Options for the 1990s and beyond...

Office of the President

December, 1989

The Near Term

FY90-91 Revenue Strategies

State Appropriation:

Base: "We get what we get..." (probably 4%)

Special Programs:
- **Extension of REF**
- **Endowed professorship match**
- **ICR match**

Capital Outlay?
- **Start of Five-Year Plan ($500 M) ... wishful thinking...**
- **East Engineering ($27 M) ... ???**

Indirect Cost Recovery:

Can allocate more of ICR to General Fund...
...IF we can identify real sponsored research costs that General Fund will now have to bear (e.g., MSRB I, II)

FY90-91 Revenue Strategies (cont)

Tuition:

- Set nonresident tuition increase at market level (8% to 10%)
- Set resident UG tuition increase at "negotiated level" (6.5%)
- Limited "unbundling" through differential UG tuition in selected professional schools (Eng, Bus, Pharm)
- First step toward equilibrating instate and outstate graduate and professional tuitions

Fees:

- Include academic programming and counseling in Housing fees
- Limited "unbundling" of other fees (labs, Res Coll, etc.)

FY90-91 Expenditure Strategies

- "Hard times" warnings
- Continuation of 1% "off the top" tax
- Provost continues to say "NO" most of the time...
  ...and when he says "YES", it is usually on a cost-sharing basis
- Selective program reduction?
  (of limited value for one-year scenarios)

Outyear Revenue Strategies

State Appropriation:

- State has neither the capacity nor the will to increase support for higher education. At best, we will track inflation through 1990s...

Tuition:

- Track nonresident tuition at private marketplace
- Price instate tuition at true costs minus "state subsidy"

  (Or at nonresident tuition minus "state subsidy")

- Equilibrate instate and outstate tuition for graduate and professional programs
- "Unbundling" strategies (more on this later...)

Outyear Revenue Strategies (cont)

Fees:

- Debt-financing fees for academic facilities construction

    (E.g., financing $120 million ==> 10% tuition increase)

- Include more academic programming fees in Housing

- Other special fees
    ...laboratories
    ...information technology
    ...special programs (Res Coll, tutorials,...)

Financial Aid:

- If it becomes necessary to continue to track outstate tuition at private levels -- and the "state subsidy" of instate tuition continues to erode -- then it may be necessary to give serious thought to restructuring financial aid

Outyear Expenditure Strategies

Key Goal: To change the corporate culture...

- **To focus our eforts on our primary missions: teaching and research (rather than becoming a "company town"...)**
- **To move units away from the idea that all new programs must be add-ons rather than substitutions**
- **To create more incentives for entrepreneurial efforts (private fund-raising, sponsored research, auxiliary activities)**
- **To create more incentives for productivity and efficiency increases at the local level**
- **To facilitate long-range (5 year) budget planning by units**

Other Outyear Strategies

- How do we control growth in a highly decentralized system (e.g., Medical Center)? Position control?

- Do we want to get serious about reducing the general level of activity of the University?
  ...enrollments
  ...number of programs
  ...number of activities

- What about "unbundling" strategies?
  - Unbundling distribution
    (telecommunications, summer sessions, networks)
  - Unbundling products
    (continuing education, languages, niche markets)
  - Unbunding pricing
    (school by school, degree by degree, fees)
  - Unbunding deployment of labor
    (faculty roles, more flexible job families)

A Business Plan for the 1990s and Beyond...

Office of the President

December, 1989

Concerns about the Costs of Education

Concerned Constituencies:

- Frustrated parents, frightened that the promise of a college education is being priced beyond their reach
- A generation of students openly skeptical about whether the degrees they seek are worth the stated price
- Public officials who are learning that just saying no to tuition hikes makes for eminently good politics
- Frustrated and disappointed trustees...

Reality:

- The cost of a college education relative to personal income has not changed in the past couple of decades.
- Strong financial aid programs have protected access for the most disadvantaged of students.
- However, it is clear that one can no longer simply "work one's way through college"...

The Costs of Excellence

- The costs of excellence will increase faster than the resources available to most institutions.
- Most will be faced with making the transition from three decades of growth to the no-growth era of the 1980s and beyond.
- More and more institutions will compete for fixed or declining pool of funds, students, and faculty candidates.
- There will likely be a shakeout in which those institutions which have already achieved a critical mass of excellence--and have the determination and capacity to sustain it--will draw the best from the available resources and accelerate away from the pack, leaving the rest to compete for a declining resource base.

Some Theorems Concerning the Costs of Higher Education

HTS Theorem #1: There has never been enough money to satisfy the legitimate aspirations of a truly enterprising faculty or administration.

HTS Theorem #2: The cost of quality in teaching and excellence will rise faster than the total resource base of most institutions.

DEVH Theorem: Over a sufficientlylong time, no resource constraints are rigid. All can be managed or changed.

Principal force driving up costs in higher education:

Competition

...for the best faculty

...for the best students

...for the best programs

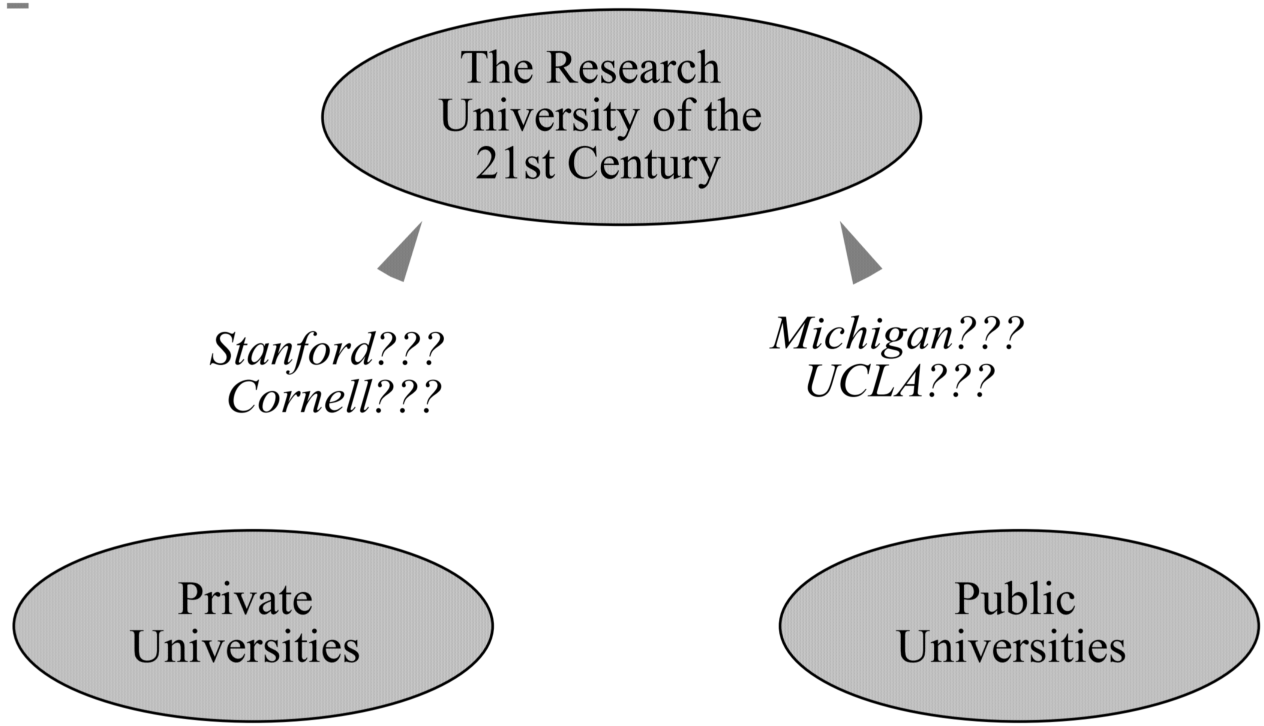
...for private resources

...for public resources

To be #1...

Observation

Since the top institutions will compete in the same marketplace--for the best students, for the best faculty, for R&D funding from Washington, from grants from industry and foundations--they will, of necessity, become increasingly similar. That is, the differences between the best public and private research universities will tend to vanish over the next two decades.



Who is our competition?

1. The Leading Public Institutions?
   UC-Berkeley, UCLA, UCSF, UCSD???
   Big Ten (Illinois, Wisconsin, Indiana,...)
   Sunbelt: UNC, UVa, Texas,

2. The Leading Private Institutions?
   Leaders: Harvard, Stanford
   Smaller "Ivys": Yale, Princeton, Columbia, Chicago, Duke
   Comprehensive: Cornell, Penn, Northwestern,...
   Special Focus: MIT, Caltech

Leading Undergraduate Programs†

1. Stanford
2. Harvard
3. Yale
4. Princeton
5. UC-Berkeley
6. Dartmouth
7. Duke
8. **Michigan**
9. Chicago
10. Brown

†US News & World Report

Leading Professional Schools†

Law	Engineering	Business	Medicine
1. Harvard	1. MIT	1. Stanford	1. Harvard
2. Yale	2. Illinois	2. Harvard	2. Hopkins
3. Michigan	3. Stanford	3. Penn	3. Penn
4. Stanford	4. UC-Berkeley	4. MIT	4. UCSF
5. Columbia	5. Caltech	5. Chicago	5. Yale
6. Chicago	**6. Michigan**	6. Northwestern	6. Washington
7. UC-Berkeley	7. Purdue	**7. Michigan**	7. Stanford
8. Virginia	8. Cornell	8. CMU	8. Duke
9. NYU	9. CMU	9. Columbia	9. Columbia
10. Penn	10. Texas	10. UC-Berkeley	10. Cornell

†US News & World Report

Office of the President

December, 1989

Financial Resources per Student†

1. Princeton
2. Harvard
3. Caltech

.....

10. UCLA
11. UC Berkeley

.....

14. U North Carolina

.....

20. Duke

.....

30. Michigan

†US News & World Report

How do we compare in resources?

A crude measure: Total "academic" expenditures per FYES student

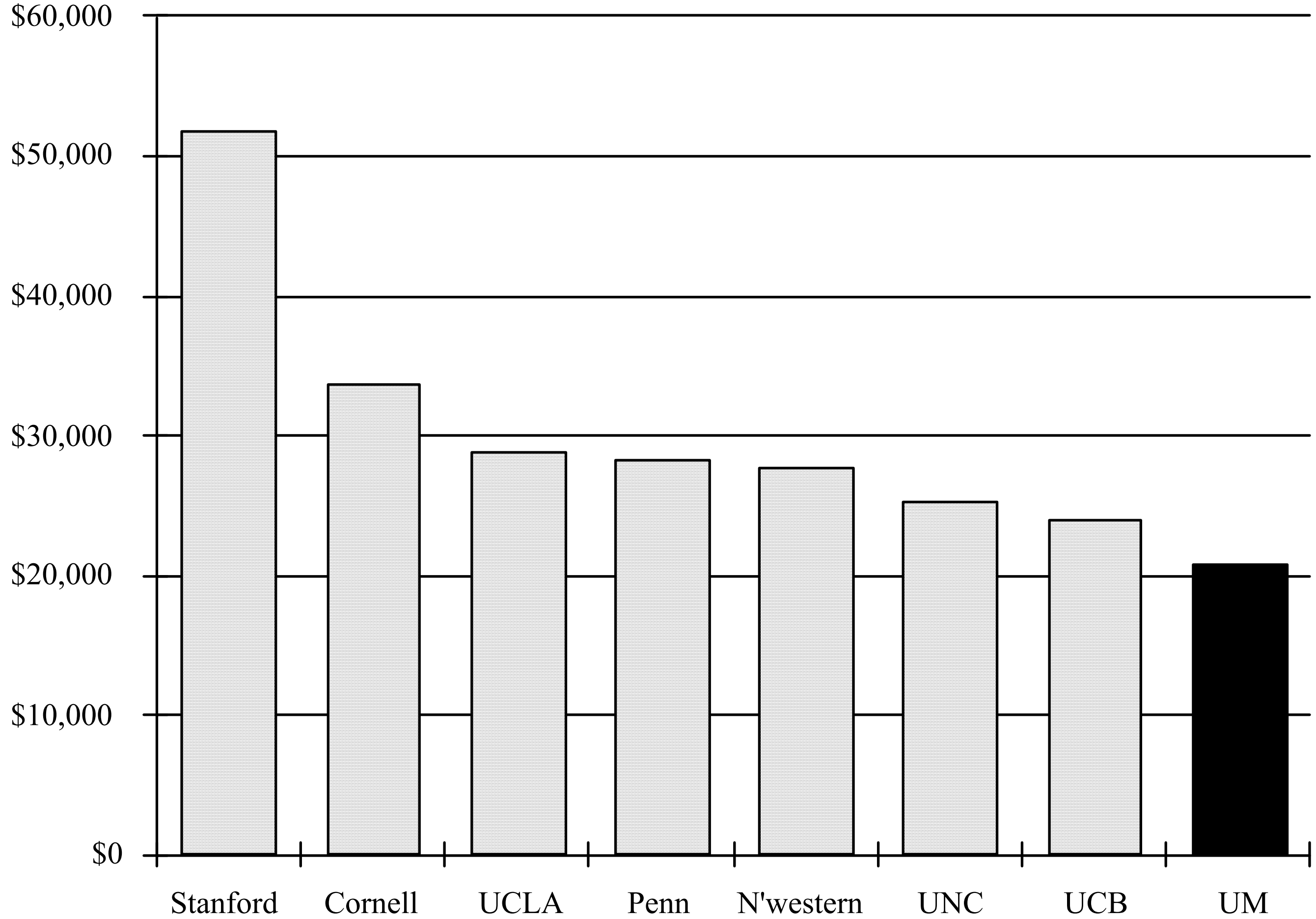
Total academic expenditures = General Fund
+ Designated Fund
+ Expendable Restricted Fund

For example, for UMAA in FY89-90, this amounts to

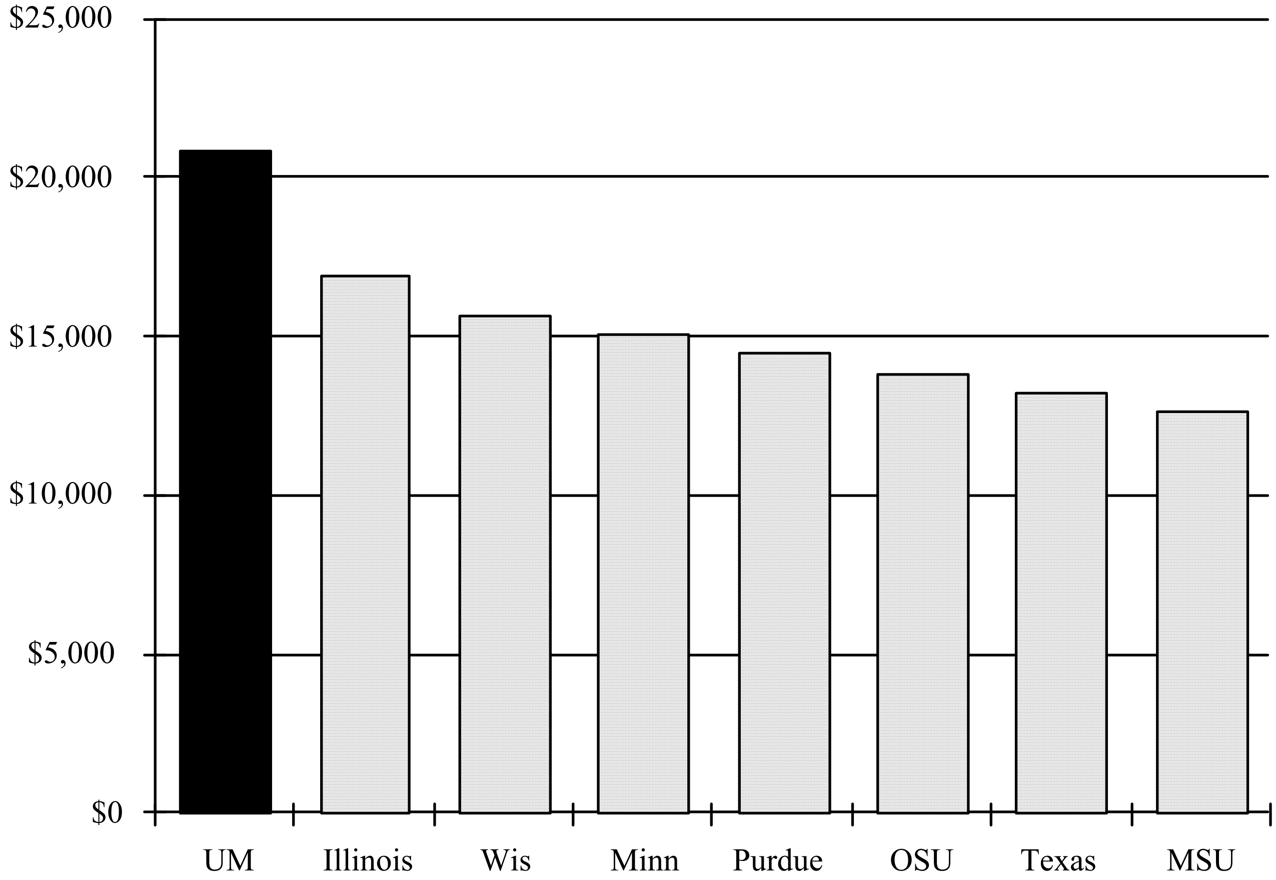
\$533 M + \$54 M + \$302 M = \$889 M / 36,000

\$24,000 per student

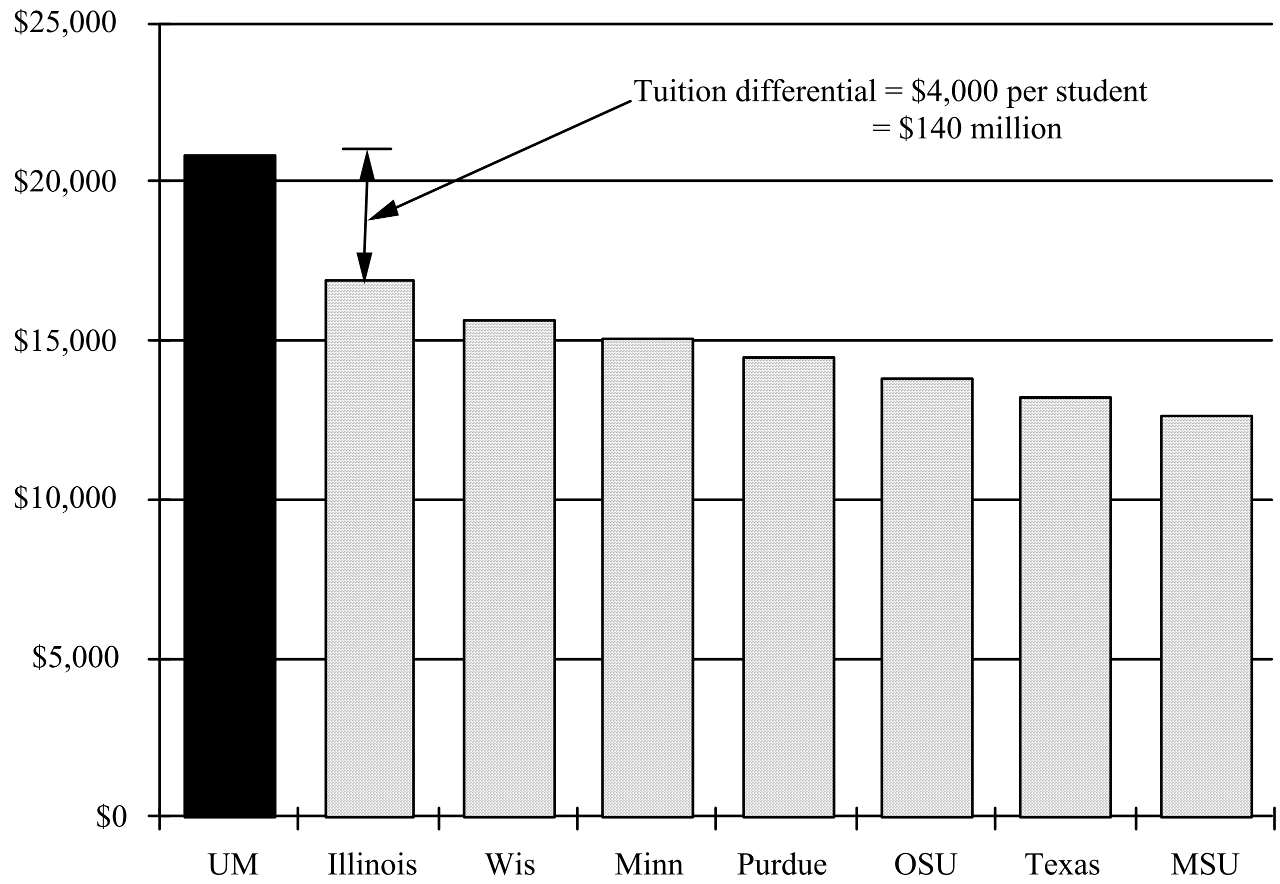
Resources per Student (FY90)



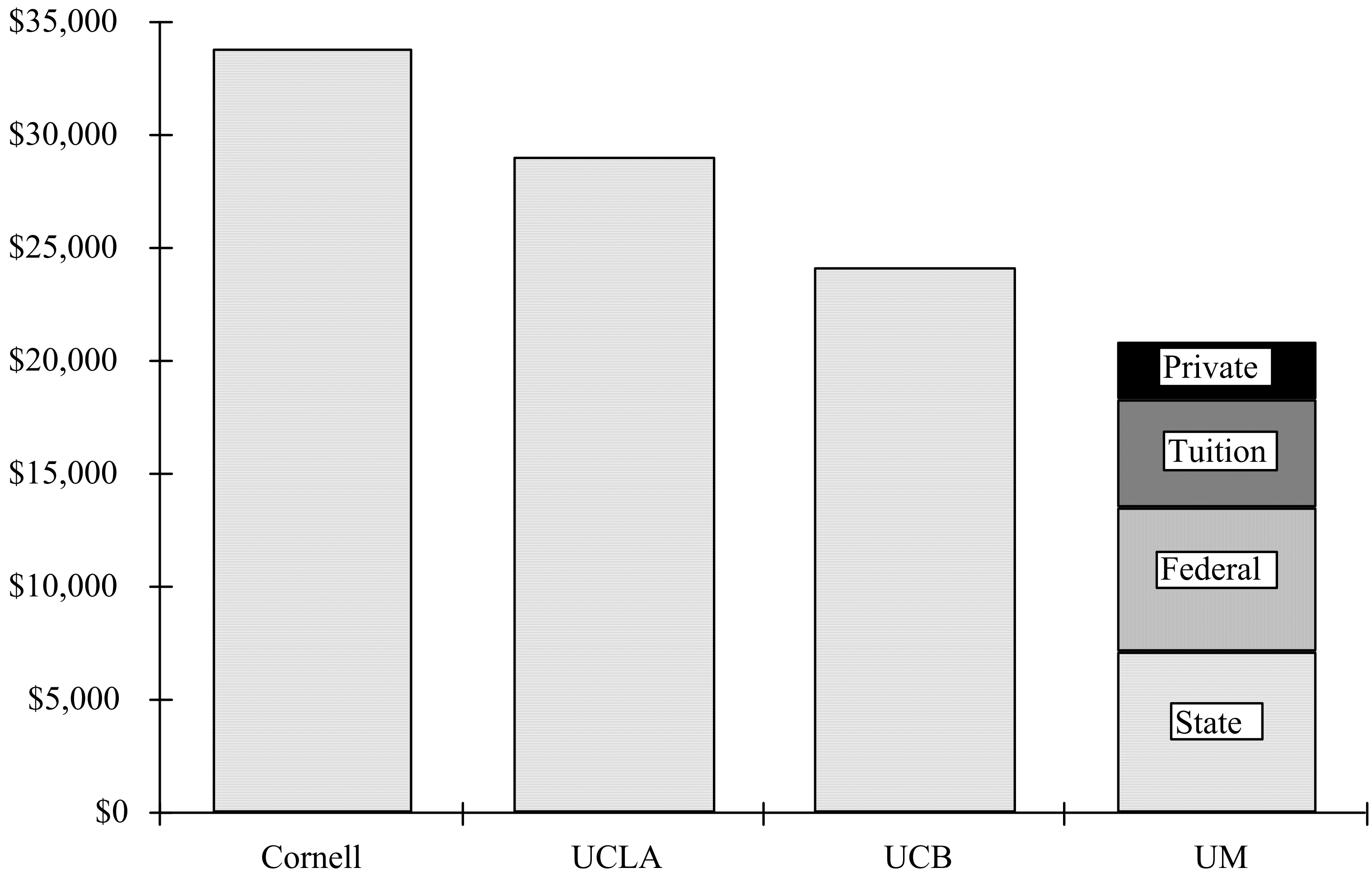
Resources per Student (FY90)



Resources per Student (FY90)



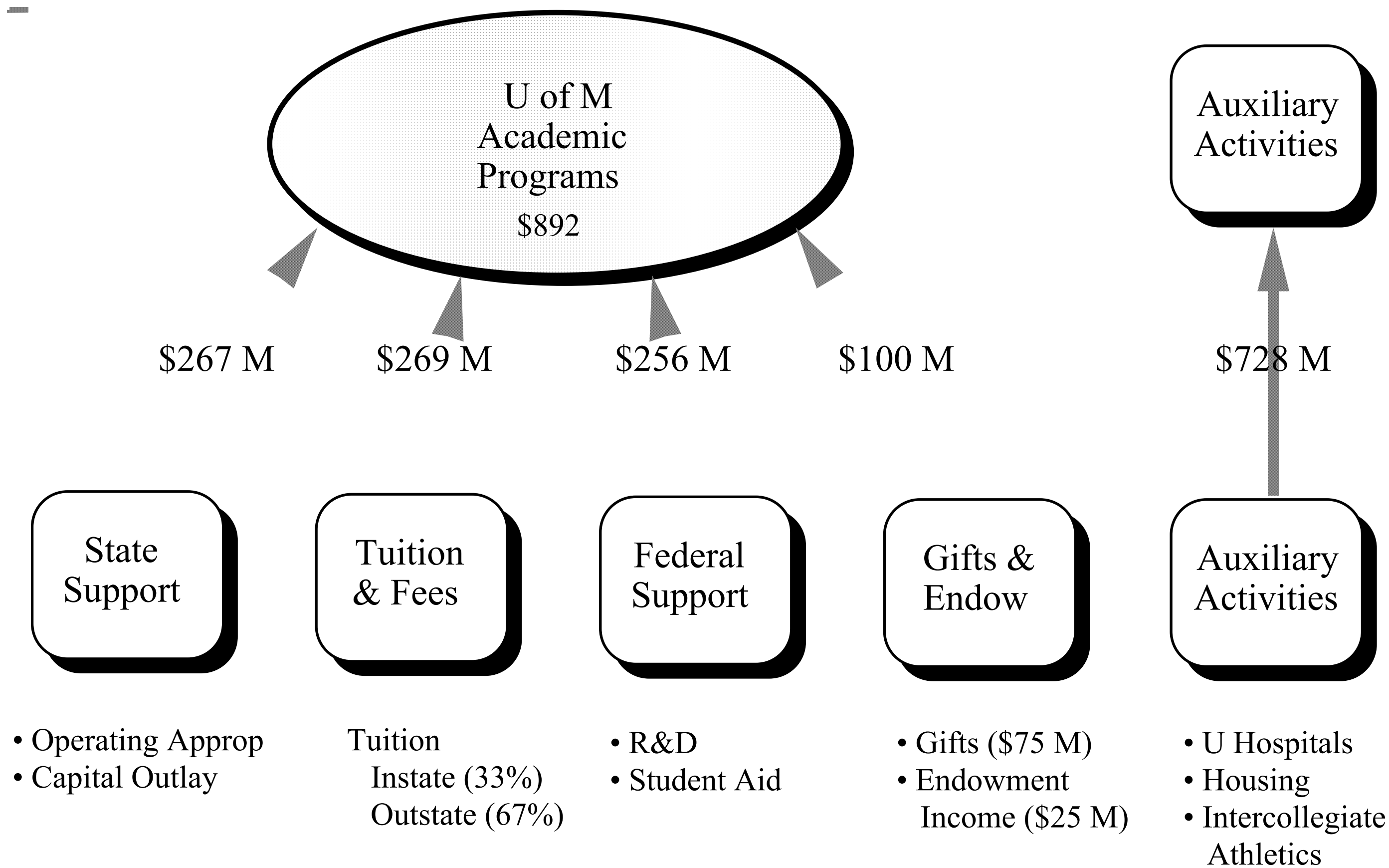
The Situation at Present



Office of the President

December, 1989

UM Revenue Portfolio (FY90)



Some Facts of Life

1. The University is presently underfunded -- with respect to our present size, breadth, and quality -- by $200 M to $300 M/y (as determined by peer comparisions).

2. Further, the University is entering one of the most intensely competitive periods in its history (for faculty, students, funds).

3. It is unlikely that the State of Michigan will have the capacity -- or the will -- in the short term to increase our state appropriations beyond their present levels (in real terms).

4. Nonresident tuition levels are now constrained by and will track the private marketplace.

5. Resident tuition levels are seriously underpriced -- with respect to actual costs, state "subsidy", and the availability of financial aid. Yet they are also constrained by political factors.

6. The present "corporate culture" of the University will make significant cost reductions, productivity increases, and even control of growth difficult.

Resource Options

Revenues:

- State Support
- Federal Support
- Tuition and Fees
- Gifts and Endowment Income
- Auxiliary Activities

Expenditures:

- Enhanced Productivity and Efficiency
- Downsizing ("Smaller But Better") Strategies
- Growth Strategies (nontraditional education)

Hybrid Strategies

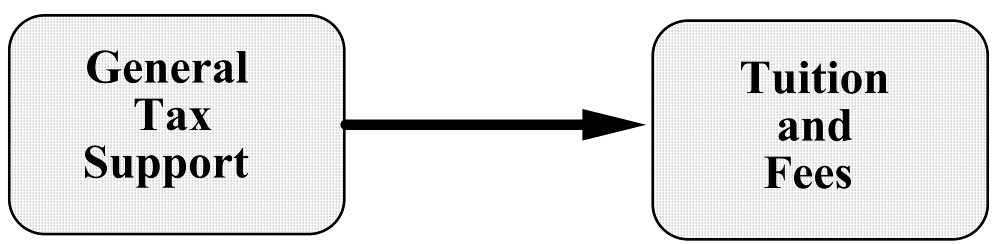
- Mixed Public/Private Strategies
- National University Strategies
- "Unbundling" Strategies

State Support

A Shift in Public Policy

The evolution of our public institutions has been shaped by *the public principle*: the public university is established and supported through general taxation to benefit society. The basic premise is that support should be by society as a whole since society gains benefits from the institution, just as do those individuals participating in its particular educational programs.

Yet, in recent years, both state and federal government have taken actions which shift the costs of public higher education from general tax revenue to the students (and their parents) who benefit most directly from this education.



Michigan's National Rankings
State Appropriation for Higher Education

	FY83-84	FY85-86	FY87-88	FY89-90
Two year % increase	42nd	10th	20th	42th
Ten year % increase	50th	43rd	35th	45th
Appro per capita	34th	28th	20th	26th
Appro as % of personal income	36th	32nd	31st	37th

Governor's Higher Ed Commission (1985)

"Public higher education in Michigan is at a crossroads..."

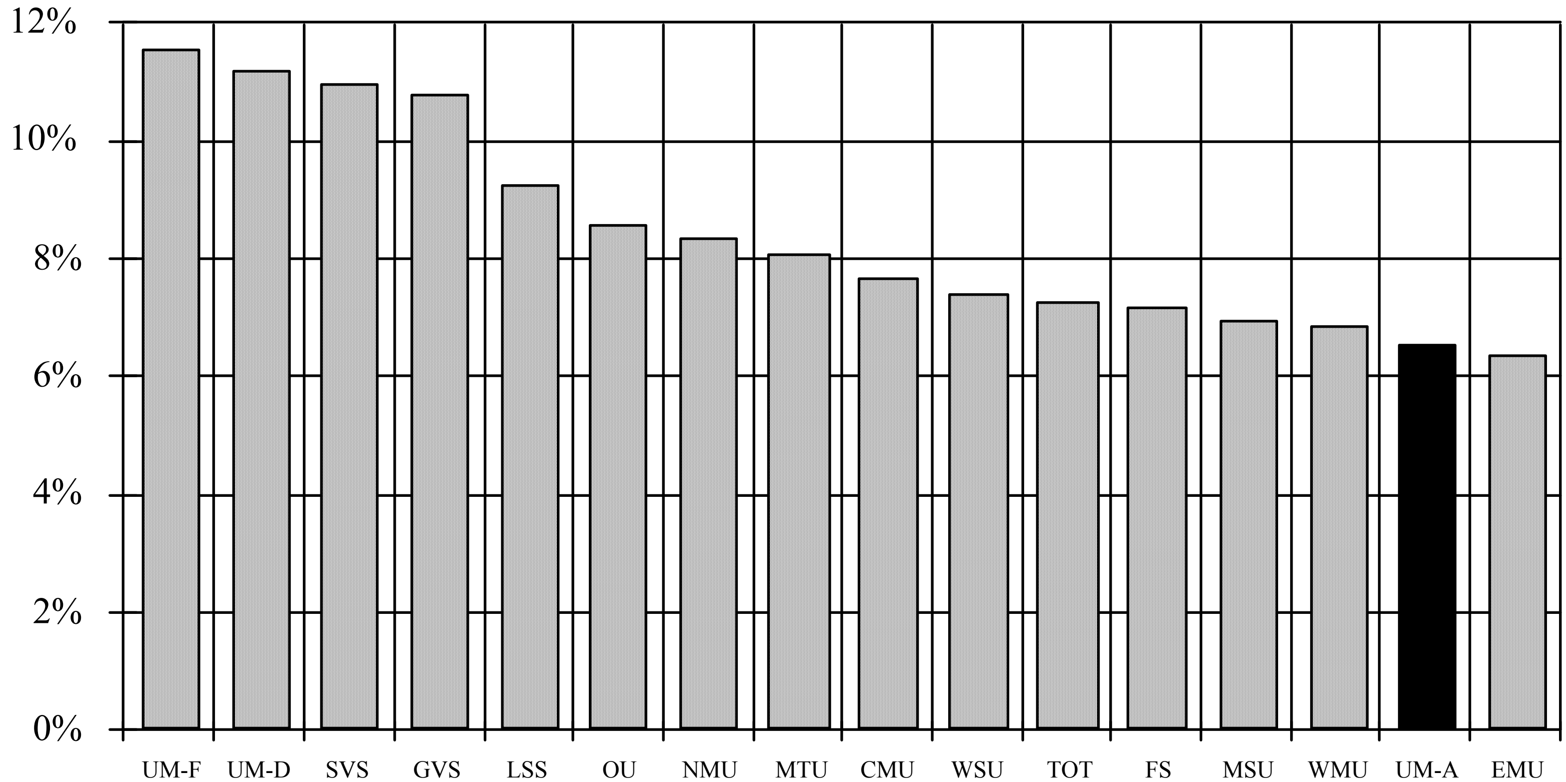
"Executive Order cuts played havoc with planning, resulting in maintenance deferrals, equipment purchases cuts, and eroded support for fundamental activities--all at a time when other states were increasing support for their systems of higher education."

"Michigan's universities deserve credit for launching a systematic process of improving effiiency and redirecting the system. From 1980 to 1984, over 100 programs were eliminated, thereby indicating the creativity and adaptability of the system.

"If nothing is done, higher education in Michigan is likely to face a future in which mediocrity is coupled with inaccessibility, a totally unacceptable result for Michigan's citizens.

"To provide wide access to a higher education system of mediocre quality is to perpetuate a hoax on Michigan's citizens."

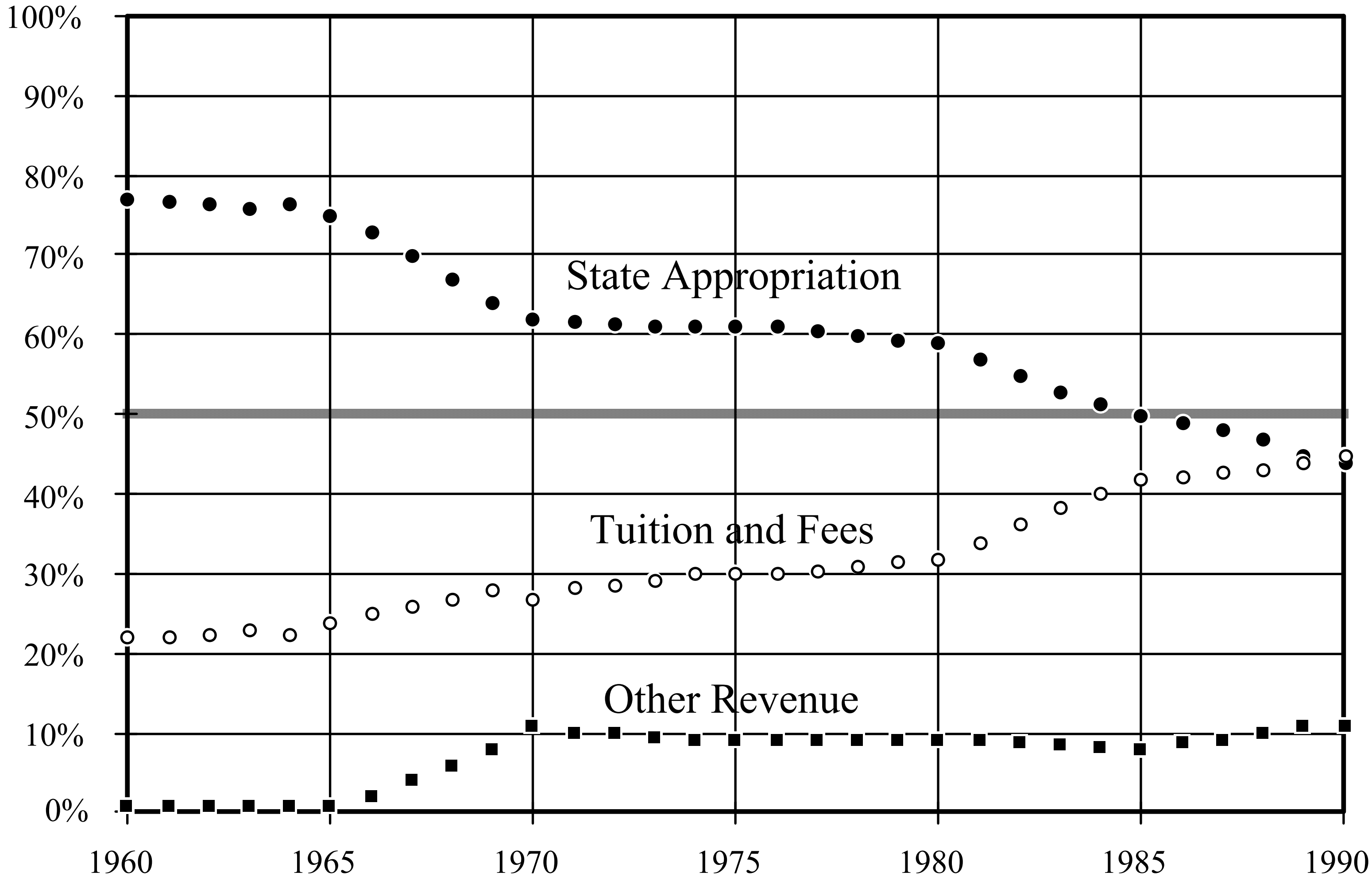
Annual Percent Growth in State Appropriations
Michigan Public Universities: FY71 to FY89



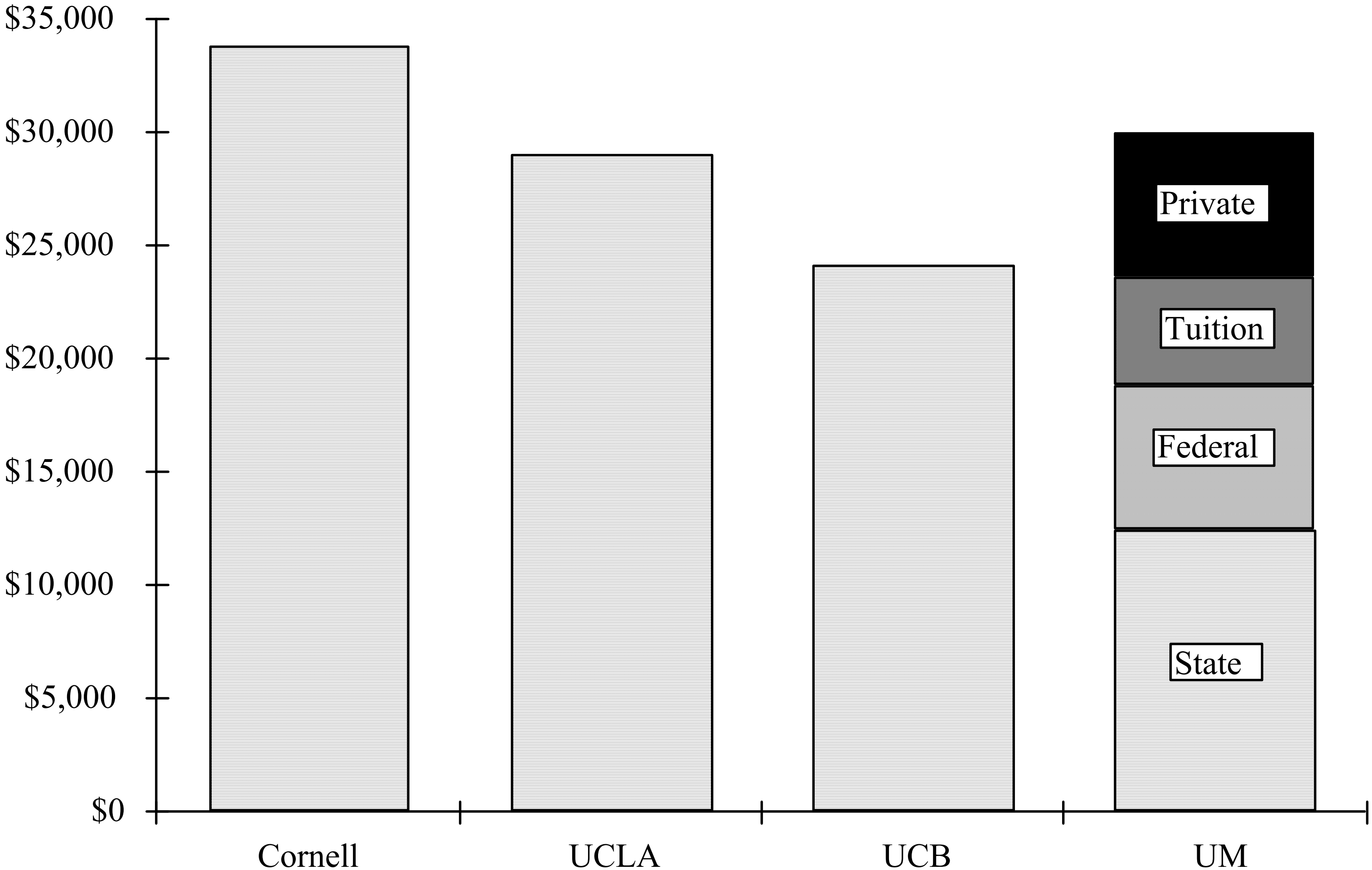
Office of the President

December, 1989

The Changing Mix ofGeneral Fund Revenue(UM-AA)



Restoring Historical Levels of State Support



State Initiatives

Immediate (this fall)

- Expand Lansing team (4+ FTEs)
- Build coalitions with other public institutions
- Identify and cultivate "champions" in Legislature
- Attempt to strengthen relationship with Governor

Near Term (this year)

- Media Relations effort
- Community Relations effort
- Alumni network (Michigan Advancement Council)
- M-PAC
- Development of Private Leadership "Roundtable"

What can we expect from the State during the 1990s?

Operating Appropriations?
- Major reallocation within existing revenue base unlikely
  (e.g.corrections, social services, health care
  -- perhaps even K-12 will come first)
- Increase in income tax unlikely
- Continuation of trend toward increasing support of
  private colleges and pet bureaucracies

Conclusion: The best we can expect is for state appropriations to track the inflation rate (and even this may be too optimistic).

Capital outlay?
- Not until corrections is brought under control.
- Even then, UMAA is unlikely to get anywhere near
  what its public peers get ($25-$50 M/year)

Attacks on Institutional Autonomy?
- Likely to continue with present administration.
- Possibility of "smoke and mirrors" approach.

Federal Support

Federal Initiatives

Immediate (this fall)

- Establish permanent Washington office
- Build relationships with Michigan Congressional Delegation
- Coordinate Washington team (3+ FTEs)

Near Term (this year)

- Alumni Networking
- National Educational Organizations
- "Deep" games???

What can we expect from the Feds during the 1990s?

Federal R&D Support

- Deficit reduction measures will constrain
- UM will continue to hold its own -- as long as we have the capacity to attract outstanding faculty!
- Increasing pressure on indirect cost recovery rates

Federal Financial Aid

- Clearly not a priority (50% decline in 1980s)
- Threats of mandatory service requirements

Other Federal Tendencies

- Increasing regulation (health, safety, conflict of interest, academic integrity, foreign involvement)
- Weakening of Michigan (and Midwest) congressional base with reapportionment

Tuition and Fees

Potential of Additional Tuition Revenue

Current private tuition levels:	$15,000
Current average UM tuition:	$5,000
Difference	$10,000

Maximum additional tuition capacity (gross):

35,000 students x $10,000 = $350 million

Discounting for financial aid (- 33%):

(2/3) x $350 million = $230 millon

Hence, net additional tuition capacity is roughly equal to present state appropriation:

Max Additional Tuition = $230 M = State Aid

Tuition Potential: Prices and Costs

Tuition Model #1: Market-Driven

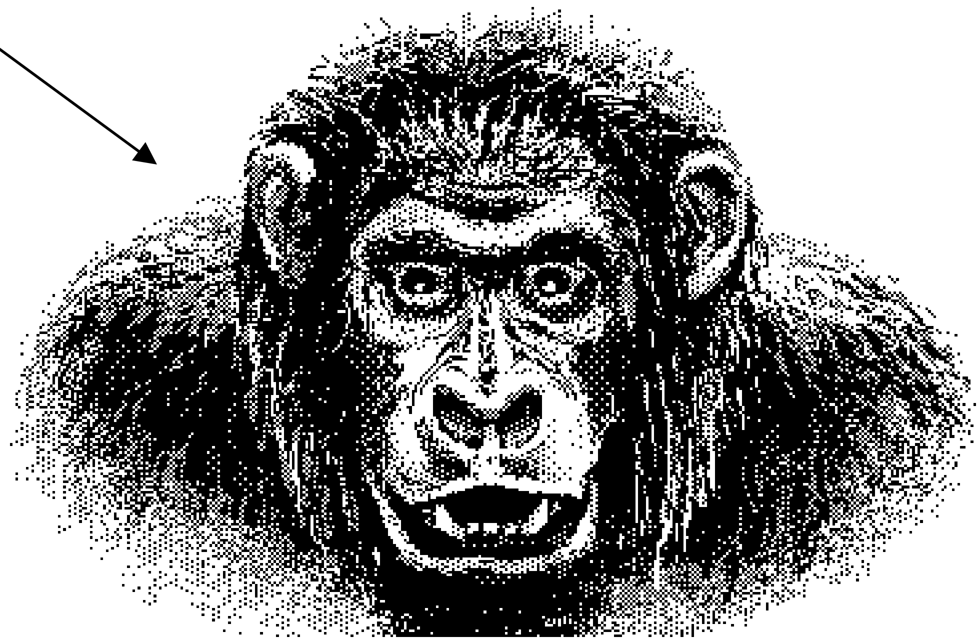
Set outstate tuition at market:	$12,000
Subtract out state subsidy per student	- 7,000
Instate tuition levels	$5,000

Tuition Model #2: Cost-Driven

Actual cost: (GF+DF+ERF)/35,000	$23,000
Subtract out federal and private support	- 11,000
Outstate tuition levels	$12,000
Subtract out state subsidy per student	- 7,000
Instate tuition levels	$5,000

Political Constraints

The MET Gorilla

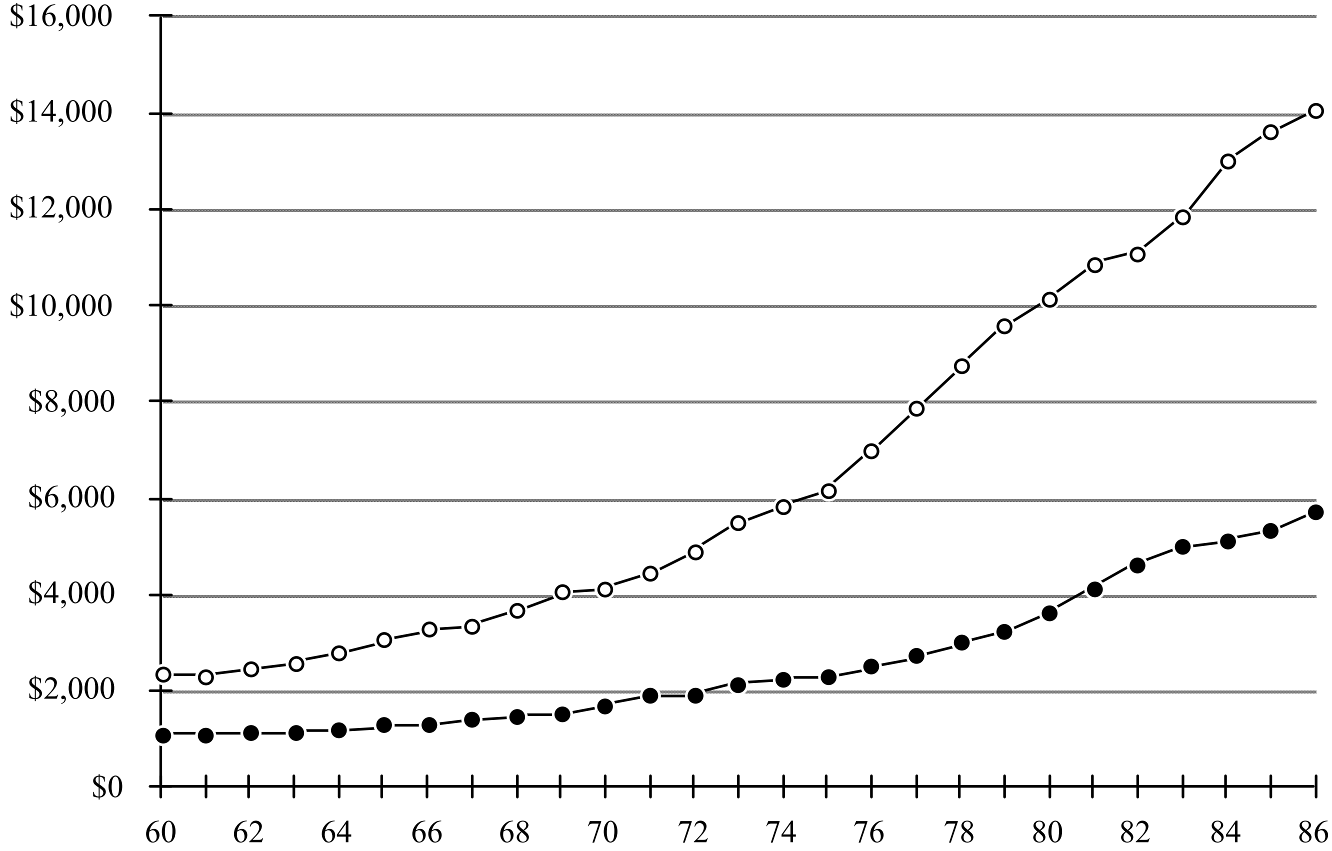


Instate
Tuition

$5,000

$3,200

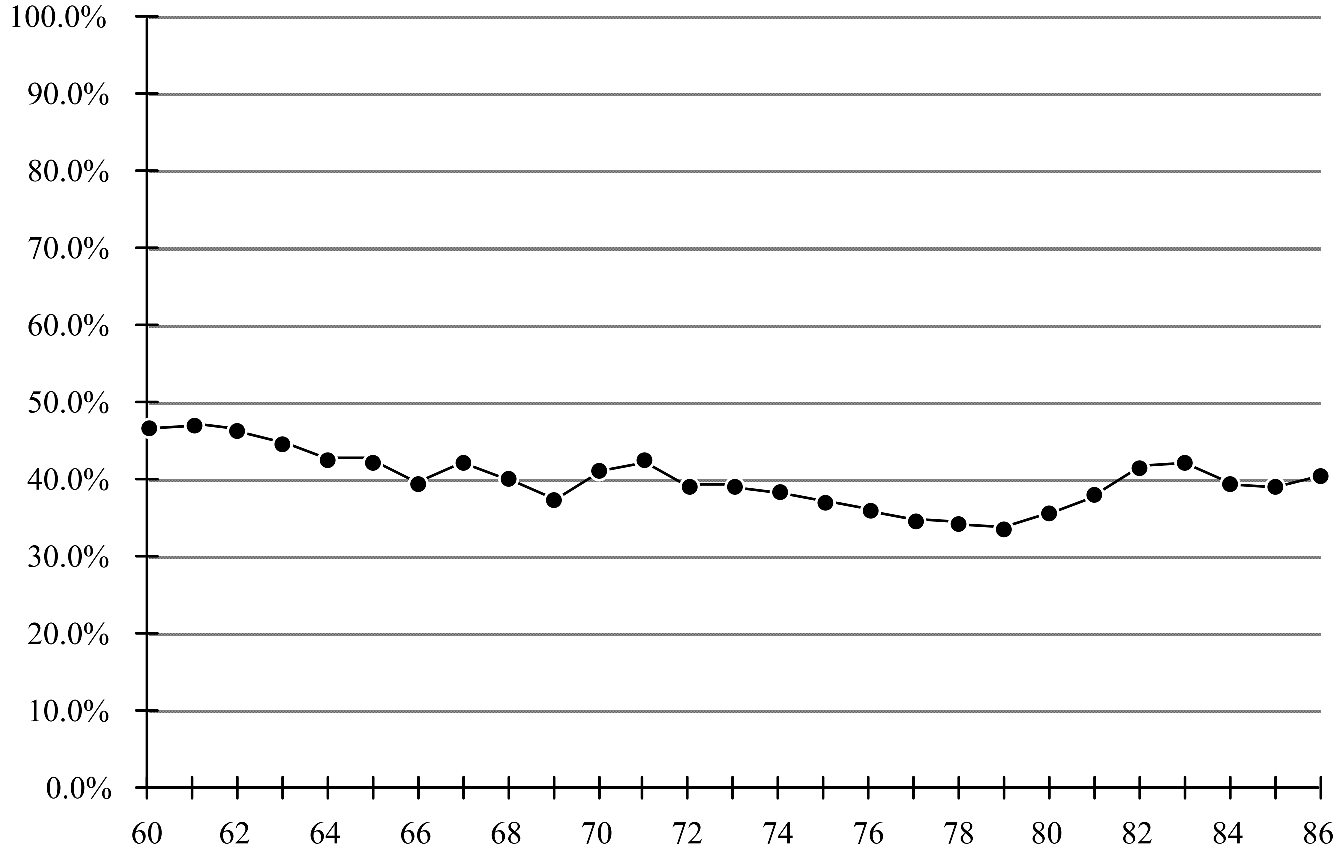
Trends in Annual Cost to Michigan Undergraduates vs Trends in Michigan Per Capital Income



Office of the President

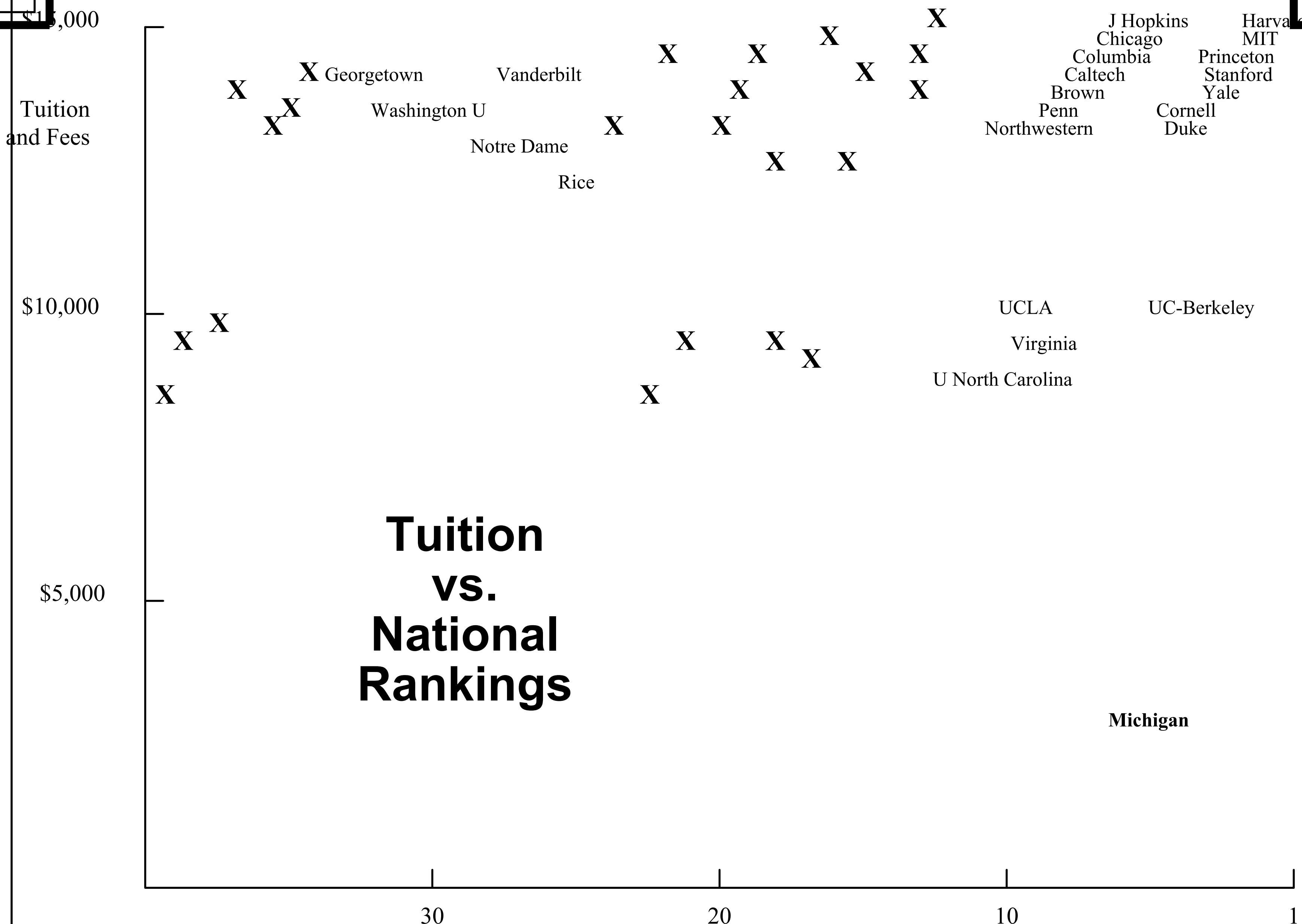
December, 1989

Annual UM-AA Tuition, Room & Board as a Percent of Michigan Per Capital Income 1960 - 1986



Office of the President

December, 1989



Office of the President

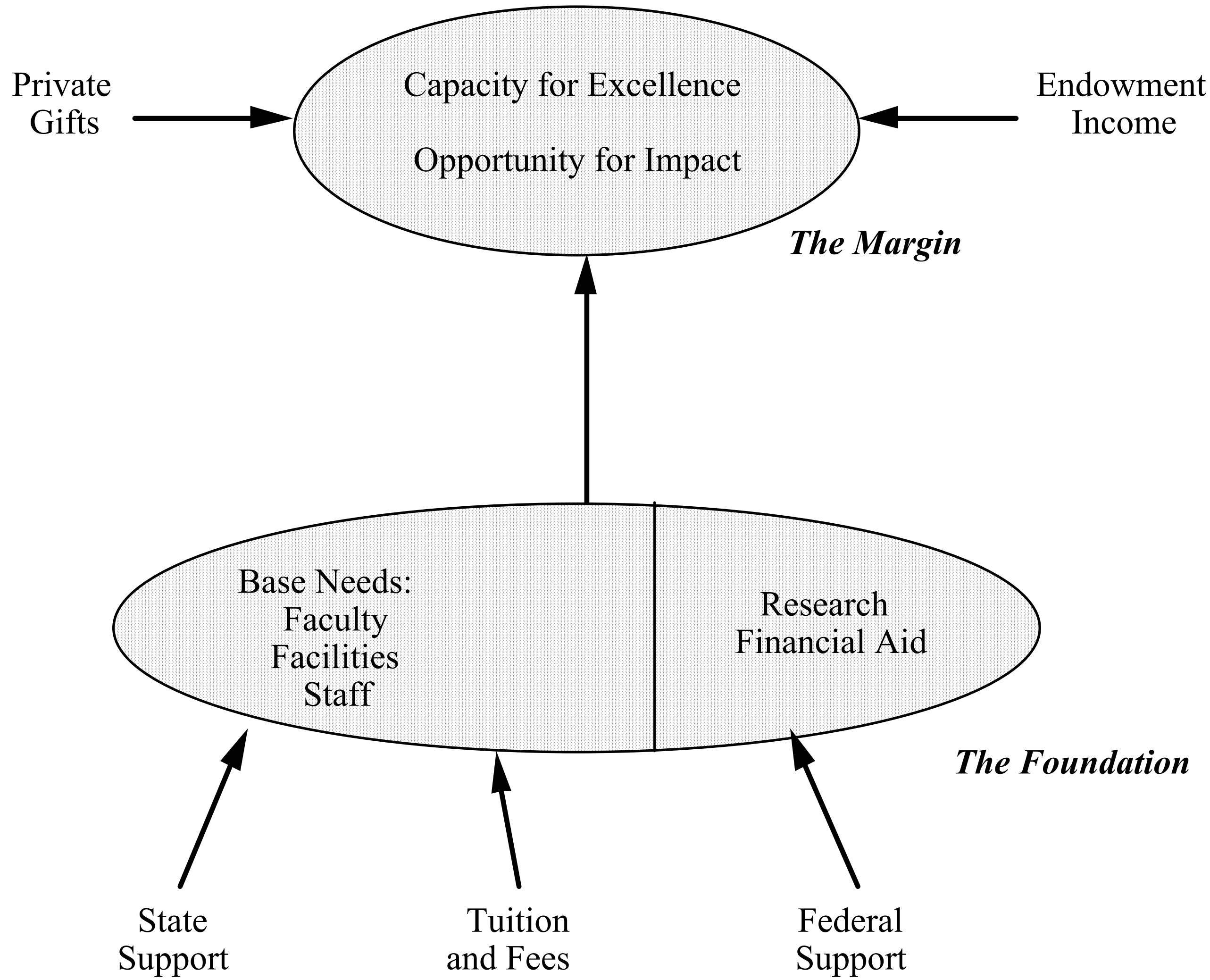
December, 1989

Gifts and Endowment Income

Office of the President

December, 1989

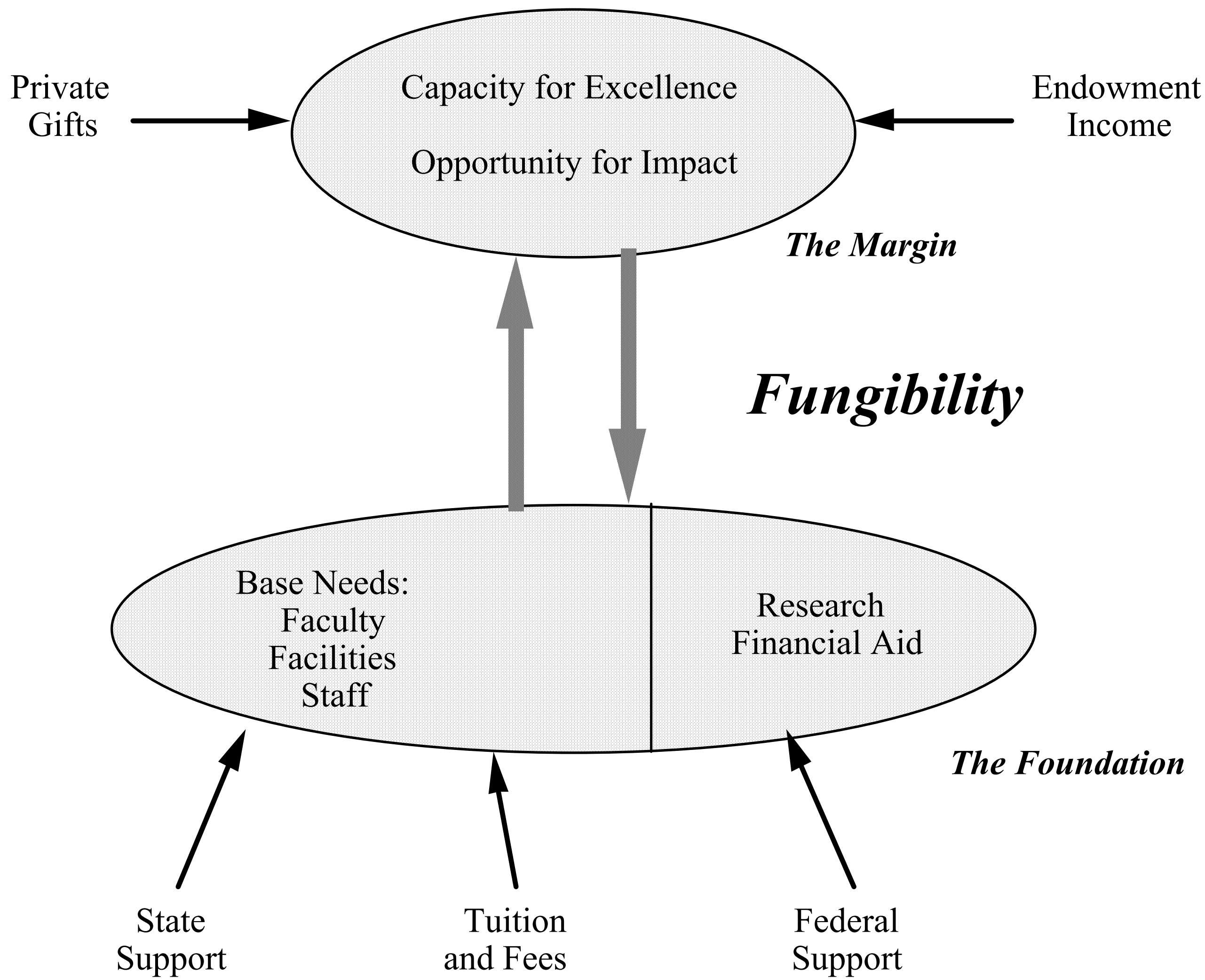
The Importance of Private Support



Office of the President

December, 1989

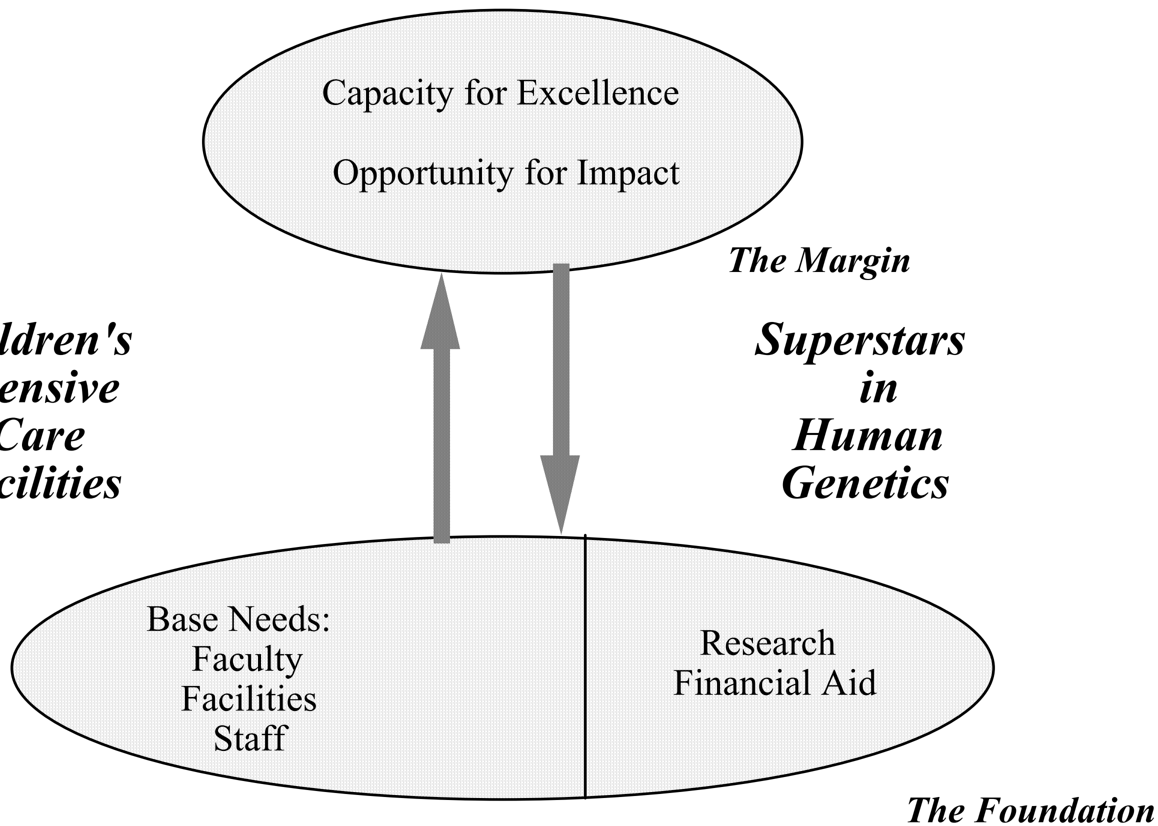
Flexibility and Fungibility



Office of the President

December, 1989

Flexibility and Fungibility: An Example



The Possibility of Strong Private Support

Present Situation:

Gifts: $72 M/y

Shows good growth...but still far from where it should be (and ranks UM only24th)

Endowment: $450 M

Very low for an institution of this size and quality.
UM ranks 29th among all universities (and
5th among public universities).

Challenge:

It seems clear that the UM must use the 1990s to make a major effort to substantially increase both private giving and endowment.

The Challenge for the 1990s

Goal: *It seems clear that the University must make a major effort to increase both private giving and endowment during the 1990s.*

Why now?

- **The 1990s is the period in which the University must take the steps necessary to position it for the 21st Century.**

- **Essentially every peer institution will be launching a major capital campaign effort during this period.**

- **We believe we will need a "campaign" level of intensity to excite our volunteer network.**

- **Without substantial increases in both private giving and endowment, it seems clear that the University will be unable to achieve its goals of leadership in the 21st Century.**

The Objective

Some observations:

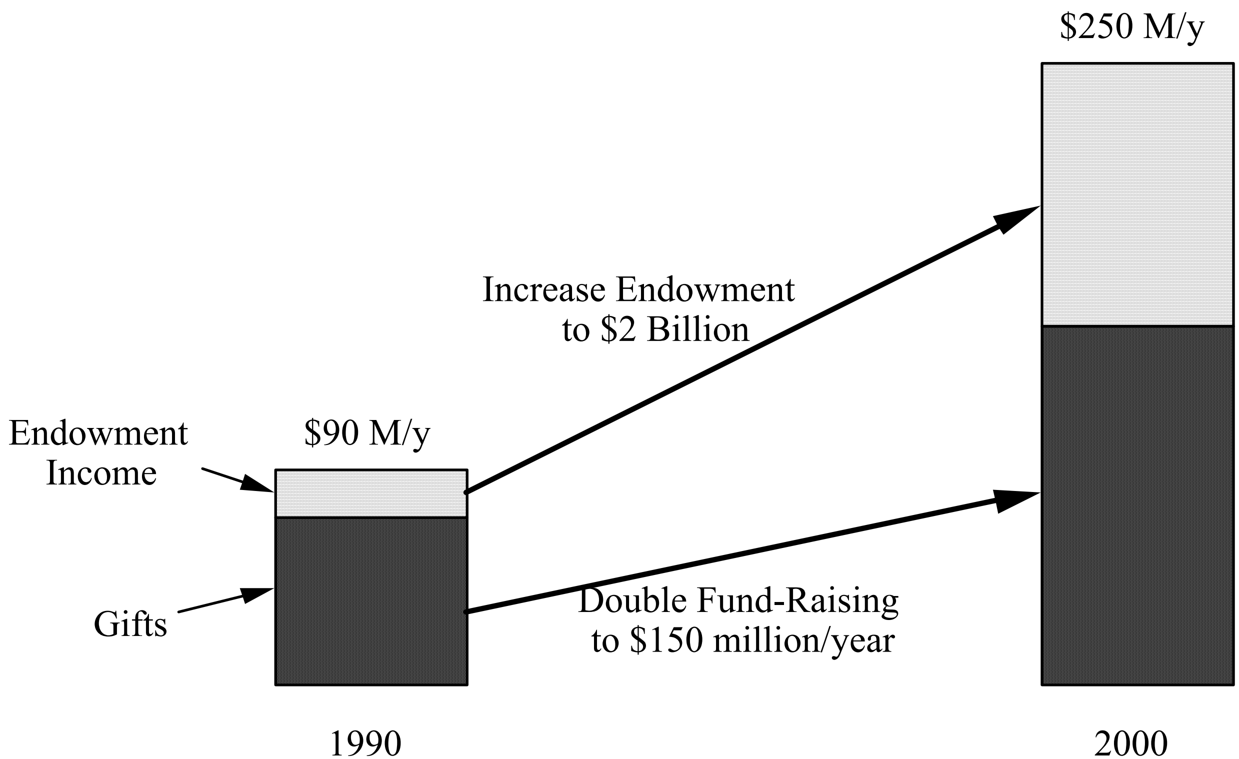
A "business as usual" approach to private fundraising during the 1990s will simply not be sufficient to meet our needs.

To calibrate the magnitude of our task, during the 1980s "Campaign for Michigan", roughly $375 M was raised over 5 years.

A "business as usual" approach that achieved 10% growth on our present $75 M/y base would yield $450 M over five years.

Hence, an intensified "campaign-level" of effort should aim at $600 M to $800 M over the first five years, with a corresponding increase over the next five year period.

A Fund-Raising Goal for the 21st Century



Office of the President

December, 1989

Auxiliary Activities

Possibilities

University Hospitals

- Possibility of more resource flow from Hospitals to health academic programs (Medicine, Nursing, Pharmacy, Public Health, Dentistry)

- But long term prognosis for "profits" is guarded

Intercollegiate Athletics

- Without major expenditure reduction, revenues cannot cover even the present level of activities
- Introduction of Tier II sports may require student fees

Housing

- Some possibility of resource flow into academic programming in resident halls (through fees)

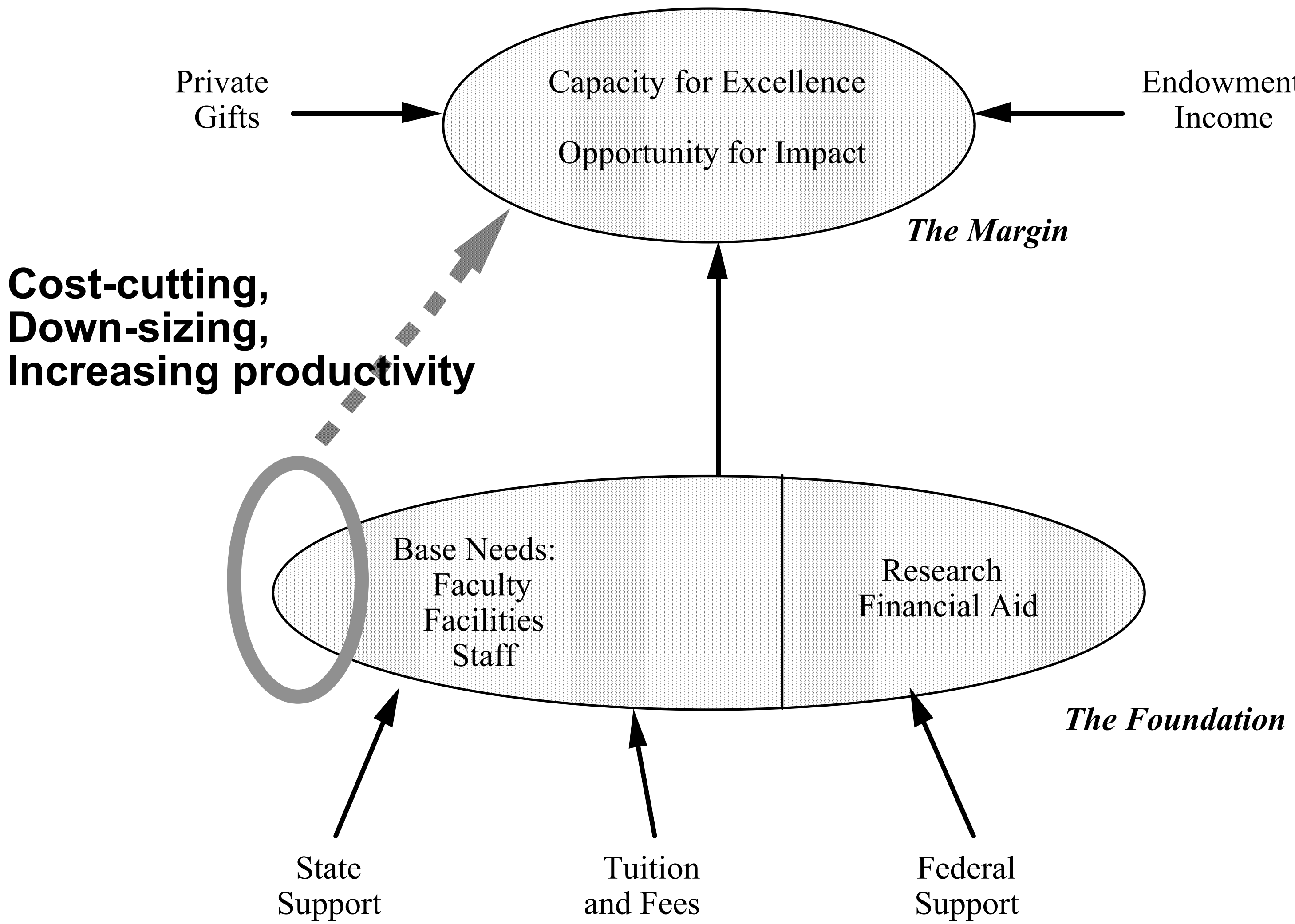
Other Ideas: spinoffs, commercial ventures

Enhanced Productivity and Efficiency

Office of the President

December, 1989

"Cost-Cutting" Approaches



Why have costs increased faster than the CPI?

- Difference in mix of higher education goods and services (books, computers, equipment,...)
- Regulations (OHSA, handicapped, financial,...)
- Erosion in federal financial aid programs (dropped in real terms by 50% during Reagan years)
- Other necessary increases in university-funded financial aid programs
- Social commitments (affirmative action, economic development, ...)
- Intensely competitive marketplace (faculty, students, grants)
- Deferred infrastructure maintenance costs

What can we expect by way of productivity increases?

- Just as one cannot speed up a symphony to make it more efficient in producing music, colleges have been unable to speed up the education process. Productivity increases in higher education tend to come in the form of increased learning.

- Serious constraints on program discontinuance (both in terms of institutional and intellectual constraints)

- Difficult to retrain staff (e.g., training a French professor to teach mathematics...)

"Smaller But Better" Strategies

Office of the President

December, 1989

A Lesson Learned

The "smaller but better" strategy of the early 1980s was a failure...

i) We didn't get any smaller. (Indeed, we continue to grow!!!)

ii) We didn't save any money.

iii) Rather than creating a psychology of prioritization and cost-effectiveness, the strategy clobbered the morale of University community and created a spirit of distrust and cynicism that we are only now beginning to emerge from.

Morale of story: We have to be VERY carefuly in using "doom and gloom" strategies. Instead we must base our efforts on building a sense of pride and leadership! (More analogous to the "total quality" efforts in industry)

Growth Strategies

Office of the President

December, 1989

Possible Growth Strategies

- More creative integration of UMF and UMD into University-wide strategic activities

- Year-round operation (since we now have 70% of campus air-conditioned)

- Telecommunications
  - television (MITN, cable)
  - computer networks (MERIT, NREN)

- Continuing Education (Lifelong education)
  Professional education (Bus Ad, Eng, Med, ...)
  Personal enrichment (Alumni University, ...)

- Niche Markets
  Seminars for government leaders

Hybrid Strategies

Office of the President

December, 1989

Mixed Public/Private Strategies

Models:

Cornell: Mixture of state-supported and endowed schools
Penn: Operates as private institutions with strong state support

Possible Approaches:

1. Allow selected schools to attempt to become "private" both in funding and operation (e.g., Law, Bus Ad, Medicine), while others (LS&A, Music, ...) receive state "subsidy".

2. Make the argument that Michigan's weakness as a state is that it has no great private universities to give its knowledge infrastructure more resilience to cyclical economic impact. U of M essentially plays this role and hence should be allowed more latitude in its operation.

3. Develop a strategy in which we determine the real costs of a Michigan education (at various levels), and then offer the state to purchase as many positions for Michigan residents at whatever tuition level they choose -- provided they offset the real costs with adequate appropriation "subsidy".

National University Strategies

General Argument:

Great midwestern public reseach universities were built during a time of great prosperity when agriculture and manufacturing were the economic engines of America.

These universities have now developed into national resources, producing much of the leadership and research for the nation.

Yet, these institutions are at great risk as the economic strength of the country has shifted to the coasts (associated with international commerce), and the midwest has been overwhelmed by other priorities (corrections, health care, social services).

Questions:

Is it in the national interest for these institutions to be pulled down by the relative prosperity of their regional economies?

Could we build a midwest Congressional coalition to pass a new "land-grant act" to provide federal assistance?

"Unbundling" Strategies

"Unbundle" Distribution:

Telecommunications, networks,...

"Unbundle" Products:

Mid-career training, nontraditional education, niche markets

"Unbundle" Pricing:

Differential tuitions and fees

"Unbundle" Labor Deployment:

Differential faculty roles (teaching, research, service)

The Costs of Education -- The Real Issues

Question 1: How good do we want Michigan to be?

Higher education is one of the most competitive industries in America, with over 3,500 institutions competing for students, faculty, funds...not to mention competing with the international marketplace.

Hence, if you tell me how good you want us to be, then I can give you a pretty good idea of how much you will have to invest

As good as...

Harvard or Stanford?	$50,000 per student-year
Berkeley or UCLA?	$30,000 per student-year
Ohio State or MSU?	$18,000 per student-year
Mississippi or Montana?	$10,000 per student-year
Southern North Dakoka State at Hoople?...	

The Costs of Education -- The Real Issues

Question 2: Who is going to pay for this quality?

The state taxpayer?

The federal taxpayer?

Parents?

Students? (through loans and work-study)

Private philanthropy from
...alumni, friends, industry, foundations...

Unfortunately, there are no other options.

Someone has to pay for quality...