ADAPT UNIVERSITY BUDGET MODELS TO PROVIDE A STRONGER FINANCIAL FUTURE

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The COVID-19 pandemic exacerbated many existing financial challenges in higher education and introduced new ones, including new cuts to state funding, evaporating international enrollments and growing on-campus costs. As universities exhaust measures such as payment deferrals, furloughs and layoffs, and controlling spending and hiring to weather pandemic-related budget deficits, many are beginning to consider more transformational changes to ensure long-term financial health.

Financial pressures and growing scrutiny of higher education in this climate will pressure leaders to include traditionally sensitive topics such as academic offerings, research initiatives and athletics in discussions of financial sustainability. An institution's budget model can have an outsize impact on its ability to evaluate such high-stakes decisions.

Universities with budget models that foster active participation in resource management from unit leaders will have a running start in reaching collaborative, data-informed judgments to stabilize revenues and costs. These universities typically have a richer, more widespread base of financial literacy and data analysis, allowing them to ground discussions more quickly in a realistic understanding of their financial profile.

Comparing University Budget Models

At the highest level, budget models typically fall into one of two categories: centralized or decentralized. Universities with centralized budget models generally pool operating revenues into a single account from which expenditure authority is allocated to the university's component units. Each unit's annual funding allocation (its "base allocation") is a blend of funds that is generally disconnected from its original sources. Base allocations are often adjusted in uniform, discretionary increments across units, notwithstanding growth or decline in funding generated by each.

Centralized budget models simplify a university's funding allocation process by creating stability. Units receive an annual budget to spend that is largely immune from swings in their actual funding generation or financial margins. This dependability allows unit leaders to direct more attention to their unit's mission delivery, but provides little incentive to pursue growth and efficiency. Financial literacy and access to relevant data is usually limited to a handful of central stakeholders.

CENTRALIZED BUDGET MODEL	DECENTRALIZED BUDGET MODEL
• Units receive blended base allocations from a single account. • Unit-level budgets remain fairly consistent year to year, regardless of revenue and margins. • Financial and resource decisions are concentrated to a small group of central stakeholders. • Examples include incremental models and models with large "base" components.	• Units receive direct or activity-based allocations based on individual revenue generation. • Unit-level budgets fluctuate depending on revenue generation and cost structure. • Deans and other unit leaders across the institution have more authority and responsibility with resource decisions. • Examples include responsibility center management, incentive-based budget models and hybrid models.

Decentralized budget models link a unit's activities to the funding it receives and create stronger incentives for unit leaders to pursue growth, innovate new offerings and identify opportunities for efficiency. Under these models, funding flows to colleges as revenue rather than a base allocation. Revenue allocations are often coupled with cost allocations to fund administrative services (e.g., finance, human resources, information technology) and additional taxes to fund central discretionary investments, which subsidize select operations and new strategic projects.

While decentralized budget models provide more financial independence and opportunity to units, they are more complex to operate. Unit leaders function as "CEOs" of their units, requiring them (particularly deans) to devote more time and resources to understanding and actively managing the financial drivers of their functions. Decentralized budget models take time to fully design, implement and prepare all stakeholders for sustained success, but taking the initial steps toward a decentralized approach can bring near-term benefits. Even early on, this effort can elevate the financial literacy and data fluency across units, leading to greater engagement as institutions make important decisions about how to transform.

Preparing for the Financial Future via the Budget Model

Encouraging collaborative, data-driven budget decisions in response to pandemic-related deficits is necessary to prepare for successful change. Regardless of which type of budget model an institution operates, higher education leaders should advocate for five elements to support more integrated and informed financial planning:

1. **A case for change:** The pandemic itself created a sense of urgency; defining and quantifying the case for change in more specific terms will align stakeholders on the challenges ahead and help coordinate a unified response. What can an enhanced approach to budget management affect in terms of future hiring, program offerings or capital investments?

2. **Consistent data sets:** Access to reliable data is critical for establishing common assumptions and starting a dialogue on potential change. Universities with decentralized budget models will likely have a depth of shared data and analyses to work from, while those with centralized budget models will need to

establish new reporting capabilities that provide visibility into credit hour production, student volumes, space utilization and other insights that illustrate their current performance.

3. **Collaborative scenario planning:** Successful change in higher education requires an approach with clear channels for stakeholder input. Universities with decentralized budget models likely have established governance structures and unit leaders with greater financial experience to involve in planning. Institutions with centralized budget models will need to develop or optimize collaboration processes to support short- and long-term change.

4. **Clear and transparent communication:** The impacts of budget decisions touch constituents across an institution. Leaders should communicate regularly with deans, faculty and other stakeholders so everyone understands the methodology behind budgeting and any updates to the process (or their roles in it). These groups must be informed on any steps that will be taken to integrate data sets and nurture collaborative scenario planning.

5. **A framework for monitoring impact:** To evolve the budget model over time, institutions need to be intentional about tracking financial trends and progress. In addition to creating reports and executive-facing dashboards that demonstrate savings and revenue generation, leaders must encourage a culture of continuous monitoring.

Prior financial crises are reminders that it takes time for university revenue streams to recover, and effects from the pandemic are far from the last financial turbulence universities will endure. Short-term measures to address shortfalls will have diminishing returns. Involving more stakeholders in resource management will be an important factor in preparing institutions to make the transformative choices necessary to stay financially sustainable.

Budget models can play an important role in this preparation, motivating unit leaders to be more involved in managing enrollment, creating new revenue streams, evolving organizational structures and designing innovative instructional models. Refining your approach to budget management can be the mechanism that empowers institutions to make change possible in the face of deficits and to sustain momentum in times of growth.

Key Takeaways

Optimizing budget models can support institutions as they make strategic financial decisions to recover from pandemic-related deficits. To do so, leaders must:

Think differently.

Consider how a new culture of budget governance could incentivize transformation over the long term.

Plan differently.

Identify the mechanisms and processes your institution needs to shift from a culture of financial data entry to thoughtful and consistent data analysis.

Act differently.

Provide resources and training that develop the financial literacy of unit leaders across the institution, instilling them with confidence to make difficult but necessary choices.

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