial Changes Motivating Most Budget Model Transitions

Revenue and Transparency Are Leading Justifications for Moving to RCM

Budget Taskforce Reports (n=40)

<table>
<thead>
<tr>
<th>Justification</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incentivize Revenue Growth</td>
<td>80%</td>
</tr>
<tr>
<td>Improve Transparency</td>
<td>67%</td>
</tr>
<tr>
<td>Control Costs</td>
<td>60%</td>
</tr>
<tr>
<td>Increase Strategic Fund</td>
<td>53%</td>
</tr>
</tbody>
</table>

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.”

The Price of Change

RCM Transition Requires Significant Time and Money

Start
Presidential taskforce on budgets convened

1
Taskforce meets with campus groups to study current model

Report on current model submitted to President

New committee formed to study alternatives

Committee drafts principles for new budget model

10 months

Consultant hired to manage model development

6 months

New committees formed to examine budget parameters

12 months

Committees begin modeling financial impact of different models

Budget Model Transition: 38 months

Model Selection

Development

Implementation

13
Training and new job roles integrated into hiring process

12
Budget office works with HR to develop training for unit managers

11
Take 3 Steps back and revise model based on feedback

10
Open forums held to explain new model and impact on campus

9
Preliminary models released showing financial impacts

8
Finance officers meet with unit leaders to discuss model impacts

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Source: “Review of Budgetary Methods and Roles at Kent State University,” 2007 Kent State, EAB interviews and analysis
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

<table>
<thead>
<tr>
<th>Department</th>
<th>FY09 Share</th>
<th>FY12 Share</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>CALS</td>
<td>+1.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ENG</td>
<td>+0.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LAS</td>
<td>-0.6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CVM</td>
<td>-0.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DSGN</td>
<td>-0.4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BUS</td>
<td>+0.7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>HSC</td>
<td>+0.2%</td>
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</tr>
</tbody>
</table>

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 pre-implementation levels

- **Stop-Loss Measures (Indefinite)**
  Set limit on how much individual units can gain or lose in a single year

Current Faculty Need Not Apply

Major Budget Overhaul Requires New Administrative Skillset

A New Job With New Responsibilities

<table>
<thead>
<tr>
<th>DEAN WANTED</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description:</strong> University seeks highly qualified dean for College of Arts &amp; Sciences</td>
</tr>
</tbody>
</table>

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

**Qualifications**
- Five-years experience in RCM budgeting environment
- 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
Defending RCM

Simple Solutions to Common Complaints About RCM

<table>
<thead>
<tr>
<th>Perverse Incentives</th>
<th>Typical Solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competition for students</td>
<td>Split-revenue models and curricular review committees blunt incentives</td>
</tr>
<tr>
<td>Departments incentivized to create low quality classes</td>
<td>Curricular review committees, faculty senate oversight blunt incentives</td>
</tr>
<tr>
<td>Financial barriers to multidisciplinary work</td>
<td>Standardized MOUs, financial incentives, and startup funds ease collaborations</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Program Costs</th>
<th>Typical Solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>High cost to teach programs disadvantaged</td>
<td>Course fee and weighted credits compensate high cost programs</td>
</tr>
<tr>
<td>Small programs unable to finance operations</td>
<td>Subvention funding provides resources to support small units</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Institutional Priorities</th>
<th>Typical Solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enrollment incentives at odds with completion agenda</td>
<td>Incorporate performance funding into allocation models</td>
</tr>
<tr>
<td>Limited resources for institution-wide initiatives</td>
<td>Subvention and revenue recapture pool resources for investments</td>
</tr>
</tbody>
</table>

The Many Meanings of RCM

Different Approaches at Large-, Mid-, and Small-Sized Institutions

**RCM-Heavy**

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

**RCM-Hybrid**

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

**RCM-Lite**

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

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Source: EAB interviews and analysis.
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

Notes:
1 | The Failure of Incremental Budgeting

2 | Lessons from RCM Leaders

3 | Budget Model Design Principles

The Periodic Table of Budget Model Elements
### Allocating Revenue

**Aligning Incentives with Targeted Growth**

Incentives to Identify and Fund Professional Masters

<table>
<thead>
<tr>
<th>Pm</th>
<th>Professional Masters</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SCH</strong></td>
<td>Prog. Margin Gen. Fund MOU</td>
</tr>
</tbody>
</table>

**Student Credit Hours**
Revenue distributed by credit hour production

**Program Margin**
Units own profit above pre-determined margin

**General Fund**
Revenue pooled into university general fund

**MOU**
Arranged revenue share for new programs

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

### Gross Revenue Share
- College: 80%
- University: 15%
- Marketing: 4%
- New Programs: 1%

Source: EAB interviews and analysis.
Aligning Incentives with Targeted Growth, Pt. II

Growth Incentives to Increase Summer Term Utilization

Student Credit Hours
Revenue distributed by credit hour production

General Fund
Revenue pooled into university general fund

MOU
Arranged revenue share for new programs

CLEVELAND STATE UNIVERSITY
engagedlearning®

Baseline set as rolling 5-year revenue average

Calculate gross revenue above baseline

Revenue above baseline shared with units

50% College
50% University

Aligning Incentives with Targeted Growth, Pt. III

Supporting and Incentivizing Research Through ICR Allocation

PI
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

Most Funds Retained in General Fund

Most Funds to VP for Research

Most Funds to Deans

Indiana University

Source: EAB "Optimizing the Distribution of F&A Recovery Funds" 2008; EAB interviews and analysis.
The Periodic Table of Budget Model Elements

Allocating Costs

**Diminishing Returns to Complexity**

USC Sees Downside to Complicated Cost Allocation Methodology

100+ cost allocations with unique formulas

Four cost pools driven by single metric formula

- Undergrad Services
  - (No of Majors)

- General Admin. Services
  - (Revenue Tax)

- Graduate Services
  - (No of Students)

- Research Services
  - (3-yr Grant Funding)

Expensive to manage

Easy to criticize individual metrics

Few allocations simplifies management

Cost pooling reduces measurement bias

Source: EAB interviews and analysis.
Allocating Costs

Keeping It Simple

Adjusting Space Costs for Quality

Bill to Unit
Units charged for total cost of service

Quality Assigned Square Ft
Rate based on quality of space occupied

New space classified by cost of maintenance

High Cost = 1.10
Average 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
$14.00

Facilities Cost

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Source: EAB interviews and analysis.

Notes:
Go Big or Go Home

Central Strategic Funds Increasingly Critical

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Elites
- Facing new competitive pressure
- Doubling down on ambitious large-scale initiatives

Strivers
- Poised to dramatically improve ranking/reputation
- Accelerating investments in infrastructure and programs

Fighters
- Navigating shifting demand and student markets
- Upgrading campus infrastructure to keep pace

Strength in Traditional Markets
Prior Commitments
Even in an RCM Context Funding Strategic Reserves Poses Challenges

Tuition Revenue Distribution Model
Public Research University

- **Tuition Revenue**: $330M
  - 90% Academic Units: $297M
  - 10% Subvention Fund: $33M

- **Hold Harmless Funding**: $22M
- **Capital Projects**: $10M
- **Strategic Reserves**: < $1M

1-3% Median budget for strategic initiatives
Less than 0.3% for strategic initiatives

Source: EAB interviews and analysis.

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Building a War Chest in Tight Times
How to Create Centralized Funds in a Decentralized Model

- **Sustainability**
  - Identify hoarded resources and capture for reallocation
  - Labor Cost Savings benefits, work rule changes
  - Piggyback on state-imposed cuts to create extra reserve that stays centrally controlled
  - Cut discretionary budgets and staff in academic units

- **Expected Return**
  - Control faculty and staff positions through vacancy review and centralization
  - Tax revenue or expenditures in academic units to recapture share of funding
  - Improve efficiency or reduce service levels in central administrative services
  - Launch new revenue generating venture (aux. operation, for-profit partnership)

Source: EAB interviews and analysis.
Mission Mismatch

Budget Change Leaves Campus Poorly Aligned With University Mission

Rensselaer

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

- Not enough central revenue to invest in university-wide initiatives
- 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

<table>
<thead>
<tr>
<th>Performance plans developed by each unit</th>
<th>President reviews plans and sets budget allocations</th>
<th>Units adjust performance plans based on actual allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>β Activity budget tying each cost to institutional priority</td>
<td>β Plans ranked according to institutional priorities</td>
<td>β Final budgets required to demonstrate how funding will be used to support institutional priorities</td>
</tr>
<tr>
<td>β Budget covers all funds (unit resources and new requests)</td>
<td>β Allocations based on performance ranking</td>
<td></td>
</tr>
</tbody>
</table>

Notes:
# The Periodic Table of Budget Model Elements

## Performance Targets

### From Enrollment to Outcomes

Integrating Performance-Based Mandates Into Your Budget Model

<table>
<thead>
<tr>
<th>Potential Unit Level PBF Tactics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Department Incentive</strong></td>
</tr>
<tr>
<td>Bonus funds tied to department-specific metrics</td>
</tr>
<tr>
<td><strong>Milestone Bonus</strong></td>
</tr>
<tr>
<td>Incentive payments tied to student completion milestones</td>
</tr>
</tbody>
</table>

### 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)

- 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

- Metric performance connected to $400K annual merit pool, split 80/20 between departments and colleges (avg. dept. payout ~$9K)
- Merit payouts connected to departmental progress towards individual & collective goals on each metric

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

Source: Used with permission from University of Wisconsin-Eau Claire: EAB interviews and analysis.
Everything But the Kitchen Sink

List of Metrics Included in Strategic Accountability Matrix

High-Impact Experiences:
- % of majors participating in collaborative research or creative activities
- % of majors participating in an internship
- % of majors participating in an intercultural immersion experience

Student Progression:
- SCH lost due to DFW
- % of majors earning 30 credits in their first year
- % of majors earning 60 credits in their first two years

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

Citizenship:
- SCH delivered in general education-eligible courses

Mini-Session Utilization:
- Winter session undergraduate SCH delivered
- Summer session undergraduate SCH delivered

Advising:
- % of freshmen with degree plans
- % of NSSE respondents that approve of departmental advising

Tuition:
- Tuition paid by students for department courses
- Tuition paid by majors

Winter and summer session tuition

Development:
- Extramural grant $
- Program revenue $
- Fundraising $

Sustainability:
- Total earned income
- Direct expenditures
- Earned income ratio (income/expenditures)

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