VARIATIONS ON A THEME OF RCM

Interest in responsibility center management as a budget model has increased in tempo. Chief business officers explain why they have rewritten the budget score to decentralize accountability.

By Margo Vanover Porter

To provide financial transparency, blunt the force of cutbacks in state and federal appropriations, and respond to consumer pushback on rising tuition, an increasing number of institutions are moving to responsibility center management (RCM). Using this budget approach, the chief financial officer delegates to individual academic units the control of revenue in exchange for financial responsibility. The evolving model helps encourage entrepreneurship, accountability, and evaluation of key measures. (For a detailed description of RCM, see "The Buck Stops Elsewhere" in the January 2013 Business Officer.)

RCM does not have to be an all-or-nothing choice, say business officers in colleges and universities that have adopted the budget model or some of its features. Rather, they note, you can pick and choose from an array of options, tailor them to your institution and its culture, and create your own unique hybrid. (To read about some reasons an institution would choose to continue using a centralized budget model, read "Don't Be Wedded to One Model.")

Louis J. Mayer, vice president for financial affairs and treasurer, Saint Joseph’s University, a private comprehensive institution in Philadelphia, insists that RCM—or certain aspects of it—can be appropriate for all sizes and types of institutions, because it aligns academic and administrative decision making with financial responsibility.

"If you don't have some form of RCM, the deans and academic leaders make operational decisions that have significant impact on the financial profiles of their programs, but those individuals are not necessarily responsible for the bottom line," he says. "If they have control over all the levers that have financial ramifications, they should also be responsible for the financial consequences of their decisions. Under the RCM model, the deans really become the CEOs of their respective colleges."

In small institutions, according to Mayer, it may be appropriate to build an RCM-type model with different margin targets for each of the colleges. For example, the provost and deans would develop target margins for each college, which might be benchmarked differently, but which would all have to sum to an overall target net margin for the entire university. Built-in incentives would allow for the colleges to share in the upside performance.

"The deans would have the autonomy to manage their colleges in a way that would produce those margins," Mayer says. "The idea is, on a weighted-average basis, the targets would all come out to, say, 4 to 5 percent for the university."
Saint Joseph's currently operates with a financial review model that has separate income and expense statements for all of its academic programs, which include both grow margins and net margins. "It's a full-allocation model, so we can tell you which programs are generating positive or negative margins or breaking even." Mayer indicates that campus leaders are currently contemplating whether to ratchet up that model to RCM levels.

"RCM models provide a financial incentive to generate additional revenue, improve financial performance, enhance academic quality, and operate in a more streamlined, cost-effective manner," he says.

**CINCINNATI PRACTICES WITH MANAGEMENT TOOL**

The decision to adopt RCM features can't be all about making money, cautions Lawrence Johnson, interim senior vice president for academic affairs and provost, University of Cincinnati, Ohio. "It has to be about quality and your mission," he emphasizes. "You need to generate the money so you can have quality programs and fulfill your mission. The money can't be the tail wagging the dog."

The University of Cincinnati opted for an RCM-like system for the 2009-10 academic year to give university leaders, both administrative and academic, a management tool to understand the fiscal implications of academic decisions, says Robert Ambach, senior vice president of administration and finance.

"I don't think we have, strictly speaking, responsibility center management," he explains. "We have what we consider performance-based budgeting." With this approach, he says, each college or responsibility center has a revenue threshold to meet each year. It can achieve that threshold by generating additional revenue, reducing expenditures, or using a combination of both.

**Trial and error.** In the past decade, two different task forces took a run at budget changes without success, he says. Finally, in 2006, a committee with members of the faculty, business office, and central office collected data from key stakeholders, conducted a national review of different models, and created the current blended system.

"We were on a historical budget system in the past," adds Johnson, who co-led the successful committee. "With the new budgeting system, we no longer play games with deans, trying to get them to tell us what their growth will be. We just project flat growth. Then we ask, 'How much money do we need to run the university?'"

If the answer is, for example, 3 percent more than last year, each college is told, "Your threshold is 3 percent. You can cover your 3 percent by reducing costs and giving 3 percent back; you can generate 3 percent in new revenue; or you can do a combination of both," explains Johnson, who is the former dean of the College of Education, Criminal Justice, and Human Services. Colleges that exceed their threshold get to keep half of their surplus. The other half goes to the provost for reinvestment in the university.

The institution ventured into the RCM-like process to soften the hit of looming shortfalls. "About five or six years ago, it became clear that federal and state support were on the decline"
as a percentage of our total revenues," Ambach says. "We were finding that units were making decisions without understanding the implications of their decisions for their units or across the university."

**Settling on decentralization.** The move from centralized decision making has buffered some of the reductions in state support by increasing enrollments in various colleges, Ambach says. "Now the deans are looking at their colleges from both a business perspective and an academic perspective." Before, explains Ambach, there was no upside or downside for not meeting enrollment targets. If a dean decided to stop a program or restrict enrollments into a program in his or her college, the permanent budget from the university would be the same as it was the previous year.

"Now," he says, "they are given a target to meet based on enrollment projections and prior-year performance. If they don't meet that enrollment threshold, they are held accountable. They need to reduce expenditures to close the gap."

To prevent that from happening, Johnson has identified seven steps that colleges can take to generate new revenue:

- Increase enrollment.
- Change the pay ratio.
- Boost retention.
- Improve efficiency.
- Create electives.
- Find new sources of external or endowment funding.
- Offer professional development programs that become a lure.

For the latter, Johnson elaborates on ways institutions can generate revenue from professional programs for the community. "You can actually sell your services while you do good things for the community," he says. "For example, there is an incredible need for kids from the community to learn to play instruments. We sell IT services. We do evaluation work for hire. We are offering art classes. That's how universities of the future have to start thinking," he insists. "It's not just getting more students."

**NORTHEASTERN REHEARSES**

Northeastern University, a private research institution in Boston, did some testing before launching into an RCM hybrid model. First, two colleges tried a modified version of RCM. Then, in its second full year of RCM, with all of the responsibility centers taking part, the institution piloted the program with eight units in FY11.

"The two original units were our law school and our adult and continuing education unit, now called the College of Professional Studies," reports Sam Solomon, treasurer and director of finance, Northeastern University. "The college of professional studies, which has grown significantly over the past 10 years, really helped drive resources for the institution. The idea was to incentivize it to grow through new online programs, certificate programs, professional masters' programs, and so forth."

Because the law school was a relatively self-contained unit, it was easy to include in the original experiment, Solomon says.
The university made the switch from a centralized system for several reasons. "We hoped to achieve transparency at a lower level, to empower our deans, and to come up with ways to expand and diversify our revenue base," Solomon says. "You do that when you create incentives at the college level. We wanted units to think about how they are spending their money and to be more responsible, instead of saying, 'I'm going to see how much I can get from someone else.'"

**Learning curve.** To explore the ramifications of the change, senior leaders formed a committee with representatives from the faculty senate, IT, and student affairs, as well as deans and associate deans in the finance area from several colleges. This decision to practice such inclusion helped ensure buy-in once the go-ahead was given. The committee was co-chaired by Solomon and the vice provost for budget, planning and administration.

The group decided that all undergraduate revenue would go to the college in which a student is enrolled. "A formula is used to buy courses from other colleges," Solomon explains. "A business student who has to take an English class buys those credits from our College of Social Sciences and Humanities at a predetermined amount. We make those entries every term so they can see what they've bought or sold. You have certain colleges that actually sell more courses than they buy."

In getting the hybrid model off the ground, Solomon recalls the struggle to answer multiple questions, such as:

- How would central costs be allocated?
- How would inter-enrollment between colleges be handled?
- How would revenue be allocated?
- Which units would be responsibility centers?

Solomon defines a responsibility center as a unit that finances support units through allocated costs and is expected to achieve revenue and expense targets. "We looked at whether our student health center should be a responsibility center and decided that was not a good way to go," he says. "You don't want the health center to think about the bottom line, so it's part of the overhead allocated out."

Responsibility centers at Northeastern include the colleges, residence halls, dining operation, parking operation, and conference centers.

**Weighing the benefits.** According to Solomon, RCM has pluses and minuses. "Units being responsible for what they are doing is a good thing," he says. "In the past, unit leaders would say, 'You're using all of my money and not giving me anything.' This way, units get to keep what they generate. And those responsible can't blame someone else."

On the flip side, responsibility center management can make it challenging to achieve strategic objectives, says Solomon, requiring that the provost and senior leaders work hand in hand with the deans. "The system is more complex and requires more coordination, forward thinking, and discussion to align institutional objectives with where the money may be," he

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**RCM HOUSE RULES**

Northeastern University has developed rules on what responsibility centers can—and can't—do. For example:

- They must use centralized functions, such as financial aid and the registrar's office.
- They must use central financial systems.
- They can't go out and borrow money.
- They can't rent space.
- They can't hire their own cleaning services.
- They can't create their own computer networks.
- They can't change the benefits package.
- They can't create their own bank accounts.
"The units generating the income may or may not be the units where you think you have the highest opportunity for reputation growth and academic enhancement. You may say that the place to grow reputation is in engineering, but if the business college is enrolling more students, how do you get the revenue from the business students to support research and the sciences? That's the tricky part."

Although the system isn't perfect, Solomon is optimistic about the institution's future with RCM. "We're only in the second full year of rolling this out. We're making adjustments. It will take time. It's a cultural change. A 100 percent of what you want will not happen overnight."

**FLORIDA FINDS TRANSPARENCY**

The University of Florida, Gainesville, abandoned its traditional incremental budgeting system in 2011, because it lacked transparency and didn't provide the incentives—or resources—to grow, change, or shrink programs, says Matthew Fajack, vice president and chief financial officer.

"Certainly on the transparency side, we have achieved our goal," he continues. "People now understand our costs and where the revenues come from. The other incentives—entrepreneurial behaviors and changing programs—have been less successful, primarily because we've had budget cuts every year. There's been a bit of trying to live through the budget cuts, rather than focusing on how to grow programs."

Sheri Austin, assistant vice president and director of university budgets, explains that dwindling state appropriations prompted the budget cuts, although many academics point fingers at RCM as the culprit. "I tell them on a continuing basis, 'It really isn't RCM that is making your budget go down. We're losing more and more state-appropriated dollars. We would be seeing these cuts no matter what model we used—the old incremental one or RCM,'" she says.

"As we use this model, year after year, they are beginning to understand that more," she continues. "Is it frustrating for them? Yes, and it will be until we start seeing a return of monies from appropriations."

**A work in progress.** At the University of Florida, all revenues from state appropriations and tuitions are allocated to the 16 colleges based on students' majors and credit hours taught. The formula takes into account whether students are pursuing lower, upper, masters' or Ph.D. degrees. Fajack estimates that the institution has 25 responsibility centers, which includes such areas as the individual colleges, parking, housing, business services, and dining. The auxiliaries, such as housing and parking, also receive all of their collected revenues.

"We allocate to the colleges 70 percent of the money based on credit hours taught and 30 percent based on majors," he says. "Other universities give 100 percent based on teaching, and they've had problems with poaching. The 70/30 split seems to be a good balance to prevent poaching students from other colleges."

Of all the colleges, Fajack credits the leaders within the business school for being the most active in pursuing the sweet spots within the RCM model—probably because they understand it better than other deans. "Because of the way our weighting system works, they have
actually shifted resources by shrinking the undergraduate and growing the graduate program," he says.

"We developed the weighting system based on the historical cost of delivery," he continues. "Their lower-level-Introduction to Accounting and Introduction to Marketing, for example-have low costs and large classes. With courses delivered via online and video classes, delivery cost has been very low. With the RCM model, it became transparent that they weren't getting much in state appropriations or tuition for those classes. They realized they could shift resources to the graduate school, a move that happens to follow one of our strategic goals."

To ensure funding for all strategic objectives, the institution created an account that is managed by the provost and president, and is supported by annual tuition increases.

**Steady improvement.** Since RCM was implemented, all of the responsibility centers have been able to meet their budgets—or come very close. "We watch it continuously and force them to meet budget so at the end of the year, we aren't surprised," Fajack says.

What happens to responsibility centers if revenue targets fall short? "They can cut operating expenses," he says. "They can reduce travel. They can reduce staff. They can reduce the number of classes for next semester to get back in line. They can require professors to teach one extra class. They might not hire an adjunct or a lecturer. They have a lot of flexibility, but they have to produce a balanced budget. That's a requirement."

As might be expected, the deans have offered numerous suggestions for improving the current system. "The majority of deans support using RCM over other budget models, but they all want to make their own tweaks. Some deans think we should have an RCM model that awards growth in research. Each dean has his or her own view of the tweaks we should make to RCM, and we're in the middle. We're having a series of meetings with the deans over the next few months to see what evolutions we should consider."

One evolution has already taken place. Fajack explains that when the institution began taxing money for endowing a chair, it got huge pushback from donors who had just contributed $1 million or so. "The donors were very upset that we taxed the funds like any other expenditure. Even though an argument could be made that they should be charged for overhead, we worried that it would hurt future fundraising, so we stopped taxing those types of funds. We try to be sensitive to all of our stakeholders and constituents. That was an area where we were not quite as sensitive as we should have been."

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