



# Strategic THINKING

about How Costs and Goals Interact

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## TAKEAWAYS

- 1 Unless boards truly understand in significant detail where revenue comes from and where it goes, they are likely to select overly simplistic cost-cutting strategies that may create short-term savings without addressing structural cost issues.
- 2 Truly effective solutions to financial crisis must be based on thorough, complex understanding of how the finances actually work and how expenditures can be better aligned with key strategic goals or revenue-generating objectives.
- 3 Cost reduction and improvement of academic quality are not mutually exclusive. However, producing both simultaneously typically requires continual monitoring of the cost-reduction strategies in the context of system and institutional missions.

IN THE GRAND ECONOMIC SCHEME, THE intense public pressure to lower costs came late to higher education. Now that it's arrived, though, it's here with a vengeance. No institution—public or private, non-profit or for-profit—has escaped the always difficult, sometimes protracted discussions of how to increase efficiency and lower costs. Although this intense pressure predates the recent Great Recession, the “new” economic climate has made the situation worse.

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Institutions' customary clamor for ever-increasing funding in order to maintain and improve quality now collides not only with decreases in the tax base, but also with survey data from the National Center for Public Policy and Higher Education, in conjunction with the survey research firm Public Agenda, showing that six in 10 Americans believe higher education cares more about its bottom line than about educating its students. Add to that the calls from some elected officials, faculty members, and other constituents for increased spending from endowments and reserves (often based on a general lack of understanding of the restricted natures of these funds), and it is no wonder that senior administrators and boards feel besieged.

The financial fallout from the Great Recession has demanded quick action on many campuses. Trustees and senior leaders are consulting any number of sources describing typical areas in which cost reductions can be made. This "low hanging fruit" approach can quickly result in lowering some costs by such strategies as leaving positions unfilled, changing procurement strategies, conserving energy, eliminating under-enrolled programs, and redesigning high-enrollment courses. Once these relatively comfortable strategies are exhausted, other more difficult approaches that target personnel costs—the largest drivers of expenses in the budget—are often implemented. Whether through required furlough days for all employees or layoffs of faculty and staff, tackling personnel costs head-on requires very difficult decisions in the context of significant financial challenges. Yet unless they are carefully planned and strategically implemented, such strategies can have significant unintended consequences, including hidden cost increases or lower-than-expected savings.

For two reasons, we urge leaders and boards to be wary of implementing strategies drawn from lists of "good ideas for reducing costs." First, unless boards truly understand in significant detail where revenue comes from and where it goes, they are likely to select overly simplistic strategies that may create short-term savings without addressing structural cost issues. Jane Wellman, director of the Delta Cost

Project, and her colleagues have shown that common assumptions about college and university spending and, by extension, assumptions of what drives colleges' actual costs, are fraught with misunderstanding and myth. Misconceptions—such as the assumption that having an expansive curriculum reflects greater quality—lead senior administrators and trustees down unproductive paths that may result in cost "sprawl" that makes it difficult to reduce costs in tight times. For example, it is typical in tight budget times to protect academic programs across the board from budget cuts.

However, this approach eliminates the opportunity to excise some of the discretionary or less-productive programs from

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an expansive curriculum. Truly effective solutions must be based on more thorough, complex understanding of how the finances actually work and how expenditures can be better aligned with key strategic goals or revenue-generating objectives. For example, workforce-education programs may seem outside the core mission of a typical master's comprehensive university and hence a good target for elimination. But such programs may actually be a much bigger revenue producer than some degree programs. Without a careful analysis of where revenue actually originates, the wrong decision could be made.

Deeper understanding leads to a richer, more complex consideration of strategies for cutting costs, which points to the second reason to be wary of "obvious" solutions. Specifically, cost-reduction strategies do not operate independently of each other, even if they are separate items on a list of strategies. Actions focused either on cost reduction or revenue enhancement must be considered in terms of how they actually interact with

other budget categories. For example, if an institution wants to increase revenue by offering a broader array of online courses, then reductions in the library's budget for online journals and other online materials would be counterproductive.

## Unintended Consequences

In statistics, if there are multiple factors or variables that are believed to determine a specific outcome, those factors or variables may be analyzed for both their individual or main effects, as well as the degree to which they combine with each other either to exert additional influence on the outcome or act to lessen (or even eliminate) the effects predicted from the individual strategies. We see this in everyday life. When we purchase goods, we may consider, among other variables, price and quality. Each variable influences our decision, but we must consider the interaction of price and quality (i.e., the best combination of price and quality) to explain why we do not always buy the least expensive item (choosing to ignore quality) or the highest-quality item (ignoring price).

Let's suppose that a university's board and administration are determined to reduce certain costs as the means of absorbing significant budget shortfalls. Assume also that all of the most obvious strategies (for example, strategic purchasing/procurement, energy savings, etc.) have already been implemented. The biggest driver of costs, personnel, is now the most likely target.

A fairly typical approach at that point is to examine programs with low enrollment and target some for closure. Peter Eckel, in the January/February 2010 issue of *Trusteeship*, provides an excellent analysis of the up-sides and down-sides of this strategy. As he points out, if handled well, program closures can reduce costs (though often not as much as initially thought) and refocus institutions. But if handled poorly, they can seriously damage institutional reputations and employees' morale. There are additional reasons for caution. First, how does the list of low-enrollment programs relate to the institution's mission? Programs central to the mission are unlikely candidates for elimination. Although a program may have few declared majors, many of its constituent courses may be fully subscribed



as electives or requirements in the general-education curriculum or in other programs. This opens the possibility of reconstituting the low-enrollment program in another configuration. Further, requirements that faculty in closed or reconstituted programs be reassigned, if at all possible, may prevent significant personnel savings other than reductions in the institution's reliance on lower-paid adjunct faculty. The result of these interactions is that the net cost reductions may be minimal at best. The only way to accrue significant savings from program reductions is to pair such reductions with elimination of faculty positions.

### Other Common Actions

Reducing staffing levels in non-academic areas is another common approach to reducing overall costs. This strategy may also include job restructuring so that more work is done by fewer people, using more efficient and effective processes. But “interaction effects” can quickly become apparent. For example, new federal reporting regulations required by the Higher Education Opportunity Act of 2008 have dramatically increased the compliance workload in some areas (for example, institutional research), resulting in the need for greater, not smaller, staffing levels. Or in another area, reductions in the grounds-keeping staff may appear logical; however, the visual appeal of the campus is an important part of recruiting new students so significant reductions may have the unintended consequence of reducing recruitment yield—making the financial situation even worse.

Finally, some institutions redesign high-enrollment courses in order to reduce costs. On the surface, that seems a natural move—simply reduce per-student costs and then accrue the savings. But in practice, it's not that simple. While the redesign process pioneered by the National Center for Academic Transformation can measurably improve learning and reduce per-student costs in any high-enrollment course, it tends to do little to reduce overall costs unless most high-enrollment courses are redesigned at the same time—and unless the savings are used either to serve more students or to decrease overall per-student expenditures in some other way. The complications created by the combined effects



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of various actions should force senior academic leaders and boards to take a multi-dimensional view.

Sorting through the complexities, though, can be greatly aided by another perspective on how to achieve net lower costs. That perspective focuses on improving *learning productivity*, which means simultaneously increasing the proportion of people in the population who hold postsecondary credentials (degrees, certificates), increasing the rate by which people attain such credentials, and decreasing the cost of obtaining these credentials.

The learning-productivity agenda responds to the national and state policy pressures on higher education to produce more citizens with postsecondary credentials more cost-effectively and at greater scale. Improving learning productivity

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is a more sophisticated process than cost cutting because it focuses on strategic educational-attainment goals, while simultaneously trying to reduce the “unit-cost” basis, such as cost-per-degree. This requires a perceptive understanding of the multiple ways in which cost-reduction strategies interact. Learning productivity assumes that a handful of measurable learning outcomes can be identified and longitudinally tracked, along with the unit-cost basis for generating those outcomes. For example, the annual ratio of degrees granted to total student headcount and the annual ratio of operating expenditures to degrees granted, taken together, provide one way of tracking at what rate and unit-cost degrees are being attained. Such ratios relate strategic outcomes to their cost basis and thus are more sophisticated than those typically found on cost-cutting lists of “low-hanging fruit.”

Another approach to learning productivity further reveals how academic quality can be increased at the same time that costs are reduced. The Pennsylvania State System of Higher Education (PASSHE) initiated a number of performance-funding measures early in the last decade that tracked such indices as production of student credit hours per faculty member, degrees conferred, percentage of eligible programs accredited by disciplinary associations, student-retention data, and graduation rates, among others. The performance funding equaled eight percent of the state appropriations. These funds were distributed to campuses based on their performance on a set of specific indicators. PASSHE also encouraged more effective use of multiple course-delivery models (for example, face-to-face, online, blended) so as to diversify and provide more convenient access to high-quality programs. Additionally, the system implemented several cost-reduction and cost-avoidance strategies, such as strategic sourcing, energy conservation, and improved process efficiency. Results to date indicate that well over \$200 million in cost savings and cost avoidance can be documented, as well as increased faculty productivity—and significantly improved student retention and completion.

Clearly, cost reduction and improvement of academic quality are not mutually exclusive. However, producing both simultaneously typically requires continual monitoring of the cost-reduction strategies in the context of system and institutional missions. For example, cost-reduction strategies that target student support services must be implemented carefully or student retention can be negatively affected.

Another example highlights some of the difficult financial and academic challenges facing many tuition-dependent institutions that have depended on the residential delivery of a core liberal-arts education. Antioch University had its origins in a residential liberal-arts college in Ohio. Over several decades, Antioch also developed a few geographically dispersed campuses focused on educating working adults. Like many private institutions, Antioch had to respond to changing educational needs and student demographics,

such as the increase in the percentage of working adults seeking further education and a decrease in the proportion of traditional-age students interested in a residential liberal-arts experience. The university's board responded by taking two steps that illustrate how cost and revenue strategies interact. On one hand, the board ultimately took the wrenchingly difficult step of suspending operations at its historic residential college and releasing the faculty and staff, all in the spirit of Jim Collins' "good-to-great" advice for the social sectors. Collins suggests, in such difficult circumstances, focusing not on cost cutting for its own sake, but rather on strategically deciding what will not be done in the future, while steadfastly adhering to core institutional values—in Antioch's case, core values of socially engaged citizenship and experiential learning.

As the second part of the strategy for moving beyond its roots—while adhering to its values and generating new revenue streams—Antioch created a doctoral program in an executive format (occasional face-to-face meetings, combined with online delivery otherwise). The program was designed to appeal to working professionals and to point the way for future development of flexible degree programs.

### Strategic Decision Making

The combination of strategic reduction and strategic investment was the key to success. Today, Antioch University is a financially and academically healthy system of five professionally oriented campuses for working adults. New academic programs automatically include an inter-campus collaboration component that draws on the doctoral program's online-delivery model for keeping overhead low and avoiding significant capital costs, while providing a flexible learning experience for working students. The university also has outsourced and centralized the management of technology to create a common, less-expensive infrastructure in support of the long-term effort to provide flexible, affordable learning to working students, many of whom can afford neither the inconvenience nor the expense of traditional residential programs.

So what should boards and senior administrators do? In our view, the path



forward lies in making a set of strategic decisions regarding institutional goals and in identifying accountability metrics (such as degree-completion rates, student credit hours generated per faculty member, and per-degree costs) for tracking both educational success and its cost structures. Strategic decision making must be grounded in the following actions:

- **Engage in strategic thinking at the board level to rethink the institution's strategic mission goals in terms of more affordable cost (business) models.** For example, the commitment to high-quality education is traditionally enacted through the expensive model of small class sizes in all courses. Over the past decade, however, some institutions have used technology to redesign high-enrollment courses both to improve learning and to reduce per-student costs. Boards and leaders should consider this possibility as a systemic means to improve overall learning productivity by focusing on the few high-enrollment courses that generate the majority of instructional revenue. Such considerations should also include determining whether to save or reallocate the savings in per-student costs. In a different vein, the Antioch story offers some possible strategies for smaller institutions willing to seek new markets and willing to consider collaborating with like-minded institutions (analogous to Antioch's five campuses) to create and jointly operate online-degree programs that draw on their geographically distributed faculties. The story also illustrates the need to sometimes give up traditional delivery models, but in strategic ways

grounded in institutional values and missions.

- **Identify and track key learning-productivity metrics**, such as student credit hours generated per faculty member, the number of degrees awarded as a percentage of the number of students, and the annual cost of a degree as a percentage of operating costs. Technology is a primary tool that can be used both to benchmark and to improve these indicators.

- **Develop a defined set of accountability measures for monitoring cost-reduction/productivity-improvement initiatives** (e.g., tracking the relationship between cost reductions and tuition levels or avoidance of future costs).

- **Foster a full understanding of how any cost-reduction strategies to be used interact with each other and with key aspects of strategic institutional goals.**

The key to understanding the combined effects of various strategies for reducing costs is that there is ultimately no effective, successful way to significantly cut college and university budgets—and still maintain the full integrity of the institution—without rethinking how colleges and universities are organized and how they generate and allocate revenue. Just as these challenges have faced every other economic sector over the past several decades, they now face us.

Understanding how various approaches to allocating resources and reducing costs will interact with strategic educational goals can lead us to smarter restructuring decisions that improve the productivity of our learning institutions. Learning is the core mission of higher education, not the cost structures and business models that enable and support it. ■

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**T'SHIP LINKS:** Peter D. Eckel, "Closing Academic Programs: Pitfalls and Possibilities." January/February 2010. Arne Duncan, "Moving Beyond the Iron Triangle." September/October 2009.