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Responsibility Center Budgeting: A Review and Commentary on the Concept and the Process

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ACADEMIC publications, professional newsletters, convention conversations, E-mail, departmental bulletin boards, and hallway conversations at academic institutions are filled with voiced concerns about the future of higher education—specifically budgets related to academic and research program support. University administrators have closed academic departments and entire campuses as well as curtailed internal and external services and engaged in restructuring efforts to reallocate scarce resources. Faculty members and staff personnel have been furloughed, not replaced, eased out with program cuts, and given promissory notes instead of pay checks.

In the midst of this turbulence, three certainties remain. At least for any future I foresee, higher education will continue to be near and dear to the hearts, minds, and pocketbooks of the American public as they think about the future of their sons and daughters. Campuses (as is true of all organizations) are likely to become increasingly closed (as defined by systems theory) to external influences and thereby be defensive and self-protective of the members of the organizations rather than open to new options to serve people for whom they were designed. Campuses will consist of faculty, students, buildings, central administration, and staffs that will be held together and guided by academic policy—at best—and budgetary wrangles—for sure.

In tough times, innovation is essential. One innovation is responsibility center budgeting (RCB) which may empower faculty (as well as administrators and staff personnel) to feel confident that if they generate more income and lower costs for their colleges and universities they will be allowed to determine how those extra funds will be spent. Since faculty talent is the only service commodity that is for sale on campuses (except for a few fortunate campuses where athletics bring in revenue rather than draining it), RCB is a concept intended to encourage faculty members and academic officers to innovate to increase revenue and reduce costs. The motivation for this innovation is the opportunity to directly benefit from the rewards of their labor and thereby have more finances to strengthen their academic and research programs.

The question to be addressed today is whether this innovation can move universities and colleges to new levels of financial creativity or whether the faculty are likely to be further demoralized by becoming the scapegoats for all campus woes related to income and expenses. Is RCB just another means by which college and university administrations can demand more work from faculty members? Or is it a way to empower faculty members to become responsible for revenues and expenditures thereby maximizing resource acquisition and allocation?

The version of responsibility center budgeting that I will discuss is espoused by Edward L. Whalen, Vice Chancellor for Administration & Finance in the University of Houston System. His office is in the administrative center of a major urban, state-supported educational system which consists of four campuses and ancillary programs located in the greater Houston area and which serve 50,000 students. The elements of this system include the flagship (a research-based, comprehensive campus with approximately 33,000 students), an upper division and graduate campus, an open admissions campus, and an upper division campus. Based primarily on his experience with RCB at Indiana University, Whalen wrote *Responsibility Center Budgeting: An Approach to Decentralized Management for Institutions of Higher Education.* That text serves as the focal point of the description and analysis that follow.

The concept of RCB fits with the trend in organizational management to empower employees. One objective of this concept is to empower persons who are responsible for setting the policies and operating the revenue generating centers of academic institutions; if properly empowered, these individuals are likely to be outward looking and thereby to generate increased income for their units and for units which serve them. The incentive to undertake RCB results from the promise that academic officers, service department heads, department chairs, and faculty members get to keep and utilize in their unit all revenues they generate above budget projections.

The dramatis personae featured in Dr. Whalen's discussion consist of academic deans, central administrators, and heads of support divisions such as student affairs, university computing, the library, and facilities management. This cast of leading characters is supported by faculty, students, state legislators, and persons or agencies that contract grants and give philanthropically. He sees RCB as a replacement for trickle down, dribble down, or skim-off budgeting processes whereby central administrators receive state appropriations, development money, and student tuition and fees which in turn are allocated to colleges, academic departments, and other university divisions. Part of that revenue system consists of collecting indirect costs from funded research and using part of development contributions to support the development staff. He says that RCB is designed to give incentives for desirable behavior, specifically those which increase revenue and decrease costs. One of his points is that faculty must become aware of the costs of the services they use such as the buildings in which they teach and have offices, the cost of telephones, photocopy services, and secretarial assistance.

As I think about this dramatis personae, I am convinced of one telling fact. If faculty are to be the major point at which revenues of a college or university are generated through state appropriation, tuition, fees, grants, and development (because of their teaching, research, and public service), their presence is slighted in the discussion Dr. Whalen provides. Their role in the negotiation of budgets, especially the definition of costs and income levels, is not made explicit in the design as he presents it, except to hint at its importance. As I interpret the plot of RCB, deans, central administrators, and heads of support centers on campus would be empowered to bill faculty for services performed in their behalf. As I think about this drama, on the one hand I foresee an empowered faculty—the ideal of the plan; on the other hand, I am reminded of taxation processes (without representation) that are captured in the archetypal character of the Sheriff of Nottingham. Taxation—demand for revenues—may be based on what the lords of the manor want to do, rather than what they can afford to do. The people of the countryside, in this case the faculty, who are at the point of production are expected to support the needs and wants of the lords of the manor. This is my characterization of the downside of RCB. Is it a fair characterization? Would the outcome be bleak on every campus?

How well RCB works on any campus or university system depends on the ability of key players to follow nine concepts and related guidelines. These concepts are sound in principle and reflect current organizational and managerial research findings and their underlying assumptions.

- Concepts related to decision making

  <u>Proximity</u> - assumes that decisions are better when they are made closer to the point where they will be implemented.

  <u>Proportionality</u> - assumes that the larger a university is, the more it should be decentralized.

  <u>Knowledge</u> - assumes that decisions are likely to be better when they are made in information rich environments.

- Concepts related to motivation

  <u>Functionality</u> - assumes that authority and command over resources should be commensurate with responsibility for the task assigned, and vice versa.

  <u>Performance recognition</u> - assumes that performance increases when distribution of responsibility and authority is made in an environment having clearly stated rewards and sanctions.

  <u>Stability</u> - assumes that stability increases the quality of planning and performance.

- Concepts related to coordination

  <u>Community</u> - stresses how institutions of higher education are collective human endeavors.

  <u>Leverage</u> - assumes that the legitimacy of institutional and local responsibilities must be established to make a decentralized decision-making operating system work.

  <u>Direction</u> - assumes that the university must have a strong and clearly defined sense of itself to make its short- and long-term efforts successful and subject to evaluation.

Based on these nine concepts, budget development should be guided by the following principles.

P1: "Responsibility should be commensurate with authority, and vice versa."
P2: "Decentralization should be proportional to organizational size and complexity."
P3: "Locally optimal decisions are not always globally optimal; central leverage is required to implement corporate (global) priorities."
P4: "Outcome measures are preferable to process measures."
P5: "Accountability is as good as the tools which measure it."
P6: "Quantitative measures of performance tend to drive out qualitative measures (a variant of Gresham's Law)."
P7: "Outcomes should matter; plans which work should lead to rewards, plans which fail should lead to sanctions."
P8: "Resource-expanding incentives are preferable to resource-dividing ones."
P9:"People play better games when they own the rules" (p. 178).

RCB is intended to counter the tendency to separate the point in an organization where decisions are made from the point where they are implemented. It is based on an indictment of current academic budgeting processes that assume that money is allocated to programs by university officers and central administrators who are so far removed from programs that they have no good measures of the quality of each program in terms of its ability to generate income or minimize costs. For that reason, people who are implementing the decisions have no incentives to minimize costs or maximize income because they see no benefit accruing to themselves for their ability to do so. Seeking to empower the key decision makers, RCB is designed to narrow "the gap between the point of decision and the point of implementation" (p. 13).

Because times for many colleges and universities—until the recent past—have been pretty good, academic administrators and other people in programs have tended to take budgets for granted. In contrast to such a cavalier attitude toward costs, RCB impresses on the participants in the budgetary process, especially people in academic programs, that nothing is free. They become responsible for knowing and accommodating to the costs of their efforts. They are assumed to be motivated to be attentive because they can benefit from conserving costs, whereas, under traditional budgeting, faculty and staff often are oblivious to the costs associated with their activities. Once people in other responsibility centers begin to send "bills" to the faculty requesting payment for use of buildings, library, student services support, and university computing, they will quickly realize what it costs to generate the revenue they use to pay the costs.

Once the decision has been made to undertake RCB, substantial effort must be devoted to defining the boundaries of responsibility centers, establishing their cost and revenue relationships, and identifying which person has primary responsibility and authority for the center. Definition of these centers must "correspond with the institution's academic and administrative structure" (p. 13). According to this approach, responsibility centers

> are charged with academic, service, and management missions. Like a university, they retain the income they earn for their activities. Like a university, they pay for all the costs of their activities—indirect as well as direct. Like a university, they function as separate financial entities retaining their year-end balances. Like a university, the heads of centers are expected to manage the resources at their disposal to maximize the effectiveness of their performance. Like a university, academic units

receive state support—not directly but through allocations of central management (p. 14).

If a college or university is driven with a cost/revenue mentality, it could lose sight of academic and research excellence, substituting instead a "K-Mart" or "Wal-Mart" attitude. Therefore, budgetary policies must be driven by academic policies: "academic priorities should lead rather than follow the budget process. Responsibility center budgeting is designed to make the budget process responsible to academic priorities" (p. 17).

Three broad kinds of responsibility centers exist on campuses: academic centers which are the primary mission units of campuses because they feature the activities that generate revenue (teaching, research, and public service); support centers (library, building services, university computing, student services); and executive management which has the "global" perspective needed to coordinate plans, evaluate the budgetary and revenue generation/allocation process, define relationships between centers, and allocate resources. The definition of this last center is likely be the most controversial because, although it is not the point of production, it is the traditional point of power and authority in a college or university. Its members are accustomed to defining the budget and expecting faculty to make do with what is provided. So special is its role in this process that RCB calls for it to have a special fund that it controls because it needs to be able to allocate funds for projects that have potential to generate revenue, reduce costs, or respond to legislative or regulatory mandates. The size of that fund, which is subject to negotiation, depends on the magnitude of projects that may need initial funding and the turbulence of internal or external environments that require organizational flexibility.

In terms of revenues, centers receive (a) a portion of state funds, (b) student tuition and fees related to instruction, and (c) other monies in the form of grants and contracts, as well as philanthropic gifts. Not all centers have direct access to these sources of revenues, but the persons responsible for them nevertheless have costs to bear. Therefore, RCB is based on the assumption that centers must charge for services rendered and pay for services received. For instance, university computing can charge academic departments and administrative centers that use its services. The dramatic change introduced by RCB is that under typical budgeting processes, managers are responsible only for direct costs. Under RCB, they are also responsible for indirect costs. "With a decentralized approach to decision making, the head of each center must recognize the effect of her or his decisions not only on the center but also on the entire institution" (p. 50).

Each center needs a means (negotiated and defined in conjunction with heads of other centers) for charging for its services. At this point, it must be noted that university executives and administrators are costs borne by the rest of the university and not points of income, except through development. Typically, however, philanthropic donors do not give monies that directly pay for administrative costs. Moreover, the ability of a campus to generate philanthropic donations depends on the current or potential quality of academic programs, research, or services to be supported by those dollars.

Viewed this way, central administration is a support center to academic centers; it needs to help them achieve their missions and therefore deserves to receive revenues to the extent that it accomplishes that mission. This line of discussion brings us to a key criterion on which the success of RCB rests. The quality of the negotiation of costs that transpires between heads of centers, a fundamental aspect of empowerment, depends on the extent to which costs of central administration are subject to honest and open review by heads of other centers and the extent to which that discussion can transpire in an information rich environment, one in which central administration shares information not typically available to faculty, deans, and service department heads.

Done properly, such negotiations, along with the cost/revenue balances that result for all centers, give the opportunity to assess each unit of the university. "Rarely does an opportunity present itself to express the relationships constituting a university as a community, with mathematical precision and elegance. Determining total costs for responsibility centers provides such an opportunity" (p. 73). The objective of direct cost attribution is to make sure that all costs are attributed to responsibility centers. In this process, "direct costs of central administration will be allocated only to academic centers" (p. 74). That relationship can be constructive or destructive to the extent that revenue generating centers, primarily consisting of academic programs, participate in an empowered manner in decisions regarding which central administration units add value to the revenue generation process. If deans are the key negotiator for costs and revenues of a college, the faculty must be confident that its interests are protected; the lust deans typically have to become members of central administration is likely to undermine the empowerment that is essential to RCB.

One can sense in his discussion of RCB that Whalen is concerned about impressing on academic members of the organization that what they do must generate revenue in an environment that costs—costs they must bear. What he is less explicit about is the awareness that central administration only adds value to the extent that it increases the process of revenue generation and guides the decision processes between RCB's—with the purpose of improving the process. It serves no other function. Therefore, in principle, any cost, other than those that enhance revenue generation, is unworthy of being funded (paid) by the academic centers.

Another point that is mute in Whalen's discussion is the value of faculty service to the university. One wonders whether the value of faculty members' service to the university governance and administration processes becomes a cost that counterbalances costs charged by central administration. Through casual observation, one could conclude that thousands of dollars of faculty time are devoted to service on college and university committees. In most campus merit review processes, such service is treated as rewardable. If faculty service to the university is without value, it should be discontinued; if it has value, then it must be credited or central administration must pay for it. That principle would have two benefits in the RCB process: (a) it would more adequately assess the value of faculty service than is routinely done through traditional merit review processes, and (b) it would make central administration aware of the true value of faculty service and demonstrate the point that those services are not a "free lunch" for the administration to enjoy. I am unaware of any campus that would allocate to a faculty member the costs of his or her professional time as an incentive to obtain philanthropic contributions or research grants.

This brief discussion of RCB is intended to highlight the issues likely to frustrate the budgeting process. Those problems could become sticking points in the decision process, but Whalen is full of hope based on the promise of RCB. Therefore, he reasons optimistically, "as long as the heads of both academic and support centers can be counted on to put the university's welfare ahead of their own self interest and the welfare of their respective units, securing agreement should present no problem" (p. 75).

Aside from considerations of the general assumptions of what are costs and revenues and how they will be negotiated, RCB introduces sets of decisions about how each budget is developed. Budgeting is sequential whereby one issue is the costs in order of their attribution or incomes in order of their generation. The head of physical facilities, for instance, charges other responsibility center heads for the costs of those facilities plus the cost of central administration. The library charges its costs plus those of physical facilities and central administration. Note: Does this set of relationships allow central administration the opportunity to hide its costs by embedding them in activities of other centers or does it allow those centers the opportunity to negotiate the value and agree to the costs of central administration? Is central administration to be no larger than, and thereby only to generate costs to serve other centers? That model is different than the skim-off method where central administration skims money before passing it to academic programs, including the ability to take monies from instructional accounts to supplement deans' salaries despite the fact that the dean does not teach or teaches courses that do not generate the kinds of revenue that the dean's salary would justify.

Throughout the budgeting process, all information must be made available to all parties to create the needed level of trust and openness. Implementation requires "Statements of objectives and policies, criteria defining responsibility centers, and methods for attributing income and for allocating expenses to them" (p. 95). Implementation requires historical data and projections regarding enrollments. It requires projections of personnel position needs, supplies and expense shortfalls, and equipment deficiencies. Openness, information driven decision making, and blending of authority and responsibility are vital to empowerment. Throughout this process, "the budgeting system has to be tailored to an institution, its leadership, and academic objectives" (p. 99). If the process works as it should, the budget will be tailored to the institution, its leadership, and its academic objectives because those elements will drive the budget development and implementation process. It will bring to the decision table the people who are accountable for the process and give them incentives and mechanisms to engage in open, informed decision making.

This proposed system arises from different sets of assumptions regarding the role different revenues and costs play in the process. "Prior to implementing responsibility center budgeting, when the budget was merely configured in an RCB format, state appropriation was distributed among centers as a balancing entry to equate income and expenditure. It was determined only after all other income and expenditure considerations were in place." "Once responsibility center budgeting is underway, state appropriation no longer plays a passive role. It becomes the device through which campus, university, and state priorities are reflected in resource allocations among programs. Rather than being the last variable to be determined in the budget construction process, it is among the first, and is set independently—in part, at least—of other sources of income and existing expenditure patterns" (p. 110).

This application of revenues is driven by new assumptions, not merely different but different for a reason. The incentive for centers, especially academic ones, to participate rests with the assumption that if they enjoy a windfall, they get to use it to develop and promote programs over which they have responsibility. The downside in the RCB system is one that academic programs are less likely to be prepared to assume. If they have a shortfall, they must generate more income or cut program costs. One way to cut costs is by using cheaper teachers, such as part-timers or teaching assistants. Another tactic is to raise the faculty/student ratios by strategies that include increasing average class size, lowering admission standards to admit less qualified students, increasing the number of required courses, increasing the number of courses each faculty member teaches per semester, reducing released time for administration, service or research activities that do not generate revenue, or reducing costs of instructional support. This last item is especially important because it assumes that if an innovation in teaching increased the quality of instruction but did not generate more money, it could not be afforded even though it would enhance the quality of the educational experience and result in better educated students.

RCB makes academic deans, department chairs, and faculty members aware of the changes which they consider. Methods they consider to adapt to conditions created by RCB may increase revenues but they may also increase costs. An increase in enrollment would generate more money from student fees, but it would incur more costs from student services, university computing, and the library. For either the increase in costs or the changes in the ways units increase revenues, a synergism exists between the center as a system located in an environment; all of that is to be guided by the mission of the university and the unit. One key element of that mission might be to maintain or increase quality. If that principle is to be maintained, then the budgeting process must reflect it. If it is not to be maintained or cannot be maintained given the constraints imposed by the environment, then the mission may have to be changed. For obvious reasons, RCB is unable to escape cart-and-horse decisions that frustrate academic planning, but it may make them more apparent and open for discussion.

Analysis provoked by considerations of RCB suggests the reality that a university, as well as its subsystems, does not operate independent of the rewards and costs made possible by its environment. "Two uncertainties beset a school's appropriation allocations: (a) funding level provided by state government and (b) central administration's allocation decisions" (p. 132). Allocation of funds by central administration should be compatible with the expectations of each legislature and reflect the university and program missions.

Strengths and Weaknesses of RCB

The strength of RCB is its ability to rationalize the budgetary process, make key players accountable, and empower heads of centers (as well as individual faculty members) who can innovate ways to generate more revenue or lower costs without harming the mission of the university or the center. If implemented correctly and fostered by people who are committed to its principles, it can go a long way to rationalize the budget process and make deans, chairs, and faculty members responsive and responsible to it.

On the other hand, the system has weaknesses that must be considered. Some weaknesses I have mentioned above and will reemphasize below. How serious these weaknesses become, it seems to me, depends on the openness of the process, the honesty and goodwill of the people involved, and the willingness to let the mission of the university drive the process instead of letting the process drive the mission. I list several weaknesses which seem to require little discussion.

1. Use cheaper instructors, part-time faculty and graduate teaching assistants.
2. Fail to use methods, such as technologies that could improve the quality of instruction, because the cost of the technology cannot be translated into additional income.
3. Develop easy, large courses.
4. Increase faculty/student ratios.
5. Divide faculty members through discussions of the number of dollars they generate versus their salaries, without being able to quantify some faculty efforts that fit the university mission. This problem often rears its ugly head under current budget systems, but would be magnified in a system where course credit hours are the primary measure of a program, as opposed to research.
6. Develop courses in one center to avoid having to pay costs to another center to teach those courses, especially service courses.
7. Develop centers of technologies, such as computer clusters, to avoid having to pay costs to university computing.
8. Create courses based on their potential to generate money and require more courses, rather than tailor the curriculum to purely academic reasons.
9. Base promotion and tenure decisions on income generation/cost savings bases.
10. Translate research, publication, and artistic endeavors into income to offset the cost of their production. (Note: Such measures could interfere with consulting relationships, as well as artistic endeavors, whereby faculty are prohibited from

such activities or required to share income from such activities with the university.)

11. Fail to properly assign cost responsibility or income. (Note: Is the university newspaper owned by a school of communication or the university?)
12. Allow imbalance between the size of centers to allow the strong to dominate the weak, the large the small.
13. Harm collegiality between centers because of fights over costs and incomes.
14. Fail to be sensitive to formula funding distortions. (Note: Engineering could earn more money by teaching communication than by paying for that service; and the cost of faculty members in one program in a college may be greater than faculty in another program despite the fact that formula funding does not reflect that difference.)
15. Engage in cost gouging. (Note: Heads of centers can charge more than the service is worth because no open market exists; will departments be allowed to seek bids for services, such as having offices painted? Can the faculty contract for outside central administration services and refuse to pay for services that lack value?)

Budget priorities and projections are difficult to achieve and thereby become the basis for determining whether a unit met or exceeded its income obligations. The examples that Whalen uses are those related to income generated at the college level, such as meeting or falling short of enrollment expectations. But he does not deal with mistakes and stupidities that other centers might seek to pass on to well-managed academic centers. To what extent is a fine, well-managed and hard working faculty to be held in a kind of institutional slavery by centers that are not well managed but nevertheless are allowed to pass costs along, even though they have no established market value?

To avoid hazards, an institution needs "a clear vision of its objectives," "a commitment to an academic agenda designed to achieve those objectives," and "strong leadership characterized by a willingness to communicate and participatory management" (p. 162). RCB should make center managers more outward looking to seek sources of revenue and cut costs. Therefore, great pressure will be placed on faculty members to solve the problems of loss of revenues. They will be scapegoats for all of the faults of the university and will be unable to define the costs that they are willing to pay for services over which they have no control. It may also assume that deans, chairs, and departments cannot engage in measures to cut costs. RCB can only work if it makes members of central administration accountable to faculty, chairs, and deans.

The last line of Whalen's book states a key premise: "we should always remember: the faculty are our entrepreneurs. They do the research and write the proposals for external funding. They teach the courses and develop the curricula. Ultimately their work and personal quality attract students, colleagues, and research support, and philanthropic donations. They must be involved" (p. 198). The big question is whether RCB can be operated by adhering to that principle, placing the faculty central to the planning, budgeting, and evaluation process.

What about excellence, especially as it is translated into instructional decisions and implementation of the reward system? Keep in mind that the reward system, the one created and implemented by the university administration, is the driving force of each college's and university's culture. How does above average teaching, quality publication and research, and public service get measured and repaid to support a program's excellence? State allocation is partially sensitive to that issue, but is RCB? What about differences in the cost to deliver services that are paid for at the same rate? Tuition may be insensitive to differences in cost to deliver three credit hours of instruction by a communication faculty member or an English faculty member. Yet, the difference in salary could be 30-40% based on the fact that English faculty members earn less than communication faculty members do.

The chief downside of RCB is that central administration can use a piece work strategy to adapt to downward spiraling budgets—to lull faculty into working harder to generate more money on the false lure of receiving more rewards. That kind of terrible outcome can only be avoided if the faculty have control over budgetary guidelines for their performance and if those performance guidelines, generated by costs of other centers, are not mandated by other centers. Central administration cannot order faculty to do more work. Therefore, RCB is a strategy that on the one hand appears to give incentives to do more work or to work smarter to receive the benefits of the efforts, but the real test of RCB will be in the process whereby the costs of other centers, including central administration, are calculated and charged to the faculty who bear the burden of paying them by obtaining revenue through tuition, state formula funding, research grants, and philanthropy.

Enough! RCB holds promise. That promise is justified because of the principles on which it is based. But as is true of any managerial system, performance depends on the people who operate it. My doubts are generated by what history has instructed me about university politics. I will believe in RCB when it is demonstrated to me that faculty members can refuse to pay their portions of the costs of poorly managed service centers and salaries of central administrators who are incompetent and therefore cost more than they are worth. Those units of a university must be measured by the degree to which they add value to its revenue units. Despite my reservations, my comments are not intended to defeat RCB but to refine it—to neither praise nor bury it.

REFERENCES AND NOTES

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