Board Budget Decisions

Protecting and Building Your Institution's Assets

BY DENNIS JONES

TAKEAWAYS

1 The strategic plan represents an institution's top priorities. Yet colleges commonly set aside financial resources to pursue them only after investing in maintaining the status quo.

2 When building a budget, boards should focus on putting institutional assets at the center of the process and aligning fiscal decisions with their college's mission and long-term goals, while investing in strategic priorities through an intentional set of decisions.

3 Such a method of allocating resources helps guarantee the long-term capacity and health of the institution and puts boards at the beginning of the process rather than the end.

IF EVER THERE WERE A TIME FOR COLLEGE AND university leaders to think creatively about allocating their resources, it is now. The pressure to enroll and graduate more students is relentless. Faced with limited employment prospects, and understanding that a decent job requires skill levels beyond those learned in high school, more and more students are knocking at the college door.

And many state policy makers and the Obama administration are calling for millions of additional students to complete college as the key to their state's and our nation's economic competitiveness.

Meanwhile, economic circumstances have created fiscal stringencies—if not crises—for all kinds of institutions. Other recessions have been characterized by quick rebounds; people could employ short-term fixes—hiring freezes, across-the-board cuts, and the like—and wait out the storm that passed very quickly. Every indication suggests that, after this recession, there will be no return to the "old normal" for many years, if ever.

The situation demands that colleges and universities be much more focused on goals and make much more strategic use of their available resources. The budget, or "resource allocation"—the most powerful tool in the policy toolkit—must be used wisely to implement the college or university's strategic plan. Unfortunately, however, the approaches that institutions usually take to resource allocation are short-term and tactical, not long-term and strategic. They reinforce the status quo rather than leverage change. And they run the risk of eroding, not preserving and enhancing, institutions' key assets.

Strategic decisions about resource allocation must be made at the very highest levels of colleges and universities. Only board members and top administrators have the responsibility to protect and build the asset structure of their institutions. Department chairs will gladly occupy a building on campus, for instance, but the last thing they would do is request money in their unit's budget to repair the roof or replace the electrical system. And rightly so. These are institution-level decisions, and only institutional-level leaders can make them.

Putting Assets at the Center of the Process

The typical budget process at most institutions starts with the prior year's allocation, makes adjustments for cost increases, and allows individual campus units to request additions to their assets—another faculty member, more equipment, and so on. In years of budget cuts, managers at all levels are given a target reduction to be accommodated, usually applied across the institution, and told to make it work.

But that tactic creates an environment in which open positions go unfilled, travel and other operating expenses are cut, and buildings and other facilities aren't maintained. Such decisions are those of expediency, not strategy. The unfilled position may be key to fulfilling the strategic plan. Similarly, reductions in travel and other operating expenses may jeopardize the professional development needed to further the institution's desired academic transformation.

The budget cuts that are easiest to make are seldom the ones that should be made. And when carried out over a multiyear period, they leave the institution shaped by accident, not design, and unable to fulfill its mission or pursue its goals.

A far better approach is strategic finance, a method of budgeting that aligns fiscal decisions—about revenues, about the core assets of the institution or system, and about the use of those assets—with the institution's mission and long-term goals. Strategic finance takes a multiyear perspective, not the "next year" or "one-year-at-a-time" perspective so common in most budget processes. Institutional leaders establish the overarching parameters of expenditure on each of the key assets and then build a budget within that framework—a much more top-down approach than the norm.

Perhaps most important, strategic finance puts creation and maintenance of institutional assets at the center of the budget process. Rather than immediately allocating funds to the various units, top administrators and boards determine the expenditures necessary to appropriately shape and maintain the asset structure of the institution.

Institutional leaders should ask questions like: How much should be "taken off the top" to pay for facilities maintenance and replacement of equipment? How should staffing patterns be changed to strengthen the institution's capacity to pursue its goals? Should the institution shift to more full-time faculty members and fewer managers? Should those faculty members be more concentrated in some disciplines and less in others?

That method of budgeting makes shaping the asset structure an intentional set of decisions, rather than the consequence, usually unintentional, of prior choices that make investments in things like building maintenance and equipment replacement an afterthought, paid for with whatever is left over. In business terms, that approach forces attention to the institutional balance sheet, not just to the operating statement. It helps prevent the overwhelming tendency to balance the budget by depreciating the institution's assets.

Determining Your Institution's Key Assets

What exactly are your institution's key assets? You should define them broadly. Most of the following are obvious, but one or two normally get overlooked in the budgeting process:

Personnel. Faculty and staff members are seldom labeled as "assets" when allocating resources. But they represent the key components in the productive capacity of their institutions. Because those assets cannot be changed quickly at most colleges and universities—faculty contracts, tenure, and other such factors must be considered—it is doubly important that your institution take a long-term view of its desired overall staffing pattern. How big does the full-time faculty have to be? Which disciplines should be strengthened, and which would still have productive capacity with fewer faculty lines? Is the institution managerially top-heavy, or is it so lean that key functions are not being performed? Reducing staff through the expediency of not filling open positions is unlikely to result in staffing aligned with needs. Nor is adding staff members without a clear understanding of how they will help your institution pursue its strategic plan.

One of the reasons to consider personnel as an asset is because it reinforces the importance of being concerned about human "depreciation." All assets can lose productive capacity over time unless specific efforts are made to counteract the decline that normally occurs. Human assets are no exception. Employees must acquire new knowledge and skills as the world changes around them. Many will need formal professional-development opportunities if they are to make their maximum contribution to your institution. Too many big investments in software systems, for example, are at least partially wasted because of a lack of training for primary users. Such problems could be avoided with conscious attention to a professional-development item in the budget.

Curricula. This asset almost always gets ignored in the process of building the budget. But like other assets, curricula depreciate over time unless a conscious effort is made to keep them current. Individual professors can generally be relied upon to keep their courses up to date, but your institution should review the overall academic program on a periodic basis. Money must be set aside each year to pay faculty members to thoroughly examine the curricula, work with their colleagues to identify areas of unnecessary course overlap, and suggest ways in which the pieces can be made into a more coherent whole. Your institution should develop and support a plan that allows each program to be evaluated and enhanced at least every seven to 10 years.

Students. Given the size of scholarship expenditures and tuition discounts that many colleges offer students, it behooves institutions to be much more intentional about their investments in creating a student body. You should ask two questions: First, are funds being invested in ways that yield a student body with the desired characteristics—not just in terms of size, but diversity, programmatic interests, and other features? Second, are students being retained and completing a program of study? If the answer to either or both of these questions is no, your institution's strategy for investing in its student body should be reexamined.

Facilities. While facilities are an obvious asset, their maintenance is often neglected when building a budget. A responsibility of institutional leadership is to halt, if not reverse, the accumulation of deferred maintenance on the institution's physical plant. To do that requires that about 2 percent of the replacement value of the plant be devoted to renewal of facilities every year. Such funding should be allocated "off the top" in the initial stages of budgeting.

Equipment. A clear plan for creating the technological infrastructure for your campus and for updating it on a regular basis is a necessary aspect of the budget process. Once approved, this budgetary amount should also be allocated in the beginning.

Information resources. In the old days, a key budget item was for the acquisition of books. But today, many other means of accessing information must be considered as well. One basic question to ask is whether the library should buy an asset, such as a book, or pay an annual fee for access to the information.

Financial assets. You should determine whether or not operating resources should be set aside to build endowment or other financial assets of the institution. This decision is separate from the one concerning operating reserves or contingency funds. If your institution has a policy of explicitly putting some of its operating revenues in the equivalent of a savings account, the size of that intended transfer should be factored in at the beginning of building the budget.

Intangible assets. There are times when such assets need attention, particularly if your institution is seeking to rebrand itself or thinks its image has been sullied and must be restored. In the overall scheme of things, intangible assets may not be a big budget item, but the question about whether and how much to invest in creating and polishing a positive image should be asked in the normal course of events.

Investing Resources in Strategic Goals

Once your board and top administrators have identified your institution's key assets, you should create a separate budget category for strategic investments. The strategic plan represents a statement of the institution's top priorities. Yet colleges and universities commonly set aside funds to pursue those priorities only after investing in maintaining the status quo. If your strategic plan really does reflect institutional priorities, then the dollars to pursue them should be among the first allocated, not the last. The strategic plan will never get accomplished if money can't be put behind it.

Most institutions devote less than 2 percent of the operating budget to this item, but it can have far reaching effects if used effectively. Some suggestions:

- Don't invest the money in anything requiring a recurring expense. If additional staff are needed to carry out the strategic plan, those decisions should be reflected in decisions about personnel or curricula assets.
- Solicit good ideas broadly. Open up the competition for resources to everyone; good ideas about strategic initiatives and changes aren't the protected domain of any one group.
- Make the financial tie to the strategic plan inescapable. This is not a slush fund for those who didn't get what they wanted through other avenues; it is a fund to be used with great intentionality. Don't let it go away even in the toughest of times. If need be, force reductions elsewhere to keep this pool intact.

Your institution should also create a management-reserve or contingency-fund item. Like the strategic-initiatives pool, it cannot be viewed as a slush fund. One way to enforce a level of discipline in the use of the funds is to insist that money spent in any year be replenished as the top priority in creating the budget for the subsequent year.

To pull the pieces together, your institution must estimate its revenues and then add up the costs associated with each of the assets, the strategic-initiative pool, the contingency fund, and the budget items over which the institution has little or no control—at least in the short run—like utilities and property insurance. Almost inevitably the expenditure requirements will exceed the revenues available to support them. At this point, you must consider your alternatives.

Assessing Your Options

The choices made in the budget-balancing process will necessarily be specific to your institution. There are no rules. But you should base any decisions on leaving the institution in the strongest position to fulfill its mission and achieve the goals of its strategic plan.

The three broad options are to:

1. **Enhance Revenue.** This is always the first choice, but in fact it is probably wise to view revenue enhancement as the strategy of last resort. It is true that a balanced budget can be achieved by reducing expenditures, raising revenues, or some combination of the two. But if this option is to be part of the answer, caution is advised.

   It's important that institutions budget only those revenues that can be predicted with considerable certainty. That means either tuition revenues or the use of financial reserves—there is no certainty associated with expecting more gift revenues or better performance of investments. Relying on those sources is an invitation to a mid-year budget realignment. (Read crisis.) It is better to be pleasantly surprised by having more revenue than anticipated. In addition, you should keep in mind all the reasons to hold tuition down—such as the need to maintain affordability, the additional price discounting that would probably be necessary, and the political ill will engendered by such actions.

You should make five-year estimates of the major revenue categories, especially tuition and state appropriations. Plan for tuition increases as a way of enforcing moderation in prices and bringing realism to discussions about how fast your institutional expenditures can increase.

2. **Make tradeoffs between maintaining assets and purchasing services.** One of the key tradeoffs that your institution can make is to disinvest in assets and contract for services to carry out necessary activities. Colleges and universities employ this option regularly, but they seldom acknowledge the nature of the tradeoffs—such as reducing or changing the asset structure—nor do they investigate the possibilities in a systematic way.

   The prime example is the substitution of part-time faculty, a contracted service, for full-time faculty, a part of the asset structure. Major shifts toward part-time faculty have occurred throughout higher education, usually the result of short-term expediency rather than long-term strategy. Seldom have institutions come to their current position as a result of a well-considered decision.

   Rather, part-timers are hired to take up slack, fill vacant positions, or reduce benefit obligations. The central questions that arise are: "Has reduction by accretion left the institution without needed personnel assets?" "How much is too much?" "In which disciplines can continued disinvestment be tolerated and in which can it not?"

   Other examples abound: outsourcing custodial services, dining-hall operations, bookstores, help desks, back-office operations, and numerous other functions; renting rather than owning and maintaining facilities; contracting for access to online-information resources rather than buying books. Unexamined in almost all institutions is the option of buying some part of the curricula as a purchased service rather than one created and maintained by the institution. Examples are institutions that contract for delivery of developmental education or for the general-education portion of technical curricula.

   There are also instances where the trade-offs can go the other way: developing an asset to replace a historically purchased service. The move in some institutions to develop cogeneration plants to replace purchased utility services is an example.

   The bottom line is that you must make clear-eyed judgments about the asset structure absolutely required to carry out your institution's mission and strategic plan, then ask the question of whether or not money can be saved (and image maintained) if your college shifts from paying for assets to purchasing a service.

3. **Recognize the freedom you have to shape the asset structure and allocate resources.** Your institution has more freedom to find ways to balance the budget than you may realize. There are multiple dimensions to decisions about the size and shape of its asset base. Take, for example, human assets. The expenditure required will be determined by:
   - *Price paid.* Will raises be given? If so, how much? Across-the-board or merit only?
   - *Teaching loads.* The heavier the teaching load the fewer the number of faculty members required to carry out the instructional function. (The University System of Maryland raised the overall number of credit hours produced by faculty members by 10 percent at each campus. That let them increase enrollments without a commensurate increase in faculty members).
   - *Appropriateness/mix.* If thoughtfully analyzed, it is likely that the work can be unbundled in ways that tenure-track faculty aren't needed for all activities. Instructors without terminal degrees may be fully qualified for some activities, like teaching developmental-education courses.
   - *Quantity.* All of the above serve to determine how many faculty and staff members of each type are needed. The secret is to start with determinations of utilization and appropriateness and *then* assess the numbers required. And don't forget: Some investment in professional development should be an explicit budget requirement.

   The same concepts apply in some other areas as well. For example, fewer classrooms are needed if those available can be used more heavily.

Making Intentional Decisions

You should take an approach to resource allocation that puts the long-term capacity and health of your institution at the center of the process. That will focus your attention on decisions that are too often either backed into (the shift from full-time to part-time faculty) or ignored (the annual investment in renewal or replacement of physical plant). More important, it puts your board and top administrators at the beginning of the process rather than at the end.

Unless an approach to resource allocation is adopted that is much more strategic than those in general use, institutions will very likely continue to depreciate their asset base and weaken their capacity to fulfill their missions. The annual decisions necessary to ward off that fate will not be easy ones, but they're far easier than those required to rebuild an institution that has slipped into serious disrepair due to shortsighted directions taken over an extended period of time. Applying the concepts that I've described will help you deal with the crucial choices inherent in the budget process in ways that can protect and enhance your institution rather than erode its core capacity. ■

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T'SHIP LINK: Scott Schulick and Cynthia E. Anderson, "On Track for the Future: A Case Study in Strategic Finance." November/December 2010. Strategic Finance Panel, "The Possibilities of Strategic Finance." March/April 2010. E.B. Wilson, "A Strategic Plan Is Just the Beginning." November/December 2009.

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