Aligning the Budget Model to Strategic Goals

Executive-Level Decision Points to Ensure Impact on Cost, Growth, and Strategy
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?

Fasten Your Seatbelts...
...It’s Going to be a Bumpy Ride

"The budget model change was a huge success...well, for all the time, turmoil, and energy we put into the change, we have to say it was a success. We quietly agreed never to speak about it again..."

Chief Business Officer
Large Public Research University
Pressures Driving Budget Model Change

Resource Allocation Decisions
- Divestment from historical funding levels demands resources shift to new opportunities
- New budget model embeds smart decision-making into the model, deans focus on increasing financial independence by making reallocations within unit

Shifting Business Model Requires Major Investments
- Evolving business model requires large strategic investments, yet financial pressures strain ability to fund investments with incremental, new revenue
- CBOs look to budget models for greater flexibility reallocating funds away from costly, historic activities and towards new growth opportunities

Demands for Transparency
- Faculty push for greater budgeting transparency, particularly in tight budget environment where administrators (necessarily) make unpopular decisions
- Suspicion of administrator compensation at one institution forced launch of a budget taskforce to reevaluate budget model and promote transparency

Deans Not Incented to Balance Mission with Financial Impact
- Financial responsibility and operational responsibility are not aligned
- Deans often make decisions based on mission and college-specific considerations
- As a result, deans do not prioritize programs with high-growth potential, drive academic efficiency initiatives across programs, or reposition unit to support strategic goals

The Allure of RCM
Pace of RCM Adoption Accelerates After Recession

Timeline of Institutions Moving to RCM Budget Models

<table>
<thead>
<tr>
<th>2000s</th>
<th>2005s</th>
<th>2010s</th>
<th>2014 and Beyond</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brandeis University</td>
<td>Iowa State University</td>
<td>McMaster University</td>
<td>Auburn University</td>
</tr>
<tr>
<td>Okanagan College</td>
<td>University of New Hampshire</td>
<td>Northeastern University</td>
<td>Cornell University</td>
</tr>
<tr>
<td>University of Utah</td>
<td>University of Utah</td>
<td>Queens University</td>
<td>George Washington University</td>
</tr>
<tr>
<td>University of New Hampshire</td>
<td></td>
<td>Simon Fraser University</td>
<td>University of Arizona</td>
</tr>
<tr>
<td>University of Utah</td>
<td></td>
<td>Texas Tech University</td>
<td>University of Kentucky</td>
</tr>
</tbody>
</table>

25% of CBOs report using RCM-type model in 2015

Institutions Adopting RCM Accelerates After Recession
Facing significant downward pressure on tuition revenue and declining state support, many institutions adopt RCM models after the recession to create transparency, control costs, and incent deans to seek opportunities for revenue growth.

Source: Business Affairs Forum interviews and analysis.
Finding the Middle Ground
Increasing Number of Institutions Moving Towards Hybrid Models

Historical Trend
Incremental  Hybrid  RCM

Emerging Trend

Common Limitations: Incremental

- Does not incent unit revenue growth or cost control
- Difficult to maintain in periods of stagnant growth
- Do not flexibly accommodate changes in enrollment patterns

Common Limitations: Hybrid

- Yields few resources for central strategic investment
- Devolves decision-making power to units at expense of central strategic vision
- Shifts resources to units based on market trends and dean performance rather than institutional priorities

Not a “One-Size-Fits-All” Model
Many Manifestations of Hybrid Model Across Institutions

Percentage of Tuition Revenue Allocation

Rutgers University
- 100% of tuition allocated to colleges
- 100% of state appropriations retained centrally
- State appropriations used for strategic investments and subvention

University of California Riverside
- 70% of tuition allocated to colleges
- 30% of tuition and 100% of state appropriations retained centrally

State University of New York at Buffalo
- Unit base budgets awarded incrementally based on historical investment agreements
- 50% of incremental revenue from modest enrollment growth and state-approved tuition increases allocated to academic units

“Everyone says they have a hybrid model. It’s like how everyone in America thinks they are middle class.”
Chief Business Officer, Public Research University

Source: Business Affairs Forum interviews and analysis.
Matching the Model to Institutional Goals

Negative Consequences of Picking a Model That Isn’t a Good Fit

No Unit Buy-In
If stakeholders reject model, they will resist acting upon model incentives or change behaviors

Time and Money Wasted
Unintended consequences lead to model tweaks, requiring additional committee time and consulting fees

Failure to Meet Strategic Goals
Without foresight and intentional incentives and policies, model mechanics disincent or distract from strategic goals

Observed Outcomes of Budget Mechanisms That Don’t Fit Institution

- Units grow in unexpected ways and require unanticipated space and HR investments
- Units create duplicate courses to steal tuition revenue from other colleges
- Units cannibalize existing program offerings in attempts to create new revenue or create new programs that fail to breakeven
- Undergraduate programs subsidize professional schools
- Units hoard resources rather than invest in mission-critical initiatives
- Units create low quality courses to poach students from other schools
- Units pursue unsustainable “yo-yo” cost cutting exercises to minimize costs
- Insufficient central resources available for strategic investment

Source: Business Affairs Forum interviews and analysis.

Targeting the Most Important Design Decisions

Hundreds of Decisions, Not All Need Executive Attention

Representative Decisions Better Addressed by Budget Model Committee

- How should we treat pre-existing MOUs?
- How should we allocate professional master’s revenue?
- Should we charge for student services based on student FTE or headcount?
- How should we allocate summer term revenue?
- How should we allocate indirect cost recovery?

- Should we use differential rates to charge for different types of facilities overhead?
- How should we allocate donor gifts?
- Should we break out library expenses into their own cost pool?
- How should we split cross-teaching revenues?
- How should we allocate extension revenue?

- Should we allocate the Provost’s office expenses to units based on student FTE or SCH share?
- Should we allocate endowment revenue?
- How should we treat auxiliaries?
- How should we charge units for the costs of running the President’s Office?
- How should we charge units for the costs of central business services?

Separating the Wheat from the Chaff

“We knew there were certain things that our model had to accomplish, and we made sure that they were built into the model. There were 100 other things that honestly could go one way or another and really wouldn’t change things.”

Ken Kaiser, CBO
Temple University

Source: Temple University, Philadelphia, PA; Business Affairs Forum interviews and analysis.
### Three Areas Demanding Executive Attention

1. **Create Financial Accountability for Deans**
   - Align stakeholders with strategic goals through performance funding, seed funding, and policies.
   - Allocate some revenues and costs to align dean-level operational responsibility with institution-wide financial imperatives.

2. **Preserve Mission-Critical Activities**
   - Protect mission-critical but financially dependent units from harm in the new model to protect institution brand, and build central reserves for major investments.

3. **Incorporate Institutional Strategic Goals**
   - Align stakeholders with strategic goals through performance funding, seed funding, and policies.

### Executive-Level Decision Points (DP)

**Create Financial Accountability for Deans**
- Incent Deans to Grow Programs through Revenue Allocation
- **DP #1**: What Percentage of Revenue Should We Allocate Through an Activity-Based Formula?
- **DP #2**: How Should We Weight SCH Versus Majors in Tuition Allocation?
- **DP #3**: Should We Use Enrollment Smoothing to Allocate Tuition Revenue?
- **DP #4**: Should We Allocate Any Forms of Differential Tuition Revenue?
- **DP #5**: Should We Allocate Unrestricted State Appropriations?

**Preserve Mission-Critical Activities**
- **DP #6**: How Do We Allocate Overhead Costs to Maximize Incentives and Maintain Buy-In?
- **DP #7**: How Do We Regulate Unit Spending to Protect Institution Finances and Strategic Goals?

**Incorporate Institutional Strategic Goals**
- **DP #8**: How Do We Ensure Sufficient Central Reserves for Strategic Investments?
- **DP #9**: How Overt or Hidden Subvention Should Subvention Be?
- **DP #10**: How Do We Motivate Units Receiving Subvention to Still Make Financial Improvement?

Source: Business Affairs Forum interviews and analysis.
Aligning the Budget Model to Strategic Goals II

**Incorporate Institutional Strategic Goals**

**IV**
Ensuring the Budget Model Advances Student Success Goals

- DP #11: How Do We Incent Student Success Goals Through the Budget Model?

**V**
Ensuring the Budget Model Supports Research Goals

- DP #12: How Do We Incent Research Growth Through the Budget Model?

**VI**
Ensuring the Budget Model Spurs Strategic New Program Launches

- DP #13: How Do We Incent Targeted New Program Launches Through the Budget Model?

Source: Business Affairs Forum interviews and analysis.

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**Optimizing University Budget Models**

**Periodic Table of Budget Model Elements**

- **Revenue Allocation**
  - Methods to allocate university revenue to units

- **Cost Allocation**
  - Methods to assign expenses for university overhead

- **Strategic Funding**
  - Sources of funding for strategic objectives

- **Performance Targets**
  - Mechanisms to inflect unit behavior

Source: Business Affairs Forum interviews and analysis.
Relying on the Deans

Deans Possess Knowledge to Grow Programs and Reduce Costs

Information Asymmetry

- Institutional Leadership Knowledge
  - Overall institutional financial health
  - Strategies for long-term financial sustainability
  - Unit alignment with institutional goal and priorities

- Dean Knowledge
  - Academic programs in high demand
  - How to adapt existing curricula to changing market
  - Opportunities to reduce space utilization

Reasons Some Deans Not Focused on Unit P+L\(^1\) (As Much As We’d Like)

- Mission Focus
- Risks of Too Much Growth
- No Benefit to Reducing Costs

\(^1\) Profit and Loss statement,

Source: Business Affairs Forum interviews and analysis.
Breaking Down Base Budgets
Allocating Revenue and Costs to Instill Financial Accountability

Methods to Increase Dean Management of Unit P+L

Level 1: Incremental Budgeting
- Majority of institutional resources tied up in unit base budgets
- Guaranteed level of unit funding undermines incentives for financial accountability

Level 2: Greater Financial Transparency
- Institutions provide unit-level P+L to show net contributors and net 'takers'
- Transparency creates political pressure for deans to improve unit finances

Level 3: Revenue and Cost Allocation
- Revenue and cost allocation creates P+L transparency and financial accountability
- Deans incented to grow existing programs, reallocate resources, and reduce cost consumption

Create Financial Accountability for Deans
Executive-Level Budget Model Decision Points

I Incenting Deans to Grow Programs Through Revenue Allocation

Decision Point #1: What Percentage of Revenue Should We Allocate Through an Activity-Based Formula?

Decision Point #2: How Should We Weight SCH Versus Majors in Tuition Allocation?

Decision Point #3: Should We Use Enrollment Smoothing to Allocate Tuition Revenue?

Decision Point #4: Should We Allocate Any Forms of Differential Tuition Revenue?

Decision Point #5: Should We Allocate Unrestricted State Appropriations?

II Driving Unit-Level Cost Containment

Decision Point #6: How Do We Allocate Overhead Costs to Maximize Incentives and Maintain Buy-In?

Decision Point #7: How Do We Regulate Unit Spending to Protect Institution Finances and Strategic Goals?

Source: Business Affairs Forum interviews and analysis.
#1: What Percentage of Revenue Should We Allocate Through an Activity-Based Formula?

Varying Percentage of Revenue Allocated Through Activity-Based Formula

<table>
<thead>
<tr>
<th>Incremental or Zero-Based</th>
<th>Full RCM</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Incremental Revenue Only</td>
<td></td>
</tr>
<tr>
<td>70%</td>
<td></td>
</tr>
</tbody>
</table>

Source: University of California Davis, Davis, CA; The Ohio State University, Columbus, OH; University of Utah, Salt Lake City, UT; Business Affairs Forum interviews and analysis.

If It Ain’t Broke….

Select Institutions Successfully Use Centralized Models

**Arizona State University**

- Centralized model in which administration takes data-driven, strategic approach to identifying competitive opportunities at unit- and institution-level
- Promotes unit-level financial accountability through strong central oversight and guidance
- Center often dictates unit-level initiatives and provides the resources to invest

**University of Notre Dame**

- Incremental budget model with targeted investments made through a thorough vetting and prioritization process
- Units present priorities for upcoming three years through a business case detailing a clear business plan, long-term implications of requests, and alignment with strategic plan
- Revenue-sharing agreements for professional and online Master’s programs led to new program launches in law, business, and architecture

Source: Arizona State University, Tempe, AZ; University of Notre Dame, Notre Dame, IN; Business Affairs Forum interviews and analysis.
Allocating Just New Revenue Insufficient
Prevents Fund Reallocation and Undermines Holistic Financial Accountability

Underwood University1 Moving Toward Greater Revenue Allocation to Promote Unit-Level Financial Accountability

Current Modified RCM Model
- Units receive historical base-budgets each year
- Awards incremental revenues from increased SCH production and tuition increases to units formulaically to encourage and reward growth
- Incremental revenues absorbed into base budgets for subsequent years
- Goal is to perform rebasing exercise every decade to right-size inaccuracies in historical base budgets

Current Model Limitations
- Focuses purely on marginal gains rather than holistic unit financial performance
- Units not incented to make targeted investments or divestments within departments or programs as they are guaranteed a base-budget each year
- Prevents reallocation of funds across the institution
- Absorption of marginal growth into base budgets creates lack of transparency and accountability

“Our current model focuses too much on marginal transactions...deans come back each year with their hands out [for their base budget] and the tough conversations about ‘right your ship’ don’t happen.”

Budget Director
Underwood University

Erring on the Side of Allocation
Full Activity-Based Allocation Unlocks Base Budgets, Incents Growth

Percentage of Revenue Allocated Through Activity-Based Formula

0% 70% 100%

Works for a Few...
Select institutions with particular culture, mission, and leadership team can succeed with largely centralized budget models

...But Most Should be Here
- Creates organic flow of resources and unlocks unit base budgets for reallocation across institution
- Instills unit-level financial accountability as deans must examine value of programs and make targeted reallocations

Source: Business Affairs Forum interviews and analysis.
#2: How Should We Weight SCH Versus Majors in Tuition Allocation?

No Magic Number, Dean Preferences Should Guide Split

<table>
<thead>
<tr>
<th>Credit Hours</th>
<th>Majors</th>
</tr>
</thead>
<tbody>
<tr>
<td>85/15</td>
<td></td>
</tr>
<tr>
<td>80/20</td>
<td></td>
</tr>
<tr>
<td>75/25</td>
<td></td>
</tr>
<tr>
<td>70/30</td>
<td></td>
</tr>
</tbody>
</table>

Majority of Institutions

Limitation: Incentive to poach students from other colleges

Limitation: Weaker link between teaching costs and revenue

"The revenue split between credit hour and major depends a bit on what you want to incentivize, but honestly there’s no magic to our number."

Assistant Director, Finance & Budget
Mid-Size Public Research University

#5: Should We Allocate Unrestricted State Appropriations?

Philosophical Divide Trending Towards Retaining Centrally

Supplements Tuition

- Tuition Revenue + State Appropriations
- Allocation Formula
- Academic Colleges

Retained at the Center

- Tuition Revenue
- Allocation Formula
- Central Admin retains, allocates to colleges
- Academic Colleges

Most Shifting Toward Retaining State Dollars Centrally
- Institutions increasingly retain state money centrally as states divest from higher education
- Holding state appropriations centrally increases central spending discretion and shields colleges from state funding volatility

Source: Kent State University, Kent, OH; Business Affairs Forum interviews and analysis.
#6: How Do We Allocate Overhead Costs to Maximize Incentives and Maintain Buy-In?

**Difficult to Balance Need for Simplicity with Calls for Precision**

**Complexity of Overhead Cost Structure Creates Imprecision**
- Hundreds of indirect costs
- Many costs do not have a clear allocation metric
- Limited accounting software capabilities

**Unit Leaders Demand Precision**
- Some allocable costs fall outside unit leaders’ control
- Indirect costs and drivers difficult for units to understand
- Zero-sum game creates “winners-and-losers” mentality

**Allocation Inherently Imprecise**

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**A False Dichotomy?**

Balancing Simplicity and Precision to Incent Better Consumption Behaviors

**Relationship Between Number of Cost Pools and Potential to Inflict Behavior Change**

- Models with 4-6 cost pools maintain simplicity while encouraging cost containment.
- Simpler models with few cost pools or a flat overhead tax are easier to understand but do not encourage behavior change or draw dean attention to costs they control.
- Models with 10+ cost pools create precision but become too complex for deans to act upon.

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Source: Business Affairs Forum interviews and analysis.
To Charge or Not to Charge?

Break Out Easily Measured, Controllable Costs to Inflect Behavior Change

Potential Cost Pools by Ease of Measurement and Unit Control

- High benefit from charging for use
  - Campus Space
  - IT Support
- Moderate benefit from charging for use
  - Research Overhead
  - Business Services
  - Library Costs
- Lower benefit from charging for use
  - Student Services
  - General Admin

Source: Business Affairs Forum interviews and analysis.

Keeping It Simple

Select One or Two Cost Drivers Per Cost Pool

<table>
<thead>
<tr>
<th>Expense</th>
<th>Revenue Tax</th>
<th>Expense Tax</th>
<th>Faculty FTE</th>
<th>Staff FTE</th>
<th>Student FTE</th>
<th>SCH</th>
<th>Other</th>
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<td>G&amp;A</td>
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<td>✔</td>
<td>✔</td>
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<td></td>
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<td>✔</td>
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<td></td>
<td></td>
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<tr>
<td>Academic Affairs</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td>✔</td>
<td>✔</td>
<td></td>
<td>Majors, Degrees</td>
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<td>Library</td>
<td>✔</td>
<td></td>
<td></td>
<td>✔</td>
<td>✔</td>
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<tr>
<td>IT</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td>Fee-for-service</td>
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<td></td>
<td></td>
<td>Asgn. Sq.Ft, Quality Asgn. Sq.Ft</td>
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<tr>
<td>Research</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>ICR, ICR Tax</td>
</tr>
</tbody>
</table>

Source: Business Affairs Forum interviews and analysis.
Starting Where You Must
Allow for Some Complexity, Move Towards Simplicity Over Time

<table>
<thead>
<tr>
<th>Institution</th>
<th>Initial Number of Pools</th>
<th>Revised Number of Pools</th>
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<tbody>
<tr>
<td>Penn</td>
<td>20+</td>
<td>6</td>
</tr>
<tr>
<td>USC University of Southern California</td>
<td>100+</td>
<td>4</td>
</tr>
<tr>
<td>University of Delaware</td>
<td>7</td>
<td>2</td>
</tr>
</tbody>
</table>

...But Old Arguments May Resurface Over Time

“Every five years or so, a new group of deans will demand to move in the opposite direction on the spectrum between simplicity and precision. The pendulum swings back and forth.”
Stephen Golding, CBO
Ohio University

Evolving Cost Allocation with Campus Concerns
Two Types of Overhead Costs May Require Breakout as Model Matures

1 Costs Not Attributable to All Units
- Units that do not generate certain overhead charges resist paying for those charges
- Institutional approaches vary; choose breakout that best fits institution-specific model principles

Rutgers University
Breaks out Student Services into its own cost pool because research centers resist paying student-driven charges

Temple University
Does not discriminate among units when allocating costs, instead allocates on basis of the "common good"

2 Costs That Become More or Less Significant Over Time
- Break out or pool costs as their overall materiality changes to facilitate deans’ understanding of year-over-year cost changes and maintain buy-in

University of Pennsylvania
Initially rolled development costs into general overhead pool but broke costs out separately when launching major capital campaign

University of Alabama at Birmingham
Set a materiality threshold to dictate which cost categories were significant enough to warrant their own cost pools

Source: Ohio University, Athens, OH; University of Delaware, Newark, DE; University of Pennsylvania, Philadelphia, PA; University of Southern California, Los Angeles, CA; Business Affairs Forum interviews and analysis.
Incorporate Remaining Costs into a Single Pool

Weighing the Advantages of Using Revenues or Expenditures as a Driver

Relative Advantages of Two Common Drivers

<table>
<thead>
<tr>
<th>Type of Charge</th>
<th>Advantages</th>
<th>Disadvantages</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of Overall Revenue</td>
<td>• More stable</td>
<td>• Risks disincentivizing revenue growth</td>
<td></td>
</tr>
<tr>
<td>Share of Overall Direct Expenditures</td>
<td>• Promotes reduced cost consumption</td>
<td>• More volatile</td>
<td></td>
</tr>
</tbody>
</table>

Typical Expenses Pooled as General Overhead

- President’s Office
- General Counsel
- Budget and Finance
- Board of Trustees
- University Relations
- Compliance
- Risk Management

Source: University of Florida, Gainesville, FL; University of North Carolina, Chapel Hill, NC; Business Affairs Forum interviews and analysis.
Controlling the Impact of Allocation Incentives

Two Challenges Necessitate Central Reserves and Subvention

Center Starved for Resources
Allocating majority of resources through can leave the center with too few funds for important strategic priorities or cross-unit investments

Units Financially Isolated
Sole reliance on allocation formula for funding leaves units exposed to market fluctuations, potentially experiencing short-term losses and making drastic cuts

Optimizing Design and Deployment of Strategic Reserves and Subvention

Executive-Level Budget Model Decision Points

III

Optimizing Design and Deployment of Strategic Reserves and Subvention

Decision Point #8: How Do We Ensure Sufficient Central Reserves for Strategic Investments?

Decision Point #9: How Overt or Hidden Should Subvention Be?

Decision Point #10: How Do We Motivate Units Receiving Subvention to Still Make Financial Improvement?

Source: Business Affairs Forum interviews and analysis.
#8: How Do We Ensure Sufficient Central Reserves for Strategic Investments?

“The Limbs Thrive While the Body Dies”

Representative Tuition Revenue Distribution Model

- Tuition Revenue: ~$330M
  - 90% Academic Units $297M
  - 10% Subvention Fund $33M
  - Hold Harmless Funding $22M
  - Capital Projects $10M
  - Strategic Reserves <$1M

Source: Business Affairs Forum interviews and analysis.

Finding an Appropriate Tax Rate for Central Fund

Examples of Tax Rates to Fund Central Strategic Reserves

Source: Michigan State University, Lansing, MI; Miami University, Oxford, OH; Ohio University, Athens, OH; Rutgers University, New Brunswick, NJ; Thompson Rivers University, Kamloops, BC; Washington University in St. Louis, MO; Business Affairs Forum interviews and analysis.
Options for Gaining Academic Leader Buy-In

Incrementing Up Tax Rate Over Several Years

- Provost Fund financed through tax on traditional undergraduate net tuition
- In FY14, tax generated $3M
- In FY19, tax will generate $9M

Earmarking Portion of Strategic Funds for Faculty Priorities

- **Faculty Equity Fund**: $1M of central dollars earmarked for a Faculty Equity Fund, used to help the institution become nationally competitive in the marketplace and improve faculty retention

- **New Academic Program Fund**: Approximately 20% of central dollars are earmarked for an Academic Program Fund, used to develop new academic programs at the university

Sharing the Wealth

Finding a Middle Ground Between Use-It-or-Lose-It and Carry-Forward

**Percentage of Budget Surplus Retained by Unit**

<table>
<thead>
<tr>
<th>Percentage Retained</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>29%</td>
</tr>
<tr>
<td>100%</td>
<td>61%</td>
</tr>
</tbody>
</table>

**Disadvantages of Use-It-or-Lose-It**

- Encourages unproductive year-end spending
- Units unable to save for long-term strategic goals

**Disadvantages of Carry-Forward**

- No additional funding for central administration

**Observed range of gain-sharing percentage is 50%-80%**

Applying Gain Sharing at an RCM Institution

Institutions with a responsibility centered management (RCM) budget model utilize 100% carry-forward with academic units, but can use gain-sharing policies to incentivize administrative unit leaders to find savings.
Meaningful Savings and Strategic Reinvestment

Results from University of Guelph’s Gain-Sharing Program

Total Gain-Sharing Savings Over Five Years

- Surplus Kept by Units: $11.9M
- Surplus Returned to Center: $10.5M

Sample Reinvestment from Central Fund and Resulting Savings

- Initial Investment: $75K
- Resulting Savings: $450K

Central provided one-time seed funding for new technology in Mail Services.

Technology enabled unit to improve processes and reduce staff from 11 to 2.

Do Not Pass Go, Do Not Collect $200

Institutions with Use-It-or-Lose-It Can “Flip the Switch” to Gain Sharing

University of the Fraser Valley
Gain-Sharing Program

- Institution previously maintained a use-it-or-lose-it policy
- In FY14, the university transitioned to a 50/50 gain-sharing policy, where 50% of any unit surplus returns to the central business office
- At the end of FY14, the university achieved $2.5M in savings
- Central administration allocated $500K of its portion to the university’s Innovation Fund for new academic and non-academic initiatives

Considerations for Implementing Gain Sharing

- Institutions moving to gain sharing from use-it-or-lose-it are often able to pull back even more than 50% of unit surpluses
- Institutions should push for the most aggressive policy culture will allow and adjust the percentage split later if necessary
**A Trickier Transition to Gain Sharing**

Institutions with 100% Carry-Forward Must Take Incremental Steps

- **Carry-Forward with Restrictions**
  Unit leaders at the University of Denver must formally submit a proposal to the Provost or Vice Chancellor for Financial Affairs to request use of carry-forward funds. Proposals must indicate how investments made with carry-forward funds will further the university’s mission.

- **Carry-Forward with a Cap**
  Units at Simon Fraser University may only retain up to 9% of their total operating budget in carry-forward funds each year.

- **Carry-Forward with Commitments**
  Units at the University of Kansas, Baltimore County carry forward 100% of year-end surpluses, units (not central administration) must offset any cuts to state appropriations using carry-forward funds.

- **Carry-Forward Held Centrally**
  Units at the University of Kansas may carry forward 100% of year-end surpluses, but money is held centrally. Deans must request access to central funds but have full control over spending decisions.

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**#9: How Overt or Hidden Should Subvention Be?**

Hidden Subvention’s Appeal: Allay Concerns and Keep Funds Flowing

- **Examples of Hidden Subvention**
  - **Historical Base Budgets**
    Ohio State University applies revenue allocation formula only to new revenues, so units continue to receive historical base budgets with inherent cross-subsidies.
  - **Cost Allocation Formula**
    One university charges the same tax rate for all types of space in order to subsidize research, which occurs in significantly more expensive spaces.
  - **Weighted Credit Hours**
    University of New Hampshire reviews SCH weighting annually and makes adjustments every 2-3 years to ensure units are not disadvantaged.

- **Three Considerations Driving Hidden Subvention**
  1. **Avoid Political Battles**
     Leaders believe explicit subsidies create a hostile culture of winners and losers, undercutting support for units that are mission-critical but financially dependent.
  2. **Simplify Transfer of Funds to Units**
     Funds flow directly to units through allocation formula rather than adding another central calculation and allocation step.
  3. **Recognize Differences in Cost of Instruction**
     Weighted credit hours reflect legitimate differences in cost of instruction, inability to raise differential tuition.

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Source: Simon Fraser University, Burnaby, BC; University of Denver, Denver, CO; University of Kansas, Lawrence, KS; University of Maryland, Baltimore County, Baltimore, MD; Business Affairs Forum interviews and analysis.
Resisting the Siren’s Call
Hidden Subvention Brings Perverse Incentives, Deans See Through Ploy

Danton State University\(^1\) Walks Away from Hidden Subvention

College of Engineering burdened with high cost of instruction, can’t cover costs

Engineering grows by 25% between 2010 and 2015

Institution weights Engineering SCHs double, providing built-in subvention

Funds marked for investment elsewhere shift to Engineering, institution loses money on each new engineering student

Danton State shifts to overt subvention for better transparency of P+L, aligned incentives

Hidden Subvention Increases Political Tension
"Weighting credit hours is great for subvention in theory, but in reality it doesn’t work well because it’s confusing and deans waste so much time arguing over the right weighting. They can see through the ploy...we should have instead had a productive conversation about how much we value our unprofitable colleges."

CBO, Public Research University

Biting the Bullet
Overt Subvention Typically Funded Through an Explicit Tax

Observed Tax Rates to Fund Subvention Pool

- 4.25% tax rate on operating revenue complemented with nearly equal funding from investment income, auxiliary contributions, etc.
- Charging a higher tax for subvention would drive additional colleges into subvention

- 8% tax rate
  - University Fund supports both subvention and strategic initiatives

- 20% tax on tuition revenue and 10.5% tax on grant overhead
  - Approximately 75% of fund for subvention, 25% for strategic funds

Source: McMaster University, Hamilton, ON; Queen’s University, Kingston, ON; University of Pennsylvania, Philadelphia, PA; Business Affairs Forum interviews and analysis.
#10: How Do We Motivate Units Receiving Subvention to Still Make Financial Improvement?

Entrenched Subvention at One University Creates Entitlement Culture

1. New decentralized model goes live in 2007, leadership plans to wean units off subvention in a few years
2. Recession hits, and units experience severe financial strain
3. Leadership keeps subvention in place with understanding that once the institution reenters a growth mode, it will subside
4. Units become dependent on subvention
5. Decentralized budget model incentives are undercut; deans are hesitant to launch new programs for fear of losing subvention funds

"The deans became completely reliant on the subvention funds, and we couldn’t take it away. It’s like reducing someone’s salary."

— CBO, Private Research University

"Making units whole with subvention when they should be in a deficit is the same thing as incremental budgeting."

— CBO, Canadian Research University

Source: Business Affairs Forum interviews and analysis.

Distinguishing Temporary from Long-Term Support

Different Tactics for Motivating Under Bridge, Mission-Critical Subvention

**Bridge Subvention**
- Temporary subvention for colleges needing financial support while acting on new revenue and cost-saving incentives
- Allows colleges to focus on growth, avoid distraction of a major financial disruption

**Mission-Critical Subvention**
- Long-term subvention for colleges unlikely to reach financial independence but important to the institution’s mission
- Allows colleges to continue contributing to the institution while making incremental financial progress

**Miami University**
- Leaders identify that College of Engineering has growth potential
- Received subvention for first two years, next year will not receive any subvention

**Miami University**
- College of Creative Arts unlikely to become financially independent in near future
- Will continue to receive subvention

Source: Miami University, Oxford, OH; Business Affairs Forum interviews and analysis.
Phasing Out Subvention Acclimates Deans, Spurs Change

### Bridge Subvention

**Setting a Clear End Date**

<table>
<thead>
<tr>
<th>Year</th>
<th>Type of Hold</th>
<th>Description</th>
<th>Representative Institution</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Learning Year</td>
<td>One-year data-sharing period to familiarize units with new allocation formula before changing budgets</td>
<td>University of Delaware</td>
</tr>
<tr>
<td>2</td>
<td>Phased Implementation</td>
<td>Increase amount of funds subject to formula in predetermined increments</td>
<td>University of Wisconsin</td>
</tr>
<tr>
<td>3</td>
<td>Stop-Loss</td>
<td>Set limit on how much funding individual units can lose in a single year</td>
<td>Queen’s University</td>
</tr>
</tbody>
</table>

### Mission-Critical Subvention

**Subvention with Strings Attached**

Incenting Some Incremental Growth in Financially Dependent Units

**Common Mission-Critical “Loss Leaders”**

- College of Music
- College of Nursing
- College of Education
- College of Social Work

**For the Love of Subvention**

“Units love subvention because they can use the funds however they want—the center doesn’t have any leverage.”

*CBO, Private Research University*

**Mimicking the IMF**

“Providing subvention should be like the IMF giving a loan. We’re providing stability, but we also want to ensure units make some structural changes.”

*CBO, Canadian Research University*
Keeping Units on Their Toes
Wilfrid Laurier Annually Assesses Subvention Need, Unit-Level Strategy

Annual Subvention Process
Through Strategic Funds

Units submit proposals detailing how they will use funds to:

1. Increase value provided to institution
2. Reduce level of subvention needed in subsequent year

Unpredictability of next year’s subvention level incents deans to act in good faith to make incremental progress

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Faculty of Music Launches Revenue-Generating, Mission-Supporting Venture

- Elite Faculty of Music teaches 100 students, has high cost of instruction
- New annual justification for subvention makes dean more cost-conscious
- Faculty launches revenue-generating conservatory for K-12 students who pay for instruction
- New conservatory also supports mission; faculty will identify top young talent to recruit to their programs

---

Source: Wilfrid Laurier University, Waterloo, ON; Business Affairs Forum interviews and analysis.
Rebalancing the Scales

Ensure Financial Accountability Does Not Distract from Central Priorities

Sole Unit Focus on P+L Risks

- Derailment of Long-Term Strategy

The College of Arts and Sciences at one institution continued to add courses for space-constrained foreign language programs rather than science programs important to state

Instead of prioritizing online programs, faculty in one university’s College of Engineering invested in new electives for existing students to boost SCH revenue

Central Intervention Necessary to Focus Unit Effort on Campus Goals

- Institutional strategic goals position institution for long-term financial success, but require unit-level focus and investment

- Central incentives and policies align unit focus on P+L management with institution-wide priorities

Source: Business Affairs Forum interviews and analysis.

Aligning Local Decisions with Central Strategy

Framework to Advance Strategic Goals Through College-Level Investments

1. Incent Outcome Measures

Determine metrics that track progress toward strategic goals and use performance funding to incentivize units to advance those metrics

2. Direct Seed Funding

Award seed funding to units that propose resource-intensive investments in initiatives that advance institutional strategic goals

3. Correct Perverse Incentives

Implement oversight and policies to correct unintended consequences or perverse incentives of new model

Three Common Strategic Goals

Advancing Student Success

Launching Targeted New Programs

Growing Research

Source: Business Affairs Forum interviews and analysis.
Incorporate Institutional Strategic Goals

Executive-Level Budget Model Decision Points

IV Ensuring the Budget Model Advances Student Success Goals

Decision Point #11: How Do We Incent Student Success Goals Through the Budget Model?

V Ensuring the Budget Model Supports Research Goals

Decision Point #12: How Do We Incent Research Growth Through the Budget Model?

VI Ensuring the Budget Model Spurs Strategic New Program Launches

Decision Point #13: How Do We Incent Targeted New Programs Launches Through the Budget Model?

Incent Outcome Measures

Beyond Credit Hours and Majors

Riverside Builds Student Success Metrics into Tuition Allocation Method

UC Riverside’s Tuition Revenue Allocation Formula

- 60% SCH
- 20% Majors
- 20% Performance Funding Pot

10%

- Rewards gains in first-year retention rates
- Institution-wide first-year retention target of 95%
- Colleges not penalized when students change majors

10%

- Rewards gains in 4-year graduation rates
- Institution-wide 4-year grad rate target of 75%
- Unit awards based on incremental progress towards target

Source: University of California, Riverside, Riverside, CA; Business Affairs Forum interviews and analysis.
Incent Outcome Measures

UK’s Performance Pot Incents Improved Retention

Kentucky’s Performance Funding Award Allocation

$5M Performance Funding Pot

75% awards undergraduate retention gains

$3.75M Increase in First-Time, Full-Time, Fall-to-Fall Students Retained

25% awards graduate retention gains

Yield Per Student Award Rate

<table>
<thead>
<tr>
<th>College</th>
<th>YOY Increase in Students Retained</th>
<th>Award Rate Per Student</th>
<th>Total Award</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>20</td>
<td>$7.5K</td>
<td>$150k</td>
</tr>
<tr>
<td>B</td>
<td>250</td>
<td>$7.5K</td>
<td>$1.875M</td>
</tr>
<tr>
<td>C</td>
<td>70</td>
<td>$7.5K</td>
<td>$525k</td>
</tr>
<tr>
<td>D</td>
<td>160</td>
<td>$7.5K</td>
<td>$1.2M</td>
</tr>
</tbody>
</table>

Year One Results

Of UK’s undergraduate colleges improved retention, received funding awards

10/11

Percentage increase in number of students retained by College of Business and Economics, largest award recipient

32.6%

One college focused on SCH production to “game” RCM revenue allocation, did not receive funding

Source: University of Kentucky, Lexington, KY; Business Affairs Forum interviews and analysis.

Direct Seed Funding

Lowering the Barrier to Entry

University of Maryland System Seed Funding Facilitates Course Redesign

Strategic goal of improving student outcomes through course redesign

Seed funding provided on matching basis

- UMD system provided matching funds to institutions up to $20K
- Institutions used funds to redesign courses by collapsing sections, flipping classes, and planning active learning modules

7%

Average drop in DFW rate (e.g., from 20% to 13%)

100%

Efforts sustained past 2-3 year design and implementation period

$1.8M

Total cost savings and avoidance across 57 courses

Source: University of Maryland, College Park, MD; Business Affairs Forum interviews and analysis.
Not Sacrificing Throughput for Efficiency’s Sake

UC Davis Intervenes to Safeguard Access to Critical Summer Courses

Institution places programmatic emphasis on summer courses to accelerate student time-to-degree

Budget model monitoring reveals departments are cutting under-enrolled summer courses to control costs

Provost incents college to offer graduation-critical summer courses with additional funds

Provost Instructional Needs Funding

- Time-to-degree critical courses guaranteed revenue allocation based on course enrollment targets, regardless of actual enrollments
- 300 out of 700 summer courses deemed critical and eligible for backfill funding
- Eligible courses include:
  - 100-level courses that are prerequisites for staying on-track in major
  - 100-level courses required of a large number of students
  - Upper division writing courses required of a large number of students

Source: University of California, Davis, Davis, CA; Business Affairs Forum interviews and analysis.

Keeping a Watchful Eye

UC Riverside Integrates KPI Monitoring into Annual Budget Process

Units Complete Standard Budget Template

- Units submit annual budget templates with P+L data
- Templates force units to report key performance indicators of central interest

Reported Student Success KPIs

- Average class sizes
- % of classes taught by adjuncts
- Number of faculty course releases
- Student:advisor ratio
- First-year retention rate
- 4- and 6-year graduation rates

Center Monitors KPI for Unintended Consequences

- Center tracks KPI data by college for inverse relationships that indicate units are sacrificing quality for revenue gains
- Provost intervenes, course corrects as necessary, reviewing 3-year trends in KPIs

“We want to make it clear that student success is a priority for UCR. We track it and built it into our revenue allocation model.”

Maria Anguiano, CBO
University of California, Riverside

Source: University of California, Riverside, Riverside, CA; Business Affairs Forum interviews and analysis.
EAB Compendium of Budget Model Profiles

Resource in Brief

• Provides comprehensive budget model overview of profiled institutions
• Areas of detail include allocation methodology, cost methodology, subvention, and performance metrics related to institutional strategic goals
• 10 draft model profiles completed to date; final compendium will include 25+ model profiles spanning diverse Carnegie Classifications and geographies

University of Washington - Bothell, 03.15.2017

Let Us Know How We Did

Type This Link Into Your Browser to Evaluate Today’s Presentation by Ron Yanosky


Please note that letters in this link are case sensitive

• Please take a minute to provide your thoughts on the presentation.
• Enter your contact information to receive a copy of the evaluation report.

THANK YOU!
Summary of Decision Points by Type of Advice

Revenue and Cost Allocation Decision Points

<table>
<thead>
<tr>
<th>Decision Point</th>
<th>Competing Options</th>
<th>Recommended Right Answer</th>
<th>A Third Way</th>
<th>EAB Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>#1 What Percentage of Revenue Should We Allocate Through an Activity-Based Formula?</td>
<td></td>
<td>✓</td>
<td></td>
<td>Most institutions should allocate bulk of revenue (70% or more) via an activity-based formula to break up base budgets and create P+L incentives for deans.</td>
</tr>
<tr>
<td>#2 How Should We Weight SCH Versus Majors in Tuition Allocation?</td>
<td>✓</td>
<td></td>
<td></td>
<td>Most institutions utilize a split between 85/15 and 70/30, but more important for senior leaders to set range and let deans pick exact split for buy-in.</td>
</tr>
<tr>
<td>#3 Should We Use Enrollment Smoothing to Allocate Tuition Revenue?</td>
<td></td>
<td></td>
<td>✓</td>
<td>Allocate tuition revenue based on current-year projections and establish central loan pool to quickly reward growth and smooth unit budget volatility.</td>
</tr>
<tr>
<td>#4 Should We Allocate Any Forms of Differential Tuition Revenue?</td>
<td></td>
<td>✓</td>
<td></td>
<td>Aside from rare exceptions, institutions should not allocate out-of-state tuition, financial aid, or weighted credit hours to avoid perverse incentives and keep deans focused on right priorities.</td>
</tr>
</tbody>
</table>
## Revenue and Cost Allocation Decision Points

<table>
<thead>
<tr>
<th>Decision Point</th>
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</thead>
<tbody>
<tr>
<td>#5 Should We Allocate Unrestricted State Appropriations?</td>
<td>✓</td>
<td></td>
<td></td>
<td>Institutions can either allocate state funds along with tuition or hold centrally for subvention or strategic investments. Senior leaders must decide on which method to use early in the design process.</td>
</tr>
<tr>
<td>#6 How Do We Allocate Overhead Costs to Maximize Incentives and Maintain Buy-In?</td>
<td></td>
<td>●</td>
<td>✓</td>
<td>Institutions should aim for 4-6 cost pools and 1-2 drivers per pool to strike a balance between simplicity and precision.</td>
</tr>
<tr>
<td>#7 How Do We Regulate Unit Spending to Protect Institution Finances and Strategic Goals?</td>
<td></td>
<td>●</td>
<td></td>
<td>Institutions should integrate oversight of unit-level spending decisions with ongoing central resource planning to ensure unit alignment with institutional finances and strategic goals.</td>
</tr>
</tbody>
</table>

Source: Business Affairs Forum interviews and analysis.

## Mission-Critical Activities Decision Points

<table>
<thead>
<tr>
<th>Decision Point</th>
<th>Competing Options</th>
<th>Recommended Right Answer</th>
<th>A Third Way</th>
<th>EAB Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>#8 How Do We Ensure Sufficient Central Reserves for Strategic Investment?</td>
<td></td>
<td>✓</td>
<td></td>
<td>Institutions should create a separate 3-5% tax on all revenue to fund central strategic reserves, and promise to use a portion of funds on unit priorities to win buy in for tax.</td>
</tr>
<tr>
<td>#9 How Overt or Hidden Should Subvention Be?</td>
<td></td>
<td>✓</td>
<td></td>
<td>Institutions should make subvention as overt as possible to avoid perverse incentives and maintain P+L transparency.</td>
</tr>
<tr>
<td>#10 How Do We Motivate Units Receiving Subvention to Still Make Financial Improvement?</td>
<td></td>
<td></td>
<td>●</td>
<td>Institutions should set a clear end date for units on bridge subvention and allocate subvention with strings attached for mission-critical units to continuously motivate deans.</td>
</tr>
</tbody>
</table>

Source: Business Affairs Forum interviews and analysis.
<table>
<thead>
<tr>
<th>Decision Point</th>
<th>Competing Options</th>
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<tbody>
<tr>
<td>#11 How Do We Incent Student Success Goals Through the Budget Model?</td>
<td>✔️</td>
<td></td>
<td></td>
<td>Institutions can use financial incentives and seed funding to encourage units to achieve student success goals. Institutions should monitor and correct for perverse budget model incentives that may impede student success.</td>
</tr>
<tr>
<td>#12 How Do We Incent Research Growth Through the Budget Model?</td>
<td>✔️</td>
<td></td>
<td></td>
<td>Institutions can use financial incentives and seed funding to encourage units to achieve research growth goals. Institutions should monitor and correct for perverse budget model incentives that may impede research growth.</td>
</tr>
<tr>
<td>#13: How Do We Incent Targeted New Program Launches Through the Budget Model?</td>
<td>✔️</td>
<td></td>
<td></td>
<td>Institutions can use financial incentives and seed funding to encourage units to launch targeted new programs. Institutions should monitor and correct for perverse budget model incentives that may impede new program launches.</td>
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