IMPROVING COST-EFFECTIVENESS:

LEADERSHIP CHALLENGES FOR PUBLIC HIGHER EDUCATION

Session Three

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Raising the rate of educational attainment in public institutions requires new approaches to financing that support greater access and degree production, beginning with how states allocate resources and extending to campus-level management. That is easier said than done in the current fiscal and political environment, where almost every state and many public universities and colleges experience changing leadership and suffer chronic budget instability. In state after state, budgetary pressures are leading toward less rather than more attainment through reductions in enrollments, program elimination, and tuition increases.

The funding problems facing most institutions can be addressed through explicit, sustained, collaborative attention to the intersection of academic and fiscal policies by state policy makers, public governing boards, institutional leaders, and faculty and staff. Although the political and fiscal environments make a sustained focus very difficult to achieve, the consequences of continued declines in attainment are too monumental to allow.

Public governing boards will be particularly important to defining this equation, especially where they can develop appropriate partnerships with governors and legislatures. Public governing boards have the statutory responsibility to balance the public agenda with institutional goals and can maintain an agenda that lives beyond changes in political or institutional leadership. The most effective states will have boards that operate at a strategic level, demonstrating mutual respect and a strong partnership with their institutional presidents or chancellors.

The most effective policy changes will recognize key dynamics and circumstances at the institutional level. These include:

1. **Double jeopardy: productivity and budget cuts.** In most states, a significant portion of any savings must go to budget reduction in ways that may not even maintain, let alone increase, productivity. Furthermore, not all productivity strategies aimed at attainment result in institutional savings – some produce savings for students but not institutions; some would cost institutions a good deal more.

2. **No silver bullets.** States have different starting points, including types of institutions, state funding levels, tuition elasticity, and state regulations. Institutions differ due to state circumstances but also due to their own mission, history, and efforts (often with state exhortation) to differentiate themselves. Policies that have a major impact in one place may have no relevance to another.

3. **New dynamics, new partners.** In some cases, events of the last 5-10 years have already changed the institutional incentive structure dramatically (e.g., no additional state funding for enrollment growth or new programs, and competition in the institution’s traditional service area from distance delivery by others). Institutions are much more market-driven
and subject to much more change than before. Institutional leaders more readily understand and accept responsibility for helping achieve state goals. In many cases, institutional leaders would be policy-makers’ best allies in finding and pursuing policy approaches that will be most effective.

4. **The flexibility paradox.** Achieving the attainment goal requires having institutions that are as strong as possible, not weakened by institutionally inappropriate requirements, excessive reporting, and unfunded (even negatively funded) mandates. In today’s constrained resource environment, incentives are powerful to the extent that decision-makers have the flexibility to respond in the best ways for their institution. Carrots and sticks only work if leaders and organizations have sufficient latitude to move accordingly. Even better, shared goals and planning can make carrots and sticks a concept of the past, replaced by mutually workable ways of doing business going forward.

5. **The governance paradox.** Many of the most significant changes absolutely require faculty leadership. Students will not benefit from a communications program designed by a biologist provost any more than a patient will benefit from a wellness protocol designed by a hospital administrator. Policies that treat campus administrators or faculty as change-resistant opponents cannot be nearly as effective or efficient as those that foster mutual understanding and partnership.

6. **The diversity paradox.** Institutions in many states have long experienced conflicting pressures from their states and university systems. A fundamental example is to expect institutions to be unique while also requiring common courses, near-universal transfer of credit, identical academic calendars, and across-the-board state funding changes. Productivity policy initiatives will work best if the institutional policy environment is at least moderately coherent.

Improving access, attainment, and cost-effectiveness requires simultaneous attention to the agenda, the metrics for enforcing it, and the strategies to link together internal and external interests. We suggest attention to four specific areas where new thinking is needed:

1) An explicit agenda for managing cultural change;

2) Creating a multi-year funding strategy, built around strategic investments rather than annual budget-balancing;

3) Funding strategies that include explicit attention to cost effectiveness as well as new revenues, including a political willingness to tackle major cost drivers; and

4) Continuous attention to internal and external communication about goals and performance.
Managing cultural change: finding common purpose, language, and values. The new funding realities require cultural and political changes in historic approaches to funding, beginning with a willingness to move beyond stubbornly held views about the connections between spending, access and quality, or what some refer to as the “iron triangle.”¹

Higher education values have long equated quality with resources, which means that spending cannot be managed without sacrificing either access or quality. Although some economic theories about the unique cost structures of the non-profit sector are consistent with these views, reality simply cannot support them. The times demand greater access and equal or greater quality despite a long, difficult recession. Furthermore, the Iron Triangle assumptions are not supported by research. Research shows a very weak relationship between spending and performance, measured not only by degree attainment but also by the level of the state population obtaining access, retention and degree production, and production of graduates who remain in-state to fill high-demand jobs.² To be sure, measures of reputation - such as admissions selectivity, or


proportions of faculty with terminal degrees, or spending on athletics and endowment earnings - all correlate with money. But for the most part these measures have little to do with the public priority to increase degree attainment. The Iron Triangle is a set of false assumptions that contribute to the fractured dialogue among higher education constituencies.

Research shows that the public, state policy makers, faculty members, and college presidents all perceive the “cost problem” and its potential solutions very differently. This creates enormous tensions within institutions about the strategies needed to move forward, making the challenge of institutional leadership extraordinarily difficult. Table 1 captures the fractured conversation about college costs, summarizing focus group research whereby different groups were asked how they viewed the college cost problem, as well as how best to solve it.

Table 1. The “Fractured” Dialogue about Higher Education Costs

<table>
<thead>
<tr>
<th>Stakeholder group</th>
<th>Definition of the “college cost” problem</th>
<th>Preferred solution to the “college cost” problem</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public</td>
<td>Caught between growing importance of higher education and decreasing access and affordability. Believe institutions value their own ‘bottom lines’ over public priorities.</td>
<td>Protect access! Keep tuitions from going up!</td>
</tr>
<tr>
<td>State financial officials (and legislators)</td>
<td>Need more college graduates. Institutions have enough money to do the job; they don’t spend it well.</td>
<td>Increase productivity! Increase retention and degree production!</td>
</tr>
<tr>
<td>Faculty</td>
<td>Big problem isn’t academic or program costs, it’s the deteriorating quality of students, and runaway spending on administration and frills. Costs can’t be cut without hurting quality</td>
<td>Raise standards, improve K-12 education, and stop talking about productivity!</td>
</tr>
<tr>
<td>College</td>
<td>Caught in an “iron triangle” between access,</td>
<td>Reinvest in higher</td>
</tr>
</tbody>
</table>


Presidents costs and quality. See it impossible to reduce costs without hurting quality or reducing access.

Like the proverbial blind men and the elephant, different perceptions reflected in the fractured language about college costs are not wrong even if they are not consistent. Inconsistencies among multiple truths are a common reality of most complicated human endeavors. More dialogue among different audiences will help to find common ground. It will not address basic differences in values about future priorities, but it can help resolve common misperceptions or half-truths about funding that get in the way of change, such as the belief that more revenues equates with quality, or that tuitions are going up because institutions are spending money on climbing walls and other amenities.4

For public institutions, boards need to manage this discussion rather than try to avoid it, by creating a visible space on their agendas for ongoing dialogue about the future and how to meet it. This may require a separate task force on strategic financing or attainment. Visible public processes need to be put in place to address how university systems or institutions will accomplish these goals, including dialogue about teaching and learning, and attention to ways that costs will be managed. Higher education leaders need to use these forums as a way to stimulate institutional learning, to put information about costs and spending into context, to educate institutional leadership, faculty, students and public policy officials about where the money comes from, where it goes, and what it buys.

Creating a multi-year funding strategy. Whether state appropriations for higher education go up or down, public institutions typically remain captives of the year-at-a-time funding dynamics created by state budgets. This results in a planning horizon that is too short to sustain any serious effort to restructure costs. While some institutions have tried on occasion to address this, they are often held hostage to state regulations that effectively penalize them for trying to move past the state agency funding model. As just one example, institutions that try to build up budget reserves to shield against drops in revenues subject themselves to year-end “sweeps” from the legislature. In some states (New York is an example), this effectively means that state funds and even student tuition revenues are being captured by the state and redirected to pay for general fund obligations like prisons and highways.

4 For more examples of ways to dispel common myths about college costs, see Jones, Dennis and Wellman, Jane(2010) 'Breaking Bad Habits: Navigating the Financial Crisis', Change: The Magazine of Higher Learning, 42: 3, 6 — 13, available at http://dx.doi.org/10.1080/00091381003730169
The result is that – far more than nonprofit or for-profit providers – public institutions operate in a revenue environment that is highly unstable, with large and unpredictable fluctuations from year to year in what is typically the single largest source of discretionary revenue (see Figure 1). The problem of instability in resources is probably more harmful to long-term repositioning of cost structures than the revenue levels themselves.

**Figure 1. Annual Percent change in state appropriations for higher education – 1960 – 2009**

There’s no easy fix to the problem of instability in state funding. Legislatures cannot statutorily commit future legislatures to long-term funding policies. Funding agreements with the governor alone can be hard to enforce in the legislature. And even with legislative and gubernatorial support, stakeholder politics– including public sector unions and students – can trump good policy. This has led some to conclude that the only way for higher education to insulate itself is to seek greater regulatory distance from state government, or even to look for constitutional protections for funding that can survive over multiple years. Both options carry the risk of even

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greater policy disaffection for higher education, and policy makers could conclude that they no longer are responsible for higher education funding.

Despite these long odds, leaders can build support for an investment approach to public finance through marketing of multi-year strategies built around attainment goals and efficiencies. They can present and defend these strategies as part of a funding compact between the state and the institutions, with mutually agreed upon goals for access, attainment, state funding, tuition, and cost management all explicit parts of the agreement.

Funding strategies that balance cost efficiencies with new revenues. Estimates of finances required to meet attainment goals vary from state to state, but analysts project an overall need for approximately three to four percent per year in constant dollars. Prior to the recession, public higher education was seeing increases in state and local appropriations averaging about 2.5% per year, which still required annual increases in tuition of more than double the rate of inflation. Clearly, the revenue options and spending habits are chronically mismatched. Long-term funding solutions must incorporate much more attention to cost effectiveness along with requests for new resources.

Cost effectiveness does not mean just budget cutting, it also means increasing productivity through parallel attention to cost management and performance:

1) by reducing spending strategically in areas that are least damaging to access and attainment;
2) by increasing the proportion of students who complete degrees, and reducing the production costs (such as credits to the degree) required to obtain the degree; and
3) by reinvesting in core academic capacity, to put cost savings into areas that are strategic priorities for the institution.

Many public institutions have already taken the immediately available cost-cutting and efficiency measures, but more is required in many states and institutions. Public universities and multi-campus systems in particular have opportunities to achieve cost savings across member institutions in administrative and support functions, through consolidation of functions, centralization of business and back-office functions, and taking advantage of economies of scale that produce long-term savings.

Achieving additional productivity requires difficult change – terminating some activities and doing others in very different ways. A recommended approach is through strategic finance -
aligning all of the institution’s resources with its mission, vision, and strategic plan. Through this process, institutional leaders develop much greater insight into their cost structures, cost and revenue drivers, and trend lines of revenue and expense. They are better able to make decisions on the basis of evidence and cost as well as anticipated benefit.

Addressing benefit costs may be the single most important area where policy officials and governing board members need to work together to address cost control. Benefit costs in public institutions have been rising more rapidly than all other spending areas, driven primarily by costs of health care but also by growing liabilities in defined-benefit retirement programs. If growth in benefits is not addressed, estimates are that funding current programs alone will require somewhere between 4 – 6% per year in base funding increases. This means that every new dollar in tuition revenue and state appropriations will go just to pay for benefits – not for new enrollments, not for improvements in teaching, not for program enhancements. In many states, this will require joint action with state policy leaders, as higher education leaders do not unilaterally control benefits. It may also require decisions to be reached through collective bargaining.

Each institution will find different routes to greater productivity, but all will require a balancing of attention to the academic/program side of the house as well as administrative costs. Many of the short-term curriculum productivity measures result in savings for students. These include dual enrollment, credit for experience or examination, and reducing the total number of credits for a degree through curriculum streamlining.

Academic restructuring that produces savings for both students and institutions is also available, such as streamlining curriculum by reducing alternative choices for students especially in general education, moving groups of students through the curriculum together in cohorts, merging or eliminating programs, and sharing curriculum with partner institutions. Changes to reduce cost must maintain or improve the quality of learning outcomes - otherwise the cost-effectiveness ratio will not improve.

Most important and often overlooked, it is academic innovation that will differentiate between those that achieve state and national goals and those that continue to struggle. The parties responsible for academic innovation are the faculty, and they cannot do it without considerable support (especially time to identify, develop, vet, and learn new approaches). Academic innovation is usually incremental and slow due not only to its intrinsic requirements but also because of limitations in accreditation requirements, risk of jeopardizing ease of transfer, risk of

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being unable to recruit new faculty or fund their period of adjustment to a new teaching-learning approach, and lack of venture capital (time or money) to develop, test, and implement new ways. Enterprise software may not easily accommodate innovations in administrative functions such as scheduling, pricing, or student progress tracking. Policies that encourage and support academic innovation will differ among states and institutions and are a potential high-payoff area for collaboration among institutions, systems, and states.

Internal and external communication about goals and performance. Shared governance in higher education – where authority for decision making is shared between state policy makers, institutional boards, campus leaders, and faculty – demands continuous attention to communication and documentation. Although most public institutions do a good deal with financial reporting, these reports seldom extend to transparency about spending. Instead, most public accountability reports focus on student tuition and financial aid with no mention of how the resources are used, or the role of tuition in the larger context of institutional revenues and spending. In today’s environment, transparency for spending must include much better evidence about where the money comes from, where they money goes, and what the money buys. Financial reports historically restate budgets, with presentations of total revenues and expenditures including auxiliary enterprises, hospitals and clinics, research institutes, dormitories and sometimes – not often enough - athletics. This approach exaggerates the amount of money that is available to go to core instructional purposes by as much as 50% in some institutions, since spending for auxiliary enterprises, athletics, hospitals, and many research activities are restricted to those purposes. Small wonder that policy makers and faculty both believe the institutions have a lot more money than they really do.

Effective accountability for productivity begins with data and metrics, but cannot end there. Data must be put into context to be meaningful, and framed to be relevant to the different audiences that will be reviewing it. Context can also come from showing patterns over time, and by comparing spending across multiple institutions. Institutions also need to translate funding into language that makes sense to all stakeholders - including prominently both legislators and faculty - by showing trade-offs and by the consequences of different funding decisions. As just one example, spending presentations should always show both dollars and percentages, with budget calculators to help all stakeholders to put numbers into perspective, such as what each 1% in student tuition revenue nets versus 1% in state appropriations, or the trade-offs between spending on salaries and benefits, or the cost of benefits compared to tuition revenues. Spending reports do not need to include details about every single area of spending, but should instead concentrate on a few benchmarks that relate back to goals and performance.
Each state has the greatest potential for success on its higher education agenda when constituents at all levels within the state have specific shared goals for access, attainment, and quality produced by dedicated institutions that are strong enough to achieve those goals. Such goals, along with good data, absolute transparency, highly effective communication across constituencies, and a willingness to deal with or suspend pre-existing mistrust in favor of sincere efforts to appreciate each constituency’s circumstances are the foundation on which effective public policy will arise.

States and institutions that are moving forward

A few years ago the University System of Maryland was virtually alone in promoting ‘efficiency and effectiveness’ as visible public agendas, but now a number of states and systems are doing this work. While none among them would claim victory at this point, the work is deeply engaged and potentially far-reaching. A few examples follow:

1) The University System of Maine and its “bend the trends” initiative, is working to put together a multi-year funding strategy capable of meeting its strategic plan priorities. The work started with a new strategic plan that serves as the basis for setting priorities and making funding decisions. They have built multi-year funding plans, beginning with an assumption that they will see NO growth in state revenues for the foreseeable future. Along with student tuition increases, they have put in place cost reductions in employee benefits (reducing by half the unfunded liability for retiree health benefits), consolidation of administrative functions, and reductions in academic programs.

2) The West Virginia Higher Education Policy Commission has led a system-wide effort to put policies and procedures in place to incorporate regular attention to cost savings as part of its plan to increase degree attainment without new investments of state resources. In addition to the usual attention to administrative efficiencies, the West Virginia plan incorporates special attention to system ways of benchmarking costs and measuring progress in reducing spending. They also have developed broad targets for improvements in productivity along with cost cutting, through reductions in student attrition and in excess credits earned en route to the degree.

3) Public university systems in Ohio and Wisconsin have both put together comprehensive initiatives built on improving the contributions from higher education to their States’ economic futures. Unlike most system-level planning efforts, these two state ‘systems’ are notable for approaching this work with the future needs of the state as the driving force for system-level planning. The work encompasses attention to increasing degree attainment necessary to build jobs and regional economic growth in the future. Both include attention to administrative cost reductions, streamlining in the delivery of
academic programs, and more effective use of low-cost options including regional universities and community colleges.

4) A number of institutions are working through planned reductions in degree offerings, through identification and potential consolidation or closure of high cost or under-performing degree programs. The Pennsylvania State System for Higher Education is one example. They have adapted long-standing policies for program review to trigger state-level reviews of programs found to have low levels of degree production or enrollment. Programs that are ‘triggered’ for review are not automatically eliminated, but must undergo a second-layer of review to determine if they meet criteria for quality and sustainability to continue in the future.