

Notes*

Senate Committee on Finance and Planning
Friday, February 18, 2005
2:00 – 4:00
488 Children's Rehab

[Note: these are notes from a discussion with John Curry, a consultant on Responsibility Center Management, Executive Vice President at MIT, who visited to discuss the University's budget model, currently labeled Incentives for Managed Growth. Some of the members of the Senate Committee on Finance and Planning joined Professor Curry for a discussion. Professor Campbell, Speaks, and Van den Bosch and Messrs. Fitzgerald and Klein were present.]

-- There should be scheduled reviews of a university's financial system.

-- Responsibility Center Management (hereinafter RCM) seems to be only about money. But there is no university that is not about money (that is, about quality). It is better to talk about the facts, which RCM can provide, than to talk about budgetary lore (who gets what and why). Understanding the flows of money helps to understand money (universities are more complicated than corporations because of the extreme variety of their activities—different disciplines, intercollegiate athletics, residence halls, etc.).

-- There are two bottom lines for any university: first is quality, second is financial. Quality means how good you are—the quality achieved for the money involved. If a university does not talk more about this, it is doing something wrong; nothing in RCM begets quality. But using RCM can help get ahead in terms of quality (a university can understand its revenues and seize opportunities). The faculty hold ultimate authority on campus; what often is missing is a faculty understanding of finances and the consequences of decisions (e.g., smaller classes means a decline in tuition income, and at places where funds are held centrally, a decision in one unit to decrease class size has effects on other parts of the university).

-- There is a Gresham's law at work: if an institution goes for revenues on the cheap at the margin, it will sully the reputation of its quality programs. Cheap dollars can be obtained quickly but they do long-term damage.

-- RCM can unleash entrepreneurialism, but without strong central leadership to guide the institution towards its goals, the whole will be increasingly less. Strong schools in these circumstances may not benefit the institution. RCM needs strong deans and a strong central administration. With strong deans and a weak central administration, there is the danger of centrifugal force tearing the institution apart. With a weak dean and strong central administration, the dean will be unable to work with the faculty.

-- Space is perhaps the university's biggest investment and is treated as a free good until a unit needs more. The institution probably has under-used space while spending money on new buildings, but it could probably solve some space problems with musical chairs and using space more efficiently. Space costs should be allocated to units.

* These minutes reflect discussion and debate at a meeting of a committee of the University of Minnesota Senate or Twin Cities Campus Assembly; none of the comments, conclusions, or actions reported in these minutes represents the views of, nor are they binding on, the Senate or Assembly, the Administration, or the Board of Regents.

-- Organizations should be decentralized in proportion to their size and complexity (no one is smart enough to run a place like this). Often authority is not devolved and decisions can be made at central levels without realizing their effects.

-- One thing that plagues RCM systems is that they may be losing the whole and the commons. The problem of the commons is usually solved by taxes on the units. The University has many commons: shared physical places outside departments/units, information technology, quality of student life outside instructional settings. Leaders must hold them as values and find ways to fund them or centrifugal forces will overcome them.

-- With respect to strong departments: in RCM, financial information should be broadly distributed by the dean. If that does not happen, the dean has missed the point. The strong provost/dean model is the same at the college level; there should be a strong dean/chair, and the benefits of RCM are lost if information is not shared.

-- (A question about support for interdisciplinary work under RCM) Disciplines are often the barrier to interdisciplinary research. The first barrier is not who earns the money, it's "what's in it for me?" The perception is that RCM is a barrier to interdisciplinary research, but in fact clarity about who has what can help rather than hinder. One possibility is to treat funding for interdisciplinary research as venture capital; the central administration might provide start-up funding. (Dr. Kvavik, host to the meeting, noted that former President Yudof put an enormous amount of money into interdisciplinary activities; this is a question of leadership priorities.)

-- (A question about the definition of strong leaders) Strong means strength as a faculty member in research and teaching, strength of personality, and once an organization reaches a certain size, strength in the management staff (e.g., professional financial officers).

-- (A question: Something the faculty must buy into: allocation of costs as well as revenues, which the University does not now do) A hole in the University of Minnesota system is that it does not allocate some central costs, especially space. It could trade dollars for square feet. The costs are known (utilities, maintenance, operations); the data are not perfect but are pretty accurate. If a unit is in a bad or old building, allocate actual costs to the unit so that the system starts out neutral. Then there will be incentives to turn off lights, etc., and to get rid of unused space. The administration can broker use of space, and it will cost a lot less to reconfigure space for new use than to build new space. There might be three categories of space: wet/clean labs, an in between category, and office space. Each has identified costs, and a small percentage of the costs could be allocated to create a pool to renovate space or add new space to supplement state funds. Allocating space costs provide an opportunity to calculate space consequences of increased activities (e.g., to increase research will require more space; a unit can ask if it can afford the space and how it might pay for it—which might be through local funding, money from the provost, or fund-raising).

-- Some market mechanism is better than none; any ability to trade will lead to a better allocation system. It is more important that there be a mechanism than that an institution have the right mechanism.

-- (Comment/question: Dr. Curry maintains that deficits should not be forgiven if a dean incurs one. Does this create incentives to increase balances and pass up opportunities?) Balances are carried forward but there could be an incentive to increase balances. The goal is a zero balance because the money is supposed to be spent on faculty and students. Savings should be reasonable. Generally RCM does not have much effect on balances. Much funding is held in departments, not by deans. If all the

money in balances is restricted and cannot be used to support the infrastructure, there is a problem. If a department chair wants money, the dean has two questions: how much will you put up and how much do I need to put up?

-- (Comment: reserves reflect the risk dynamic of a unit more than educational opportunities; it is easy to focus on reserves and not opportunities.) That means the college or department is becoming a banker, people not inclined to risky spending. If balances are too large, there is need for a conversation because a unit is foregoing opportunities. The goal is to have a small amount of money (from operations) as a cushion and a large endowment (usually from fund-raising). Excessive reserves from operations means a unit is missing opportunities (this does not mean a unit might not save money for five years for a big project).

-- (Question about what happens if a dean or president leaves tails for a new person on the job.) That is probably a problem no matter the budget structure. At one institution, the department/college receives a "profit and loss" statement each month (revenues minus expenses) compared with the budget, with the previous year, and with a projection of balances at the end of the year. These statements cause units to get used to looking at revenues and begin to understand the rules better; they reinforce responsibilities. If a unit is to meet a deficit, they need to know they have one (e.g., the number of students has dropped and tuition revenues are down—the earlier the information is provided, the better the situation can be managed).

-- (Question about funding the commons) They need to have powerful and credible champions (no RCM center calls for a new parking garage and no dean calls for funds for a library or a rec center). The case must be two-fold: if the schools must pay for common goods, the costs must be imposed on them; if the president or provost retains sufficient funds, they can fund common goods through additional funds to the RCM centers—or they can raise the money and charge nothing to the RCM centers.

-- (Question whether RCM is sensitive to economic conditions) It is, but RCM might provide a better opportunity to weather adverse circumstances because there are more opportunities in the system to adapt. In a centralized system, if there is a big cut, it is typically imposed across the board. In RCM, some deans may not be a victim of an economic cycle or may have alternative ways to generate funds or cut costs. If there is a federal system, the problems may be decentralized to the units. (If enrollment declines, there is a problem in those units, initially, and they may need help. One institution uses a "smoothing" rule (two year averages) on tuition revenues, for example, so that one downturn does not affect funding immediately. The first order of responsibility is in the unit; if there is a disaster, the central administration steps in. But a bad economy usually hurts everyone to some extent.

-- At one institution, the dean of the medical school maintained that the liberal arts were a cost sink and that the medical school was underwriting the liberal arts. Once an RCM system was adopted, it became evident that the liberal arts were underwriting the medical school because the arts and sciences were a revenue generator.

-- With RCM, one can answer questions about subsidies and the argument is about the data. RCM makes it possible to understand reasons for subsidies.

-- There are certain principles of RCM that need to be understood (all of the following are direct quotes from Responsibility Center Management: Lessons from 25 Years of Decentralized Management):

-- the closer the decision-maker is to the relevant information, the better the decision is likely to be

- the degree of decentralization of an organization should be proportional to its size and complexity
 - responsibility should be commensurate with authority and vice versa
 - the central administration should retain sufficient academic and fiscal leverage to ensure achievement of institutional goals
 - clear rewards and sanctions are required to make distribution of responsibility and authority operational, as well as to effect their coupling
 - resource-expanding incentives are preferable to resource-dividing rules
 - successful decentralization requires common information systems providing local and central managers with timely and accurate performance reports
 - outcome measures are preferable to input (process) controls
 - achievement of academic excellence requires that academic performance criteria be explicit and, where possible, quantified
 - stable financial situations facilitate good planning
 - people play better games when they own the rules
- Subventions should not be ossified. And subventions can be money—or they can be priority (e.g., in fund-raising). For example, agreement to participate in a multi-disciplinary research project may mean that a unit gets to the top of capital priorities. The administration can also provide access to debt/financing.
- (Does RCM address life-cycle costs?) Universities generally are bad at this. They often replace things with gift money or state funds; they rarely depreciate things.

-- Gary Engstrand

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