

Making It Real

Incorporating cost management and productivity improvements into financing decisions

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Higher education is being challenged to increase access and degree attainment for all student groups—a tall order under any circumstances, but particularly daunting in the current economy.

To do this, institutional and policy leaders will need to find ways to reduce costs and permanently reduce spending demands while they maintain access. This means both restructuring costs and increasing productivity—difficult concepts within higher education because of the traditions of institutional finance and an academic culture that views productivity as a bureaucratic codeword for budget cutting.

To get past some of the rhetoric that typically surrounds the topic, this article explores how this could be done, beginning with language and concepts.

Language and concepts. The language of higher education finance can be blurry, and confusion in language leads to confused decision-making. The terminology is not standard within higher education, and words that mean different things (for instance, costs and prices) are sometimes used interchangeably. But the goal of cost restructuring won't be met if institutions are simply shifting costs or cutting budgets. For this discussion, it's important to distinguish between budget cuts, cost shifts, cost reductions and productivity improvements.

- *Budget cuts* are one-time spending reductions through steps such as hiring freezes, furloughs and across-the-board reductions. Budget cuts lower spending, but they are not designed to be permanent changes to the base cost structure. As an example, a two-week unpaid furlough for an employee with a salary of \$70,000, and a benefits package costing an additional \$14,000, will save the institution \$3,230. But the salary has not changed, and unless the reductions are permanent, the employee can expect to make \$70,000 plus benefits when revenues go back up.

Unless benefits are managed, institutions will do what they have been doing to balance budgets—hire more part-time faculty, who are not eligible for benefits. Moral issues aside, this is not a prudent investment strategy.

- *Cost shifting* is a substitute of one revenue stream for another with no change in base spending. For example, if a state reduces spending for higher education, and institutions increase tuitions to backfill for lost state funds, then costs have shifted. Actual spending has not gone up, although prices have. The dynamic of cost-shifting to push spending onto students is one of the reasons policymakers and the public frequently confuse costs with prices, and assume that if institutions are raising tuitions, it's because they are spending more.

- *Cost restructuring or cost cutting* relate to permanent structural

reductions in spending. Structural reductions in costs can occur on both the “administrative” side—through restructuring of back-office support to consolidate expenses—or on the academic/program side. Cost restructuring reduces pressure on spending over time, but may not yield much in immediate savings. For instance, an institution that uses faculty attrition from retirement to phase out high-cost/low-demand programs will yield long-term savings in costs, but very little in the first few years.

- *Productivity increases* mean

increases in outputs (degrees produced, for instance) without a change in inputs (admissions requirements or revenue). Any institution that permanently reduces spending will show reduced costs per degree produced. But this can happen by increasing admissions requirements—to get better-prepared students, who require less in spending for student aid or for remedial education. In this case, costs may go down, but productivity has not actually increased. To get at instructional productivity—getting more students through to degrees

without compromising access—it is helpful to focus on what higher education professor

Bruce Johnstone of the State University of New York at Buffalo called “learning productivity”—increasing learning achieved at reduced cost to the student and to the institution. An increase in learning productivity can come from reducing the average number of units taken by students en route to the degree. Substituting credit by examination for classroom-based instruction also yields higher learning productivity.

Metrics and decision processes. A perennial challenge to an institution facing the need to restructure costs is that most don’t have data that show them where they are spending money. Most fiscal measures are presentations of institutional budgets or financial statements—neither of which shows how resources are used within the institution. Finding data that translate spending into academic performance—for instance spending per degree, or spending per discipline—requires looking at spending, not revenues or balance sheets.

Before institutions start restructuring costs, they need to begin with data that show them where their money comes from and what it buys. Even aggregate data will show patterns in where costs are increasing disproportionately and can be the basis for more granular studies. To get at cost drivers within the instructional program, and particularly to tackle issues of increasing productivity, institutions need to get to “unit cost data”—or spending per FTE of student credit—by discipline and degree level. This can help them generate measures of cost per degree, and the relative cost

of “excess” units taken en route to the degree, versus the cost of student attrition.

Using data on revenue and spending trends, the Delta Cost Project has identified the following as the most promising candidates for permanently reducing costs and increasing productivity.

Cost restructuring

- **Employee benefits, including pensions as well as health benefits.** Spending for employee benefits—particularly retirement and health benefits—is on “auto pilot” in many institutions as they are higher education’s fastest growing expenditures. These are politically popular, and pensions, in particular, cannot be retroactively changed for current employees. But the costs are consuming a higher proportion of resources each year—an amount that shows no signs of going down. Even if we are successful in containing growth in health care costs, losses to public retirement funds have been severe, which will require even higher contributions in the future if they are to remain actuarially sound. Unless benefits are managed, institutions will have no choice but to do what they have been doing to balance the budgets—which is to hire more part-time faculty, who are not eligible for benefits. Moral issues aside, this is not a prudent investment strategy for an industry wanting to increase student learning and degree attainment.

- **Student aid.** Another fast-growing spending area has been student aid, particularly “merit” aid going to students to induce them to enroll in a particular institution. Merit aid may help the academic pedigree of individual institutions, but it does nothing to

increase overall productivity, since it goes to students who would go to college somewhere without it.

- **Administrative spending.** Administrative spending, for activities as varied as executive staff, legal services and campus safety have also been increasing faster than spending on faculty or student services. Frequent targets of faculty and public criticism, these spending areas are examples of things that may be individually important, but collectively difficult to justify. All institutions need to be able to scrub their administrative payrolls to be sure their resources are applied to public and institutional priorities.

- **Academic program consolidation.** Every institution has some high-cost/low-demand programs that can be eliminated or consolidated to save money. Program consolidations are tricky politically, and painful for faculty in particular. And because they don’t yield much in short-term savings, most institutions avoid them, in preference to phasing out programs when faculty retire. But programs are the building blocks for academic expenses, and each program carries with it attendant costs for student services, academic support, grounds and buildings and employee benefits.

- **Faculty turnover planning.** Faculty turnover planning provides an opportunity for every institution to restructure faculty costs, using the occasion of retirement to anticipate and enact permanent changes in staffing and compensation patterns. Most institutions will say that recruiting new faculty costs more—not less—than the faculty of the past. This is true in high-cost, high-demand disciplines such as economics, health sciences

and engineering. But it is not similarly true in the humanities and social sciences. Turnover planning also gives an institution an opportunity to think about new ways to compensate the profession—such as by recruiting faculty who are paid to be full-time teachers, and who might be put on revolving five-year contracts rather than tenure. A controversial topic, to be sure—but probably better for quality and morale than the current pattern, which is to allow the majority of credit hours in lower division courses to be taught by graduate assistants and part-time lecturers.

Increasing learning productivity

- **Reduce excess credits to the degree.** Research on the cost of degree production shows that “excess credits”—courses that exceed the minimum required for the degree—add around 27%

first-time students do not persist to a degree. This translates into additional costs, not to mention fewer graduates. Studies of attrition and the costs of attrition show that most of the attrition for undergraduates occurs in the first two years of degree work, thereby increasing average degree costs by around 20%. (The cost is lower than the 30% figure that might be expected because unit costs are typically lowest for lower division students.) Attrition is most costly at the doctoral level—more than doubling the cost of graduate degree production. Most doctoral attrition occurs after students have been advanced to candidacy—clearly a huge loss in academic productivity.

- **Increase use of distance-based learning.** Technology offers an opportunity for increasing academic productivity by substituting distance delivered instruction for classroom

Turning this trajectory around will require sustained attention to the problem of educational inequality, and the leaky pipeline that persistently disadvantages first-generation and low-income students.

Compared with that, solving the structural financial problem is small potatoes. But if we don’t fix the financing side, through permanent restructuring of costs and greater attention to productivity, the failures of our funding system will be the reason our country fails in academic performance. Surely we can do better than that.

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to the average cost to produce a degree. Moreover, the four-year degree has incremented into a five-year degree for many students. Getting “excess” credits down to zero is probably not realistic or academically desirable, but getting them down to no more than an additional semester’s worth of coursework is a good place to start. Eliminating excess credits also helps cut student costs to the degree—reducing the additional tuition and fees needed to stay in school, as well as foregone income.

- **Reduce attrition.** Patterns of attrition vary across different types of institutions. But in the majority of institutions, about 30% of

instruction. Studies of the costs and benefits of technology-enhanced instruction show that student learning can actually be increased in these models, so even if costs are not reduced (a hot topic and a debatable point in some studies), the learning outcomes go up.

Public perceptions to the contrary, higher education leaders are no strangers to budget cutting. But the dominant model has been to reduce spending through one-time strategies rather than through permanent reductions in core cost structures. If current trends persist, in 2025 the U.S. will have lower levels of educational attainment than most of the developed world.