

SENATE  
Report of the Subcommittee  
on  
Cost Containment

## Budgetary Policies and Strategic Issues

**Faculty Senate Committee on Administration  
Report on Cost Containment  
and  
Allocation of University Resources**

*March 4, 1998*

### To the University Community

*The committee on cost containment is a subcommittee of the Senate Committee on Administration. The Senate Executive Committee received the subcommittee's report on March 3, 1998. The full report of the Committee on Administration for the academic year 1997-98 will be published in a subsequent issue of Almanac. Comments and questions are encouraged.*



— Vivian C. Seltzer, Chair of the Faculty Senate

## Budgetary Policies and Strategic Issues

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March 4, 1998

#### A. Preface

The fundamental purpose of University expenditures is to implement its basic missions of teaching and scholarship. It is generally recognized that in order to do this the University must allocate funds for activities and services that are not used directly for the support of instruction or research. In principle, at least, these exist to enhance our basic missions.

The Faculty Senate Committee on Administration adopts the obvious principle that the balance between expenditures for direct support of the academic mission and those for the ancillary functions must maximize the excellence of our teaching and scholarship. All budgets, at every level of budgetary responsibility, should be continually examined in the light of this principle.

The report we present here is an examination of University budgets for the past eighteen years in an effort to understand the evolution of the current budgetary allocations and their impact on the academic mission of the University.

#### B. Background

It is no secret that the University of Pennsylvania has been undergoing massive changes. These are the result of changing societal expectations, financial pressures and our growth over the past decade. The administration, both at the University and school levels, has taken, and continues to take, important and far reaching steps to meet the challenges arising from these changing conditions. The Faculty Senate applauds and supports those administrative initiatives that decrease expenses, increase revenues and streamline our operations so as to enhance the excellence of our academic missions.

But the faculty has a special responsibility that goes beyond supporting what we deem appropriate and criticizing or ignoring the rest. The faculty has the ultimate responsibility for the creation and transmission of knowledge which is the essence of the University mission. It is inevitable that administrative policies and practices have a strong impact on that mission. While we recognize that the administration shares our goals of academic excellence, the faculty is the most appropriate group to represent the fundamental mission of the University in the creation and implementation of academic

strategy and policy. To that end, the Senate Committee on Administration has been given the charge to examine cost containment efforts as well as the relative proportion of funding allocated to direct academic functions and to other activities of the University.

Based on the general sense of the Committee, and on an earlier study by the Senate, it is clear that the current structure of budgetary allocations has long historical roots and that it is necessary to examine the evolution of these allocations. Accordingly, the Senate Committee on Administration appointed a Subcommittee on Cost Containment which analyzed University budgets for years ranging from 1980 to 1998 and developed some parameters that it believes illuminate the nature of the changes that have taken place since 1980. Our work is based on University figures, definitions and nomenclature given in the projected University budgets prepared for approval of the Board of Trustees.

This analysis shows that large scale shifts in the relative allocation of funds have taken place over the past eighteen years that occurred as a result of the accumulation of a series of relatively small annual changes. The effect of these changes has dramatically altered the allocation of resources with the result that there has been the equivalent of a major strategic shift in University activities. As a consequence, the schools now have a significantly larger financial burden and find it much more difficult to maintain or improve their academic quality while trying to balance their budgets. This burden is structural and built into the budget.

The overall impact of the changes is that, relative to 1980, a smaller fraction of University expenditures is now allocated to direct academic activities. In this regard, it is encouraging to note that projections for the 1998 budget show a reversal of at least some of these trends.

#### C. Categories of Concern

A number of issues and concerns emerged from this analysis that need to be examined from a strategic viewpoint:

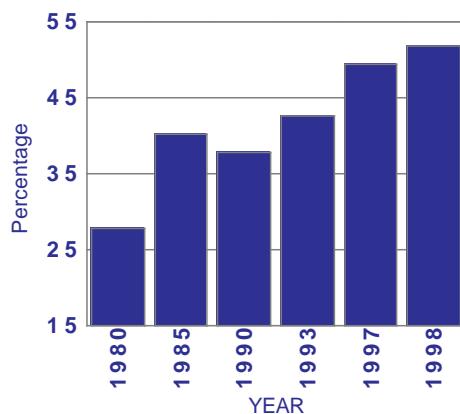
1. *Health care services have grown rapidly until they currently account for more than half of the University budget.* These include hospitals owned by the University, the Clinical Practices of the University of Pennsylvania (CPUP),

and Associated Medical Practices. As shown in **Chart 1**, in 1980, 28% of the total University expenditures were for health care services. By 1997, this had grown to over 49% and is projected to be 52% in 1998. This amounts to a health services budget of \$1.35 billion. It must be stressed that these figures refer to health services only and do not include any academic activities of the School of Medicine, or medical research or the dental practice in the School of Dental Medicine. Also, they do not include the recent acquisitions of Pennsylvania and Phoenixville hospitals. We are all proud of the quality of health care that is available at Penn and recognize that it has generally been financially sound to date. Nevertheless, the great increase in health care services needs to be examined in the light of the strategic objectives of the University. Accordingly, we raise the following questions:

a. What is the risk that changes in governmental or insurance companies policies will erode health care revenues? What would be the impact of health care deficits on the rest of the University?

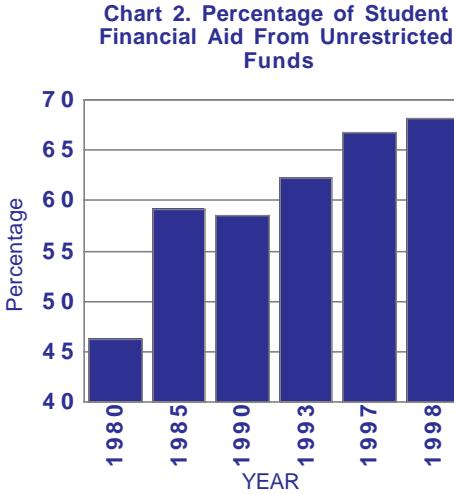
b. What are the appropriate health care services that are required to guarantee the continued excellence of medical education and research at the University?

**Chart 1. Health Care Services Budget as a Percentage of Total Budget**



**2. The unrestricted budget for undergraduate student aid has grown dramatically as shown in Chart 2.** In 1998, the total tuition revenues will be \$366 million and student financial aid will be 38% of this or \$141 million. The need for substantial student aid is unquestioned. At the same time, it must be recognized that, whereas in 1980 44% of our student aid was on unrestricted budgets, it is now 68%. These are funds that do not come from endowments or grants, but are charged directly to the schools as a cost and in 1998 amount to \$96 million. Unless some other way is found to finance student aid, such as through endowments, the schools will continue to bear this burden. This will make it ever more difficult for the schools to improve academic excellence and still balance their budgets.

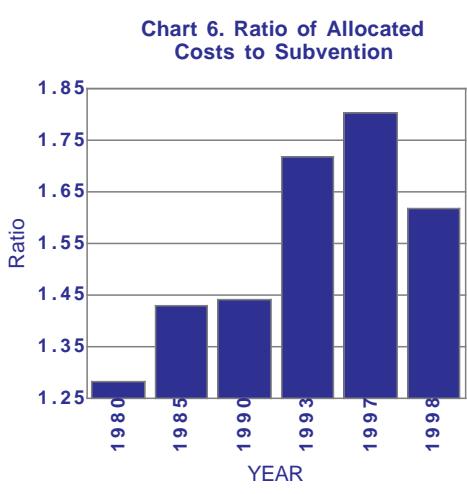
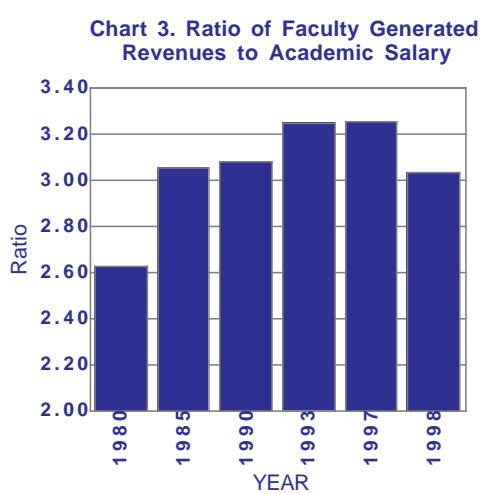
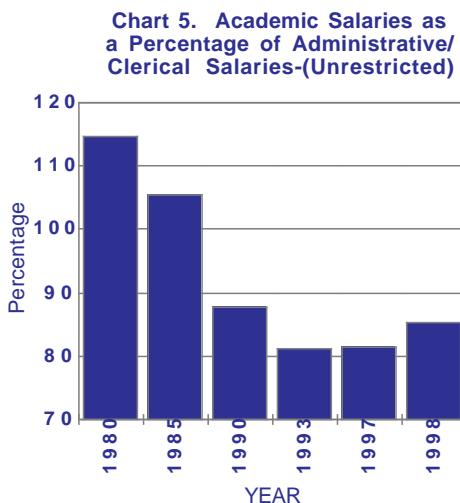
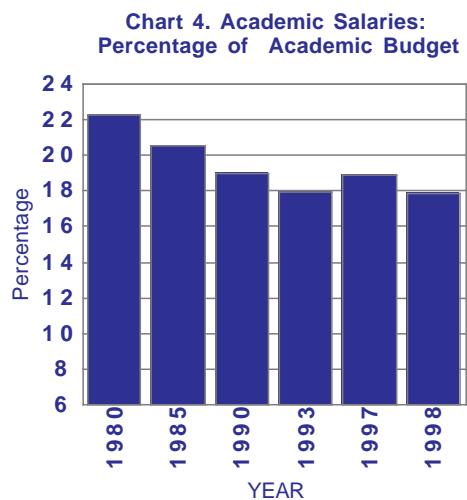
**3. The contribution of faculty activity to University revenues has increased substantially since 1980 and is \$680 million for 1998.** Exclusive of health care, University revenues in 1998 are projected to be \$1.1 billion and revenues from teaching and research provide 62% of this income. Clearly, faculty centered activities are the major source of University revenues (exclusive of health care services). **Chart 3** shows the ratio of teaching and research revenues to academic salaries which, in 1997, was at the impressive level of 3.29. (This is a commonly used measure of revenue generating efficiency in professional firms, for which this ratio is generally less than three.) These figures do not include the Clinical Practices of the University of Pennsylvania (CPUP) faculty. This ratio is quite high and has been essentially constant in recent years. While this testifies to the excellence and commitment of the faculty, our concern is that it may not be possible to increase or even maintain such a ratio in the future and in fact it is projected to fall to 3.04 in fiscal 1998. It is likely that an increase in revenues generated through teaching and research cannot be expected if the size of the faculty (exclusive of CPUP) is held constant. In addition to this financial concern, there is the question of the extent to which the use of adjunct and part-time faculty have contributed to the high value of this ratio and of the possible consequences of this for the quality of education.



**4. The ratio of faculty salaries to University budgets has been decreasing and is now small by all measures.** The total for academic salaries in 1998 is \$224 million, which is only 17.8% of the total for academic expenditures. As shown in **Chart 4** this is down from 22.3% 1980. This downward trend is even more pronounced if expenditures for the health care budget are included; academic salaries went from 16% of the total budget in 1980 to only 8.6% in 1998. If the unrestricted salary expense is examined, it is found to be \$128 million, which is less than 5% of the total University budget for 1998. This is an astonishing figure since it represents the allocation of funds not committed for special purposes such as grants or endowments. These figures raise a serious issue concerning the shift of resources away from direct academic activities.

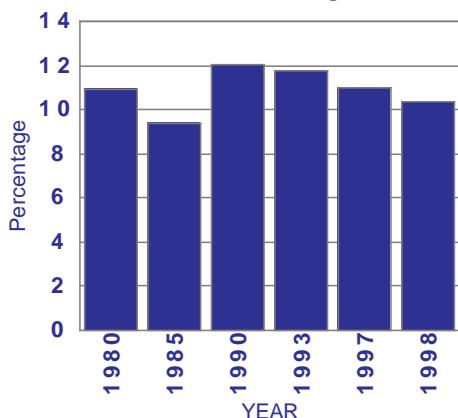
**5. Unrestricted administrative/clerical salaries have become higher than those for faculty.** Whereas unrestricted academic salaries were 15% higher than unrestricted administrative/clerical salaries in 1980, they decreased to 20% lower in the decade of the nineties. Unrestricted budgetary figures are significant because the unrestricted funds are those for which free allocation choices can be made. They do not include designated funds from endowments or research grants. Accordingly, the downward shift shown in **Chart 5** is another manifestation of the change of resource allocation away from direct academic activities. It is gratifying to note that in the 1998 budget there is a reversal of this trend with the ratio climbing back up from 0.81 to 0.85. This may be the result of recent cost containment measures or outsourcing being implemented by the University administration although the unrestricted funds allocated to administrative/clerical salaries is still \$150 million.

**6. Allocated costs have become much larger than the subvention.** The difference between allocated costs and subvention is of major importance for school budgets. The allocated costs are charges to the schools for support of University administration, services and resource centers. The subvention contains the central University contribution to school budgets. As shown in **Chart 6**, allocated costs have increased more rapidly than the subvention. In 1980, the difference was only \$9 million, but this gap grew



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**Chart 7. Academic Investment and Gift Income as a Percentage of Academic Budget**



to \$69 million by 1997. The ability of the schools to improve academic excellence while bearing this burden is seriously diminished. The reversal of this trend in the 1998 budget is most welcome.

**7. Academic return on endowment investment and gift income is not increasing as a percentage of the academic budget.** From 1980 to 1997, University revenues from gifts and investments grew from \$30 million to \$114 million. This was a remarkable achievement. But the University budget grew so rapidly that the percentage contribution of investments and gifts actually went down slightly from 10.9% to 10.4% as shown in **Chart 7**. If investment and gift income remain a constant fraction of University budgets and if growth of revenues from faculty productivity gains is not likely to occur, then what will be the source of increased revenue to fund the academic challenges of the next century?

## D. Summary and Conclusions

An analysis of the University budgets over the past eighteen years reveals a major shift in the relative allocation of resources away from the support of direct academic programs to other activities. This shift is summarized in the Table below which gives the values for the parameters from 1980 and 1998, which are defined and displayed in the Charts 1 through 7 above.

**Table: Summary of Changes in Selected Budgetary Parameters from 1980 to 1998**

| Parameter                                    | 1980  | 1998 | Chart No. |
|----------------------------------------------|-------|------|-----------|
| % Health Care                                | 27.8  | 51.7 | 1         |
| % Student Aid From Unrestricted Funds        | 46.2  | 68.1 | 2         |
| Ratio Academic Revenues to Academic Salaries | 2.6   | 3.0  | 3         |
| % Academic Salaries of Academic Budget       | 22.3  | 17.8 | 4         |
| % Academic Salaries of Admin./Clerical       | 114.7 | 85.3 | 5         |
| Ratio of allocated Costs to Subvention       | 1.3   | 1.6  | 6         |
| % Investments Plus Gifts of Academic Budget  | 10.9  | 10.4 | 7         |

While this shift occurred incrementally over two decades, it now has the appearance of a *de facto* strategic change in the mission of the University. The largest change has been in the size of health care services which has the effect of making the academic functions of the University an ever-decreasing fraction of our total effort. Independently of budgetary factors, the question of the extent to which the University should be dispensing health care, relative to its basic mission of education and scholarship, needs to be examined.

Beyond the issue of health care, there have been changes that were made at the expense of the direct support of academic programs. These included increases in the direct charges for student aid to the unrestricted school budgets, the decreasing fraction of the budget allocated to academic salaries, the large increases in allocated costs relative to the subvention and the increasing expenditures for administrative/clerical salaries. A measure of the resulting burden to the schools is the sum of the unrestricted student financial aid and the difference between allocated costs and subvention. This currently adds up to approximately \$160 million and amounts to a structural deficit built into the school budgets. It is worthwhile to stress the magnitude of this number since it is over 23.5% of the total revenues from teaching and instruction.

A major conclusion of this study is that each of the categories of concern given above needs to be examined from a strategic standpoint relative to the basic University mission of education and scholarship. It is the opinion of this Committee that the historical shifts displayed here have not favored this mission. It is important to determine the extent to which this is true, and the effect that the past history should have on future strategy and budgetary policy. Given the current University efforts on cost containment, and the reversal of at least some of the trends given above, now would be a most opportune time to do this. For the future, the University should not be in a position that allows long-term incremental budgetary decisions to produce fundamental changes without an explicit budgetary strategy. A critically important point is that neither faculty-generated revenues nor income from gifts and investments can be expected to contribute significantly higher percentages to the academic budgets in the near future. Consideration of strategic budgetary reallocations is therefore essential.

The *Agenda for Excellence* as articulated for the University and the individual schools provides a guide for specific school action to achieve academic strategic objectives. The issues presented in this report, on the other hand, are general in that they do not address specific academic programs or issues in specific schools. Rather, they address the broader University strategic budgetary framework within which the schools must structure their activities. It is imperative that they be dealt with in such a way as to insure the continuing growth in quality of education and scholarship.

## E. Recommendations

In view of the importance of the issues presented in this report to the academic health of the University, the Committee makes the following recommendations:

1. The Faculty Senate Committee on Administration keep cost containment and resource allocation as a continuing part of its agenda with a permanent subcommittee for this purpose.

2. The issue of health care services and its relation to the rest of the University is complex as well as important. We recommend that the Faculty Senate form a separate committee to analyze and make specific recommendations on this issue.

3. We recommend that the University consider whether it should adopt the following strategic objectives:

(a) Establish a development objective for student financial aid that would result in the fraction of student aid charged to unrestricted school budgets being reduced to one-half over a five year period, and ultimately to zero.

(b) Decrease the gap between allocated costs and subvention by 50% over the next five years and to zero over the next ten years.

(c) Shift the allocation of resources so that the unrestricted administrative/clerical salaries become lower than those for faculty.

4. We recommend that the Academic Planning and Budget Committee form a Subcommittee on University Budget Objectives. The purpose of this subcommittee would be to recommend specific budgetary strategic objectives and continually examine University budgets to assess the extent to which these objectives are met. The faculty members on the Academic Planning and Budget Committee should be members of this subcommittee. The results of this sub-committee's work should be reported annually to the Senate and the Board of Trustees, as well as to the University Central Administration.

It may be that there were compelling reasons for at least some portion of the evolution of the budgetary structure. Nevertheless, it is clear that there has been a real shift of resources away from direct academic activities over the past two decades and that this needs to be corrected.

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