

A blue-tinted photograph of a forest with a gravel path leading through trees. The path is in the foreground, and the trees are in the background. The overall mood is serene and natural.

KENNEDY & COMPANY

Innovative Strategies for Higher Education

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**How RCM Fails...
and How it Can Still Be Used**

For large and complex colleges and university, decentralized budgeting strategies such as Responsibility Center Management (RCM) have served as a means of delivering greater autonomy to academic units. This shift towards decentralized budget modeling has been exacerbated over the last 15 years with declining state appropriations, higher competition for traditional undergraduate students, and the rise of online programming. More than ever, academic and financial leaders are being pushed for stronger financial performances from Boards of Trustees, while also hearing calls for greater budget autonomy from Deans. All the while, institutions are trying to look forward to identify the optimal allocation of faculty lines and student support services within the institution and each individual academic unit to support and enable growth in the future.

Although some stakeholders push for decentralized budgeting models, they are not right for all institutions. Only the largest and most complex institutions serving multiple funding sources, academic units, and constituencies should consider a fully decentralized budget model. The implementation, training, and administration of these decentralized budget models is too complex for small institutions.


In many cases, institutions should only consider a fully decentralized budget model if they:

- ❖ Contain 5+ degree-granting units
- ❖ Have at least a \$200MM of operating budget, and
- ❖ Derive significant funding from multiple sources (e.g., tuition, research, auxiliaries, and/or state appropriations)



In fact, some institutions that have implemented decentralized budgeting models have abandoned them due to large drops in state appropriations, incentives that have unintentionally fomented internal competition, governance models that do not adequately protect the core curriculum, or a greater competition amongst academic units for a revenue pool that is not growing rapidly enough. In these cases, senior leaders are forced to scale back or unwind decentralized budgeting models to maintain greater central control over institutional resources.

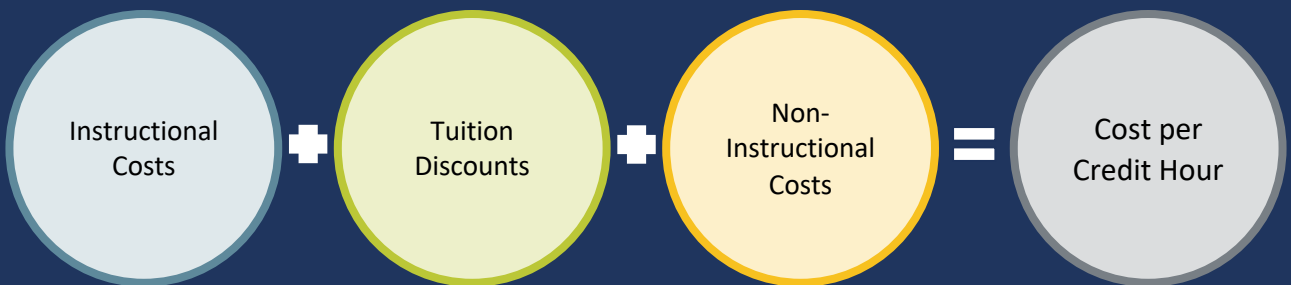
Institutions that have abandoned decentralized budgeting models are often left with complex challenges to integrate the legacy processes and philosophy back into a base budgeting framework. However, all institutions—regardless of their current budget structure—can find some benefits from components of decentralized budgeting models. Specifically, this can be done by tying strategic priorities to financial incentives for academic units. Academic units are more efficient in their operations when given greater control over their own budgets. In turn, this greater control over budgets (which is often guided by central leadership) and incentives for efficient operations at the unit level leads to budgetary benefits that roll up to the institutional level.



For both 1) institutions moving away from RCM budget models and 2) those operating under a more standard base budgeting framework, some decentralized structure(s) can more effectively tie financial incentives to institutional strategies. Nearly all these strategies allow senior leadership to monitor and modify the incentives to reward academic units as goals shift and evolve at the institutional level. What are some of these strategies? And how can institutions incorporate them into their current budget model?

COST OF INSTRUCTION MODELING

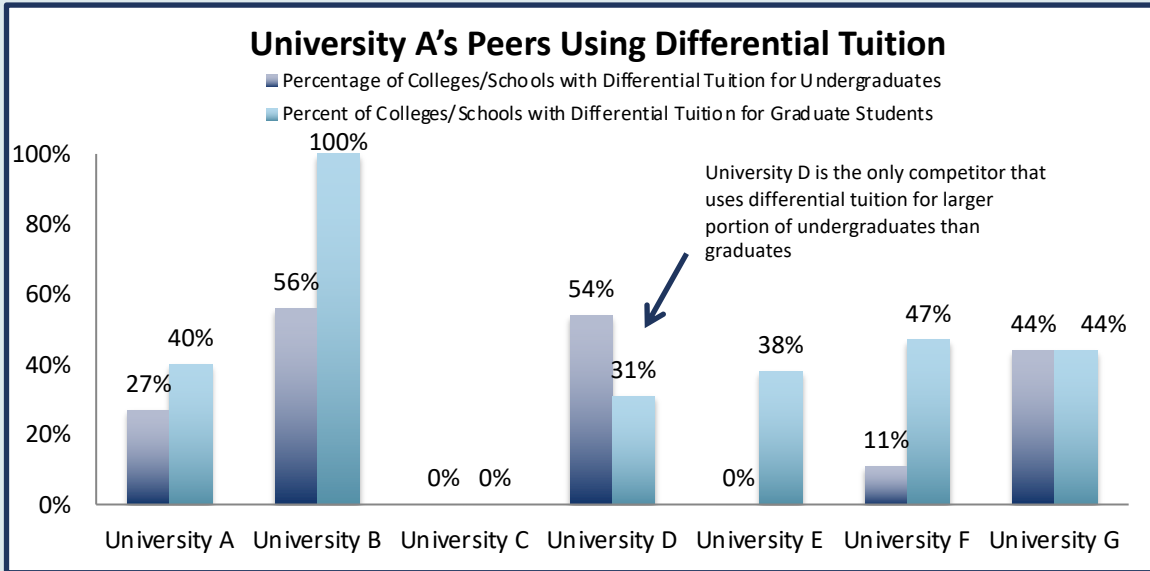
Institutions can easily assess their high-level financial picture and understand in aggregate how they are performing via their annual reporting process. However, they often find difficulty in generating insights on the revenues and costs incurred by academic units to determine the equitable distribution of shared services, cost of delivery, and revenue generation within a School or College. Understanding the decentralized financial picture for each academic unit helps institutions answer important questions such as, “How should we spend additional marketing dollars?” or “Which academic units are most in need of strategic funds?” The key to this analysis is the process of normalizing indirect costs via various proxies to help assess the important charges of Facilities, Information Technology, Marketing, Enrollment, and other central services equitably across the users of those services, especially as student demand for central resources evolves. Over the last ten years, the National Center for Education Statistics (NCES) reports that costs to deliver student services and institutional support have grown 12.3% faster than tuition revenues at public four-year institutions (National Center for Education Statistics, 2021a) and 14.6% faster than tuition revenues at private, non-profit, four-year institutions (National Center for Education Statistics, 2021b). The equitable sharing of indirect costs allows for the “right” allocation of revenues and costs within each academic unit and also provides a clear picture of the financial performance of Schools and Colleges to serve as a baseline for forecasting in future years and scenario planning for cost increases, appropriations changes, or new investments to enhance the student experience.



Factors for Cost Accounting

- | | | | |
|------------------|------------------|-------------|--|
| ❖ Faculty salary | ❖ Scholarships | ❖ Marketing | <i>Calculated for all academic programs + certificates</i> |
| ❖ Fringe rates | ❖ Grants | ❖ Supplies | |
| ❖ Teaching load | ❖ Assistantships | ❖ Travel | |

DIFFERENTIATED TUITION PRICING



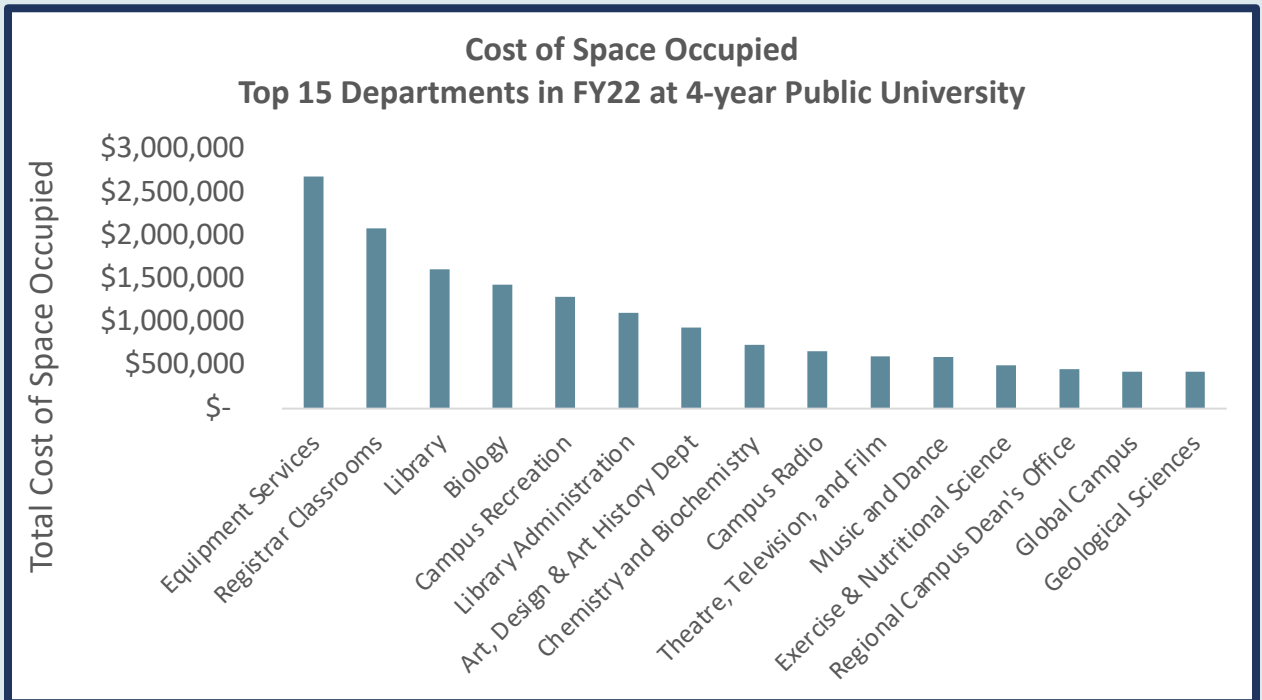
Source: Kennedy & Company Anonymized 4-Year Public University Client Deliverable

At most institutions, undergraduate tuition rates are the same (or very similar) for all courses of study. However, colleges and universities can leverage pricing strategies used by the private sector to dynamically price tuition within each academic unit to its specific market. With an effective understanding of external market conditions through market and competitive analysis for similar programs, institutions can determine applicants' propensity to yield based on specific demographic and financial variables. This allows institutions to understand the pricing power of each academic unit based on its elasticity of demand, incoming test scores / GPA, mix of residents vs. non-residents, and tuition discounting structures.

Just as an airline might differentiate between fare classes to price its offerings to customers with varying preferences and price points, institutions can implement market-based pricing by matching sticker prices and net prices by academic unit to optimize net tuition revenues for student demand. This practice is common in the field of Masters credentials, particularly amongst MBA programs vs. other Business master's program offerings. In many cases, efforts to implement differential pricing structures are low since variable net prices are already assessed to students within each academic unit (or program) via discounting strategies that benefit students in some units more than others. This allows institutions to maximize revenues while and align tuition dollars to the academic units that need them most to continue to grow.

SPACE CHARGE MODEL

Most institutions throughout the country offer space free of charge to academic and administrative units as a “common good.” However, at nearly every institution, operations and maintenance costs for space are the largest non-salary costs that institutions incur (Duke University Financial Services, 2023) and in Kennedy & Company’s experience with clients, this typically amounts to, \$15–\$25 annually per assignable square foot. Further complicating matters, some campus spaces cost much more than others (e.g., research spaces and laboratories). Institutions utilizing decentralized budget models can pass these costs along to academic units as a strategy to drive efficient space usage and better match space investments to space needs. Even for institutions on base budgeting models, providing “shadow bills” that outline the costs incurred for space occupancy and maintenance at each academic and administrative unit allows for awareness of space costs and provides behavioral incentives for the efficient and optimal usage of space. This greater level of data also allows for central leaders to make more data-informed space decisions with far-reaching impacts. Specifically, this data can enable the launch of more virtual program offerings, hoteling or office sharing arrangements, and utilities savings sharing pools.



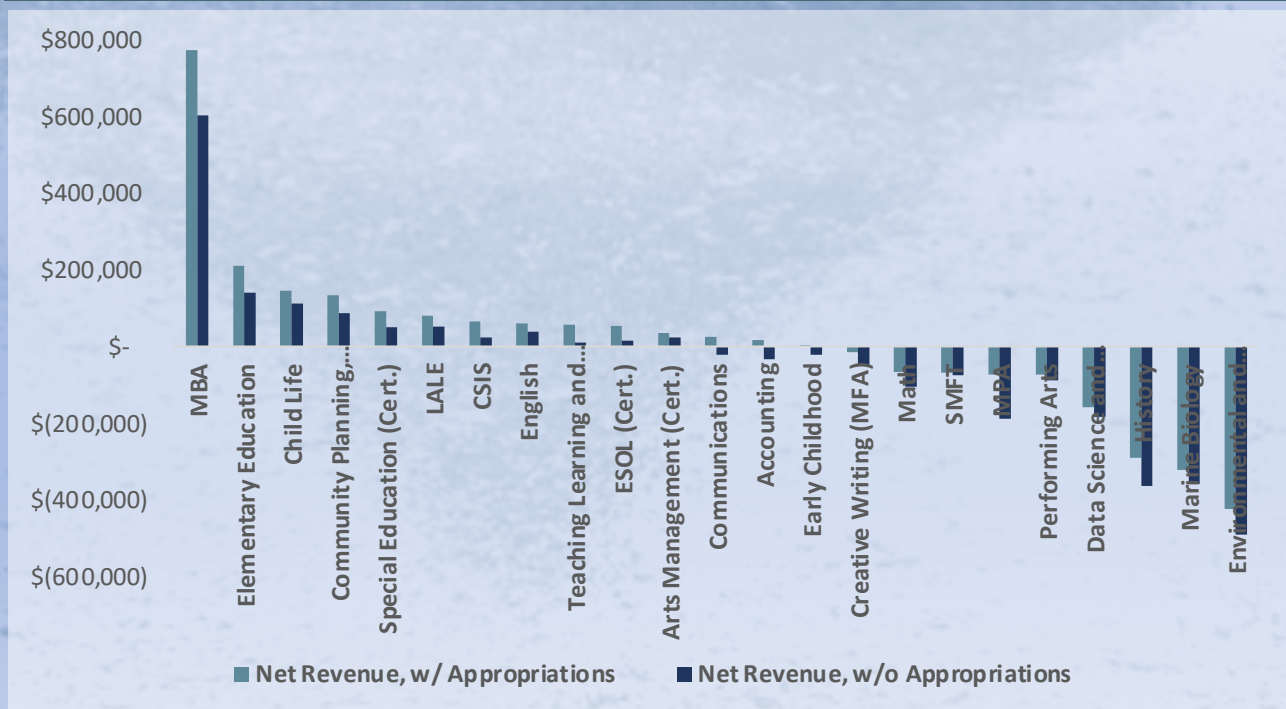
Source: Kennedy & Company Anonymized 4-Year Public University Client Deliverable

FINANCIAL INCENTIVES FOR MEETING ENROLLMENT STRATEGIES

In base budgeting models, academic units are not empowered to generate their own enrollments at the undergraduate level, thus creating a structure with no financial incentives for them to grow or strategically target new markets. Institutions with decentralized budgeting processes focus on delivering some financial incentives for academic units that increase their enrollments to provide a structure that fosters innovation in new program development. Additionally, when structured appropriately, these incentives can and should prevent academic units from entering into arrangements with external firms via revenue share agreements to fast-track the launch of new programs but significantly limit upside.

Importantly, senior leaders must set up a governance structure that ensures a sharing and coordination on the courses within the core curriculum to avoid cannibalization and competition within the institution for the same students. Research suggests that five years after full implementation, tuition revenues can increase up to 15% under a decentralized budgeting model with greater incentives to academic units for meeting enrollment goals (Jaquette, Kramer & Curs, 2016). Putting these dollars generated from growth back in the hands of Deans provides an opportunity to “grow the pie” for the entire institution.

Net Revenue, by Graduate Program Inclusive of Direct + Indirect Costs



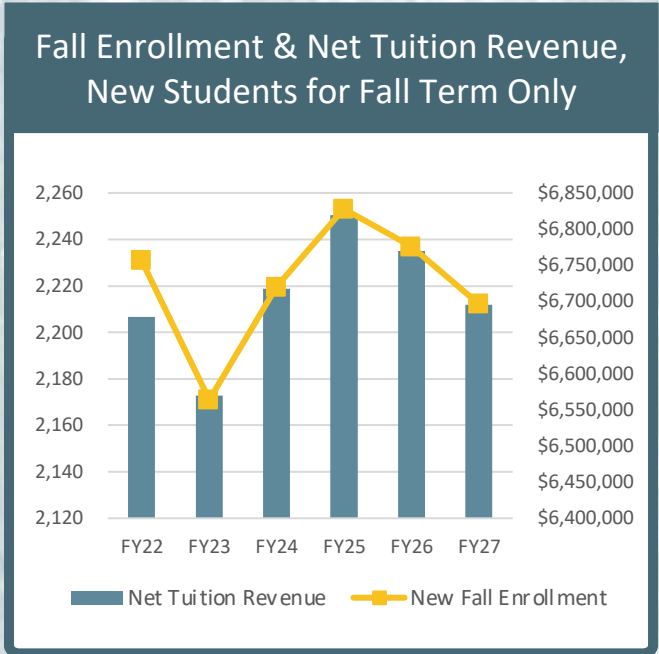
Source: Kennedy & Company Anonymized 4-Year Public University Client Deliverable

ENROLLMENT FORECASTING

Upcoming demographic challenges resulting from fewer high school graduates, increasing competition, and changing student demands have made it harder for institutions to project their year-to-year enrollments, both in aggregate and at the academic unit level. Between 2022 and 2030, the Western Interstate Commission for Higher Education (WICHE) projects a 3% decline in the number of high school graduates nationwide, as the annual total of high school graduates peaks in 2024-2025 and declines continue beyond 2030 (WICHE, 2020).

Institutions must be conscious of shifts in the mix of traditional and nontraditional students, particularly as the number of traditional prospective high school graduates declines and demand for nontraditional credentials, short-courses, and online modalities continues to grow post-COVID. These uncertainties and gradual shifts in the market for undergraduate education lead to myriad problems, including strategic faculty hiring, academic capacity and space planning, and budget forecasting for future years.

By engaging in a more thoughtful and rigorous enrollment forecasting process, institutions can foster more diligent conversations between Enrollment Management and Finance to anticipate enrollment changes at an institutional and academic unit level for years into the future. Enrollment forecasts are a key component of the enrollment strategy and budget development process for institutions on decentralized budget models but that should be more widely utilized by all institutions, regardless of their current budgeting strategy. Ideally, these forecasts should be granular (at the program level, if possible) to provide senior leaders insights on the changing composition of enrollments in future years to ensure an optimal mix of faculty and student support resources at each academic unit.



Source: Kennedy & Company Anonymized 4-Year Private University Client Deliverable

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