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# Show Me the Money: How to Drive Value from RCM Without Adopting an RCM Budget Model

Higher education institutions rely on a wide variety of approaches to manage their budgets, from a centralized system of incremental budgeting to a decentralized Responsibility Center Management (RCM) budget model, with many other options and hybrid approaches in between. You may be one of the many universities still using more traditional incremental budgeting approaches because of its simplicity and ease of use. If so, then you likely run into issues with financial transparency and being able to fully support and validate strategic decisions with accurate financial data. To overcome this, some large universities have moved to RCM budget models, which provide individual units with more autonomy and increased transparency. Although this approach is complicated and not right for everyone, the principles used in RCM budgeting can be applied in more traditional budget model environments to increase transparency without adding complexity.

In this article, we will provide an overview of the different budget model options and how you can take the best of both approaches to improve your operations and strategic decision making.

## What is incremental budgeting? Should I still use it?

Incremental budgeting refers to building a new budget based on the budget from the prior period, usually by making marginal adjustments up or down from previous budget values. The actual budget design usually happens at the broad, institutional level, and when overall expected revenue increases or decreases, these changes are generally felt across the organization. This model is popular among universities due to its simplicity, ease of implementation, and the resulting budgetary stability, which allows for easier unit-level planning.

However, incremental budgeting can obscure implicit university investments that were strategic at one point, but have been lost or forgotten over the years. For example, the Engineering School may have seen an increase in their operating budget to support substantial maintenance and repairs necessary in their old, crumbling building five years ago. After moving into their new building, however, with little maintenance required, they did not see a budget decrease, because the investment decision had been forgotten.

Over the years, the appropriate cost of operating each individual unit often deviates from its budget, so central university decision-makers don't know the true financial health of each unit. This makes it difficult for university leadership to make fully-informed strategic decisions about where to allocate or reallocate funds.

## What about the RCM budget model? Would that work better for me?

RCM budgeting refers to delegating operational budget authority to schools and other revenue-generating units within a university. Each unit has some level of autonomy over its own revenues and expenses, more similar to a traditional corporate P&L. A school / department will collect its own tuition, the rec center will receive its portion of the student fee, etc. Generally, revenue-generating units are responsible for paying for their own direct expenses (e.g., salary costs, supply costs, scholarships), as well as their portion of university overhead expenses (e.g., facilities costs, central HR costs, central IT costs). The RCM model provides greater transparency into the financial health of each unit and empowers unit leaders to make the best use of limited financial resources, encouraging innovation and efficiency.

However, the devil is always in the details, and implementing RCM can be politically difficult and create new challenges for the university.

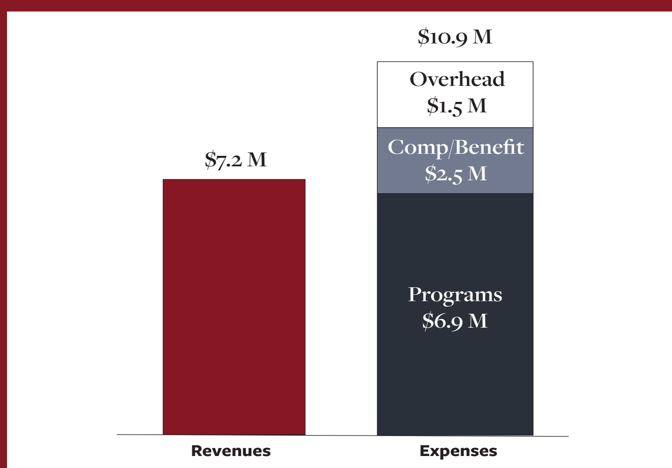
## THE IMPORTANCE OF CHANGE MANAGEMENT

The RCM model is complex and can be challenging to initially implement and get right. When making the switch to RCM, there will be winners and losers for each of the allocation methodologies for revenue and overhead expenses, and the political battles can be intense. For example, the Law School may face a reduction as a result of the new RCM model, which can lead to entrenched resistance from the Dean and other Law School senior leaders.

## THE NEED FOR GOVERNANCE AND DECISION RIGHTS

Without properly-designed decision rights and thoughtfully-developed overhead allocation equations, individual units may operate counter to the best interests of the university as a whole. For example, with budget autonomy under an RCM model, the Law School may grow frustrated with HR service levels and develop its own HR function internally rather than pay for use of the central HR function. Law School service levels improve, but the Law School's decision increases the overall cost of HR for the university.

**Budget model analysis** results in a quasi-P&L for each unit. At one university, international education was a presidential strategic priority, but financial and executive leadership did not understand the magnitude of the investment in international programs. RCM analysis showed that the university provided a $3M "subsidy" to international programs and allowed university leadership to make strategic decisions around investments in international programs.




## THE VALUE OF CROSS-SUBSIDIES

RCM introduces a "profit" motive and mentally into university budgeting, but universities are not for-profit corporations. Smaller-scale, less-popular programs, such as Philosophy or Art History, may never be able to appear profitable, but they are critical parts of the university's social and educational mission. Under traditional budgeting, these programs are "subsidized" by larger-scale departments, such as English or Psychology. RCM can make it more politically challenging, if not impossible, for "profitable" programs to subsidize other programs that are more costly.

**Although there are benefits** to any RCM model, the challenges may prove too much for some institutions without autonomously-operating units. In particular, smaller-scale or centrally-managed universities may find the complexities of the RCM model impractical and counter to their culture.

## How can I achieve the financial transparency of the RCM model, but avoid the complexity of fully adopting it?

If moving to an RCM model isn't the right path for your university, you can still achieve transparency by conducting a deep-dive financial analysis, which is usually the first step for implementing an RCM model. The financial analysis disentangles the complex budgetary decisions made over the years to provide transparency into the financials of each unit. In essence, the financial analysis simulates adopting an RCM model by allocating the revenues and costs, both direct and university overhead, to the unit that generated them – essentially creating a P&L statement for each university unit.

Determining which unit generated each tuition or gift dollar and each IT or procurement expense can be somewhat complicated, and potentially controversial, but provides greater transparency into the financial health and incentives of units throughout campus. For instance, your residence life program that might appear profitable in your current budget, but the program could be costing you more than you realize due to obscured cleaning and maintenance expenses incurred by the central facilities functions.

The RCM analysis can be conducted regularly (e.g. annually) and provide one input into the central budgeting process. By conducting this RCM financial analysis, these and other types of financial implications will become transparent, arming you with the information you need to make strategic decisions.

## This sounds great, but what kind of decisions do universities typically make with this analysis?

After understanding the true financials of each university unit, there are a number of different strategic decisions universities can make, for example:

### PROGRAM OFFERING REVIEW

Using the RCM financial analysis as an input, leadership can make informed discussions about their academic program offerings. They can decide which programs should be expanded (e.g., because they are highly profitable and well-performing) and which ones should be considered for elimination or downsizing due to financial and other performance issues.

**"We were able to do so much with the budget analysis. Our Board had been pressuring our academic leadership to consolidate programs, and we were able to demonstrate that consolidation didn't make sense – each program had a positive contribution margin. We were also able to justify differential tuition for our Nursing and Visual Arts programs and realign some of our budget toward our strategic priorities. The budget analysis was an extremely powerful tool."**

**- University Senior Vice President and CFO**

### TUITION ADJUSTMENT JUSTIFICATION

The financial analysis can also be used to justify tuition or fee adjustments. For example, it can identify costly programs that are good candidates for differential tuition or additional course fees, as well as student programs that may require increased or decreased student fees to cover changes in offerings.

### OUTSOURCING DECISION

For functions that are not core to the university's mission (e.g., bookstore, dining, facilities, etc.), the financial analysis can provide insight into the total cost of the function. This can be used as an input into outsourcing decisions to help universities compare the costs of outside providers versus keeping the service in-house.

### BUDGET PROCESS MODIFICATION

Perhaps most straight-forward, the analysis can inform changes to the current budgeting process. For example, intermittent re-baselining current budgets, adjusting overhead fees charged to units or developing a strategic fund that can be centrally allocated, on an annual basis, for strategic projects.

**As universities continue** to face increasing financial pressure to cut costs and evaluate all elements of your operations, financial transparency is becoming increasingly critical. Regardless of whether you ultimately decide to pursue an RCM budget model, completing an RCM-style financial analysis can uncover a wealth of knowledge and insight into your university's or your unit's financials. This can be used to inform a variety of strategic decisions that can better set your university up for future success.

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