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Thinking About RCM

A Discussion Paper
for
The Algonquin College of Applied Arts and Technology

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Institutions that consider adopting a form of Responsibility Center Management (RCM) often make the mistake of thinking they are simply changing the way they budget income and expense, when in fact they are fundamentally changing governance and management relationships across the institution. The big change RCM makes is to establish that the monies an institution's Schools earn in fact belong to the Schools—it is their income and they have the prime responsibility of deciding how those funds are to be spent.

The purpose of this discussion paper is to set the stage for conversations across Algonquin College focusing on the very real changes RCM will introduce and the specific decisions the College must make as it completes its design of an Algonquin-specific RCM. The paper proceeds in three blocks by asking:

- How does an Algonquin-specific RCM differ from Algonquin's current budget system?
- What are the major decisions Algonquin must make in order to put in place an Algonquin-specific RCM?
- How will authority and responsibility be divided between the Central Administration, the Office of the Vice President Academic, and the Offices of the School Deans?

1. A Catalog of Differences

The first and most obvious difference RCM introduces into the economy of an institution is a fundamentally new focus on earned income. Currently the Algonquin budget system is one that allocates to the Schools permission to spend money in ways that are judged academically and financially appropriate. It is the central administration's responsibility to make certain that the sum of authorized expenses does not exceed the College's total income and that those expenses conform to provincial laws and other regulations.

In an RCM system, each individual School is said to earn its own income—principally tuitions, program fees, and research and other grants and contracts—and these funds in fact belong to the Schools. In most RCM systems each School also receives a central allotment, usually defined as a subvention, which, combined with its own income, represents the funds a given School has to pursue its academic agenda.

An agreed-upon part of that income is returned to the Central Administration in the form of allocated cost charges equal to each School's fair share of central administrative costs and the cost of operating and maintaining the facilities each School uses. Currently Algonquin Schools are charged allocated costs for their facilities but they are not charged for any administrative costs.

The Central Administration has four sources of discretionary income: it can reserve for itself a part or all of the provincial grants it receives; it can levy a tax on the direct income each School earns; it can operate some programs—auxiliary enterprises being a prime example—and retain for its own purposes the profits from those enterprises. Finally, the Central Administration can retain for its own purposes the philanthropic funds the College raises centrally—the philanthropic funds the Schools raise belong to the Schools minus whatever allocated costs are charged to cover the costs the Central Administration incurs in helping the Schools raise those funds.

Some of these central funds can be used by the Central Administration to cover its own operating costs thus lowering the amount of monies that need to be collected as allocated cost charges. For the most part, however, the Central Administration is expected to use its monies to support the efforts of the individual Schools—either as subventions or as one-time grants for specific purposes including the covering of income shortfalls.

Two additional differences derive from this focus on incomes rather than allowed expenditures. First, Schools are expected to know best how to generate both new (i.e. entrepreneurial) and sustaining income. Each School is expected to develop detailed strategies and to monitor closely the success of those strategies in raising the amount of income necessary to offset its planned expenditures.

Second, where in the past the Central Administration established specific expenditure levels often using quite specific categories of expense (e.g., salaries, equipment, travel and so forth), under RCM the School proposes to the Central Administration an expenditure plan for its approval. In this iterative process the Central Administration can establish expenditure guidelines and limits (e.g., salary increases), but not detailed allocations.

2. Necessary Decisions

The most immediate challenge facing the Central Administration as Algonquin moves to implement an Algonquin-specific RCM is to specify the rules by which

RCM will operate. First up will be the design of the algorithms by which the Schools are charged their fair share of the College's central administrative costs. The fact that Algonquin College has developed an effective and efficient set of algorithms for distributing space and facility costs to the Schools will prove helpful. Most institutions that have adopted RCM budgeting have eventually learned that less is more—that simple straightforward rules of allocation are better understood than complex algorithms that attempt to take account of the complexities that accompany the provision of administrative services in a large, multi-discipline institution.

The second task will be the specification of the rates by which the Central Administration taxes School incomes. If the Central Administration retains sufficient funds from other sources—the provincial grant, for example—then a tax on income is not necessary. Choosing how much to tax income is, in general, a matter of striking a balance between the need for the Schools to have a real incentive to develop new programs and the need for sufficient central funds for steering the institution. Some institutions have also developed different taxing rates for differing revenue streams—for example, taxing tuition income at a lower rate than purely entrepreneurial income.

The third task involves deciding how quickly Algonquin wants the flow of funds to respond to short- as well as long-term market trends. It makes sense, for example, to use a three-year average for the dispersal of tuition revenue. Thus a School that has a sudden contraction in its student base would have two years to absorb the consequence of this shift. On the other hand, a School couldn't suddenly increase its revenue by admitting more students—the additional revenue would come to the School over three years rather than all at once.

The final set of decisions that must be made as Algonquin moves to implement an RCM system is the number and responsibilities of the administrative staff assigned to the management of the system. Generally, an RCM system is more taxing of administrative personnel than a system that focuses solely on expenditure control. All the staff currently necessary to make certain that monies are spent appropriately will be equally necessary in an RCM system, making certain that funds are properly accounted for, and that the sum of individual budgets within a School add up to the expected amounts. In many Schools some additional staff will be required for the management of income flows at the School level. School budget offices will be needed to project likely revenue, track receivables, and calculate appropriate prices for the goods and services the Schools supply to the market. RCM, to put the matter most succinctly, is not very tolerant of surprises—and the way to prevent them is to have skilled staff capable of monitoring the flow of funds.

In some institutions additional staff prove to be necessary in a Vice President for Academic Affairs Office (or equivalent) as that entity comes to be the control point for the financial performance of each of the Schools. Algonquin College is fortunate in already having a fully staffed and effective budget and analytic function within the Office of the Vice President Academic, which should be able to adapt quickly to the discipline of an Algonquin-specific RCM system.

3. Recalibrating Political Balances

The final set of challenges facing Algonquin as it moves to implement RCM involves recalibrating the relationships between the Central Administration, the Office of the Vice President Academic, and the individual Schools, which under RCM become the principal locus of economic decision making. Ordinarily under an expenditure approval budget system, most decisions are top-down. The Central Administration decides how much of the institution's total expenditures will be allocated to the Chief Academic Officer (in Algonquin's case, the Vice President Academic), who in turn considers the requests from individual Schools and determines how and where to invest those funds, either in new academic programs or to shore up current programs that need additional expenditure authority. It is a system that often fosters piecemeal decision making since it is shaped, on the one hand, by the total amount of new expenditure authority that is available, and, on the other, by each Dean's calculations as to which requests will prove most attractive to the Chief Academic Officer.

Under RCM this process is reversed with important consequences. A School and its Dean begin by estimating the amount of new and continuing funds they are likely to have. It proves equally important to ask which investments are likely to yield sufficient new revenues to offset a School's initial costs over time. Finally, the School and its Dean need to ask which of the School's current costs can be eliminated in order to increase discretionary spending authority. The result of these analyses and calculations is a financial plan that supports the School's academic plan. Both documents are then submitted to the Chief Academic Officer as part of the annual budget process.

That official—at Algonquin the Vice President Academic—next reviews each of the School's financial and academic plans—testing their feasibility, asking whether additional savings might be necessary or possible, and considering how each of the Schools' separate financial and academic plans fit together. The Chief Academic Officer also has funds with which to help individual Schools—either to shore up programs that face a diminished market or to provide venture capital to the Schools for the launching of new programs. The amount of this kind of funding that is available is a function of the rate at which each of the Schools' direct income has been taxed by the Central Administration and how much of the funds granted to the Central Administration directly (for example, the provincial grant) are available for redistribution to the Schools in support of their financial and academic plans.

While academic purposes play a central role in these discussions, the first question to be asked is whether a given School has sufficient income to both sustain current operations and invest in new programs. Again, it is this focus on revenue, rather than expenditure control, that distinguishes RCM. Academic plans are necessarily tested in terms of their appeal to the market as well as their academic worthiness. Neither the promise of new market revenue nor the academic appeal of a particular initiative in itself should provide sufficient rationale for making new investments, though as critics of RCM have pointed out, it may prove too easy to allow the appeal of new monies to obscure the fact that a particular academic initiative might not prove very academically appealing after all.

This altered way of doing business inevitably changes the roles assigned to an institution's principal academic officers. Deans become the institution's primary entrepreneurs, challenging their faculty to consider how their Schools might go about their business doing things differently. The Dean has to assemble the staff that can assist the individual faculty and department/program chairs in identifying new markets, estimating how much start-up funding will prove necessary, and monitoring the operations of the new programs once they are launched. The Dean is also ultimately responsible for assembling both the financial and academic plans that must be submitted for review to the Chief Academic Officer.

Under RCM, it is not the Chief Academic Officer who approves or funds individual lines of expense—for example, a new faculty hire or the purchasing of a critically needed piece of equipment. The Chief Academic officer instead becomes a reviewer of plans and strategies designed to strengthen the submitting School. He or she must resist the temptation to micro-manage the process and instead help the Deans, both individually and collectively, focus on the bigger questions. And the Chief Academic Officer must use the central funds at his or her disposal—the system's venture capital—judiciously, always asking what is the promise of long-term pay-off, both in terms of new revenue and academic quality, in each investment. No less important, it becomes the responsibility of the Chief Academic Officer to ensure that the investments the Schools are making add up to more than the simple sum of their parts—that collectively they make substantial contributions to the institution's financial sustainability and academic quality. Under RCM, the Chief Academic Officer becomes more of a shaper of programs and initiatives than a manager of operations.

Under RCM the President of the institution has a more constrained role. His or her first responsibility is to ensure that the institution has an efficient infrastructure that readily and effectively provides the services the Schools pay for through their allocated cost charges. The President is also expected to enunciate the institution's common purposes and core values. To the extent the institution depends on substantial non-entrepreneurial external funding—whether from governmental or philanthropic agencies—it is the President's responsibility to protect and where possible to expand that funding. On occasion the President may act as a kind of institutional venture capitalist, working with the Chief Academic Officer and the Deans to mount a major institution-wide initiative—for example, a large contract to supply special services—but under RCM those efforts generally belong to the Deans and the Chief Academic Officer.

Ultimately the President's principal task under RCM is to ensure that the institution's principal leaders and managers first understand and then take advantage of the opportunities RCM makes possible. Discharging this responsibility begins with the picking of the right kind of people to be the institution's senior leaders. Just as important, it is the President who must ensure they continue to share a commitment to common values and purposes. As a system, RCM does not set out to encourage the philosophy of "each School a tub on its own bottom," though the temptation will always be for the most successful Deans and their Schools to strive for ever greater independence. Controlling these centrifugal pressures—even to the point of replacing otherwise successful Deans who see themselves and their Schools as detached from the parent institution—is first and foremost the responsibility of the President. Equally important, however, is the responsibility of making sure that each School is led by a Dean who is sufficiently entrepreneurial and who can effectively manage an entrepreneurial enterprise.