UC BERKELEY

Business Plan

Vice Chancellor John Wilton
Administration & Finance
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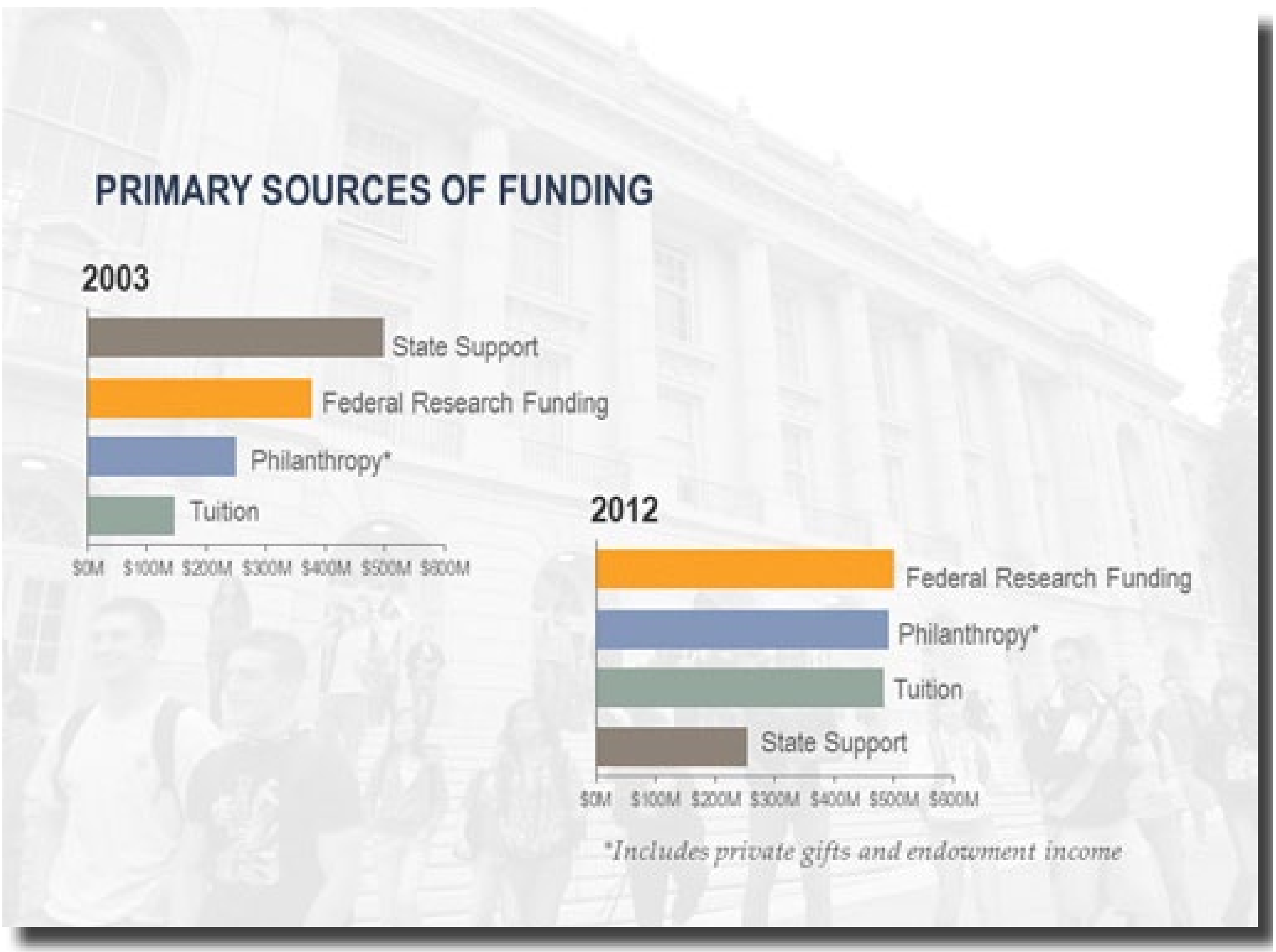
Introduction

Berkeley needs to respond to fundamental changes if it is to remain financially sustainable and academically excellent.

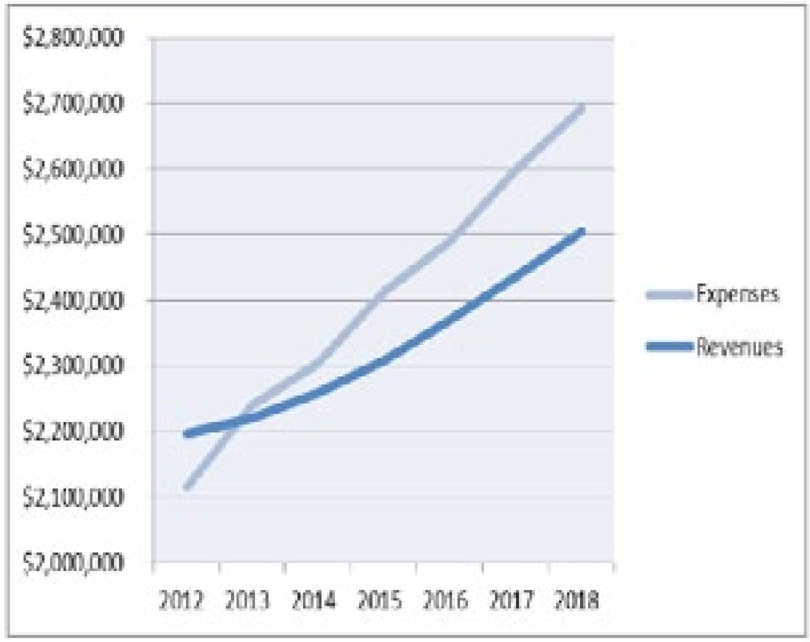
One of the most important changes Berkeley has experienced recently is in regard to how it finances itself. As the graph below shows, there has been a significant shift in the composition of our four major revenue sources. Since 2003, state appropriations have been cut by 50% in nominal terms, or about 70% in real dollars.

As a consequence, state appropriations have fallen from being the primary source of revenue for Berkeley to the least important in dollar terms by a wide margin. State appropriations now account for about 10.5% of total revenue (down from over 50%). Fortunately, Berkeley has been successful in increasing the other major sources of revenue (namely, government contract and grants, philanthropy, and tuition/fees) at a slightly faster pace than the cuts in state funding, enabling Berkeley to continue to expand. Thus, talk of our demise is greatly exaggerated, particularly by our competitors. Berkeley has continued to grow. Nevertheless, Berkeley will face considerable financial challenges.



The challenge

Aside from the change in the composition of our revenues, the graph above highlights three other key issues:



1 Berkeley is in a more competitive world – whether it likes it or not. The level of state support is the result of a complex and unpredictable political process whereas Berkeley has to compete for contracts and grants, philanthropy, and students.

2 There is an underlying "fungibility" problem – that is, while some revenue can be applied against most expenses (it is "fungible"), some revenue is restricted (particularly philanthropy and contracts and grants). Thus, Berkeley can have a priority funding need in one area and a surplus elsewhere.

3 The governance model is misaligned with current revenue sources and the need to be flexible and respond quickly to changing circumstances/needs. The governance framework that was put into place in the 1870's served the UC well during a time when the vast majority of funding derived from the state. The fact that 90% of our revenue now comes from "other" sources raises questions related to the distribution of decision rights – particularly given that the UC system is now vastly more complex and that the pace of change is accelerating.

The detailed financial model that we have built for Berkeley indicates that we are projected to run a persistent and growing fiscal deficit from 2013 on, which expands to close to $200 million by 2018.

While the model is built from the ground up, allowing for fairly detailed projections, the "base case" is determined by assumptions around some key expense and revenue drivers. On the expense side, one of the main cost increases derives from the higher employer pension contribution rate that is determined at the UC level, which in turn is driven by the current "funding gap" in the pension plan and the absence of any meaningful contribution by the state (or pension reform). On a positive note, the base case assumes we are successful in implementing our ambitious cost reduction exercise (Operational Excellence), which is designed to reduce annual administration costs by $75 million over the next few years. On the revenue side, we do not assume, as others do, that state appropriations "bounce back," but we do project philanthropy to increase at the rate achieved over the past few years and that tuition is raised by about 5% per year.

While Berkeley can bridge the resulting financing gap in the short run, partly by using its financial reserves, this is clearly not a sustainable strategy. Eventually we will be unable to finance the level of access and excellence that makes Berkeley the premier public university in the US. Given the importance of Berkeley in intellectual, economic, and social terms, we can not let this happen. Consequently, a business plan needs to be developed that allows us to preserve Berkeley's access and excellence under most probable outcomes.

Our "financing problem" is not unique to Berkeley. All of the ten campuses within the UC system face a similar aggregate challenge. This is a consequence of the decade's long disinvestment by the State of California in the UC system. It has come to a head because the absolute level of state support has fallen to a minimum level and recent cuts have been both large and imposed over a short time frame, leaving little time to react. UCOP has indicated that by 2018, the UC system will need an additional $2.5 billion to meet funding requirements for enrollment growth and other mandatory cost increases (9/15/11 Regents Discussion, "Development of a Multi-Year Budget Plan"). In response, UCOP has developed a UC-wide strategy that is primarily predicated on increasing tuition and state appropriations.

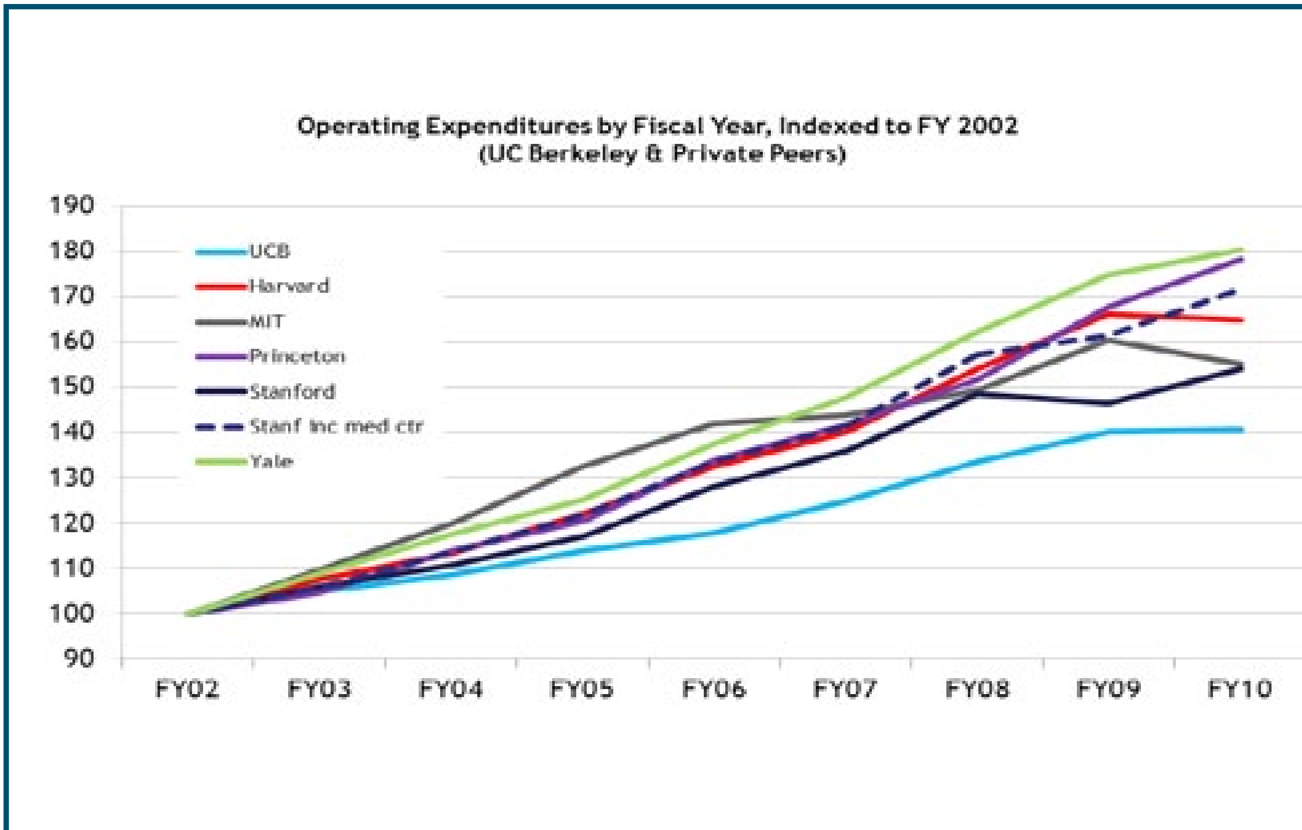
While an increase in state funding would be very welcome, given recent history and the financial condition of the state, we feel it would be sensible to develop an alternative or supplementary approach.

The approach we are proposing would enable each campus to maintain or improve current standards of access and excellence thus strengthening the system as a whole. All UC campuses, except Merced, have been operating for at least forty years. In that time, each of them have developed their own unique character, strengths, and place in the world of higher education. Thus, our focus should be on developing a strategy that does not allow the best public university system in the US to go into decline. We spell out below, in broad terms, the 15 steps that are necessary for Berkeley.

Before doing so, we would note that we are neither suggesting nor supporting the "privatization" of Berkeley, nor are we arguing for the fragmentation of the UC system. Berkeley is strongly committed to maintaining its public purpose and adhering to the core values that underpin its public mission. Indeed, it is our purpose and values that have allowed us to retain our faculty, staff, and students despite significant cuts in budgets and being "off market."

Many of Berkeley's peers are richly endowed and have the latitude to make campus specific business decisions allowing them to quickly adjust to the opportunities and challenges they confront (see the growth in expenditures in the graph on page 5; UCB is the bottom light blue line). They can attract the best students, faculty, and staff they need to maintain their pre-eminence and competitiveness within an increasing global environment.

Berkeley needs to be able to do the same, as well as retain its specific public character. Compensation for key members of the Berkeley community is significantly below market levels and we are finding it increasingly difficult to recruit talent in some areas (finance and IT). A solution will require a predictable and higher level of investment in Berkeley. The last decade indicates that such a strategy cannot be based on the hope that the state will provide either the stability or the level of funding Berkeley requires.

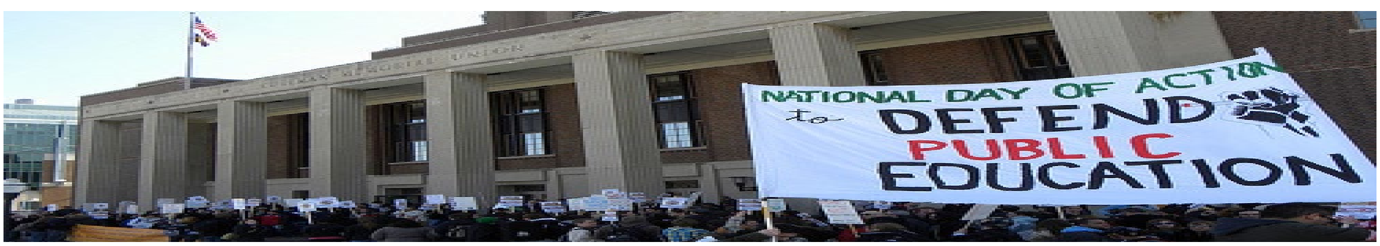


The solution

There is no silver bullet. At Berkeley, we are taking a multi-pronged approach that involves our constituents at all levels: Federal and State Governments, the UC System, and our own campus. Based on this approach, we are suggesting the following 15 actions. While these actions are not all that is required, they would form the foundation of a plan that our key constituencies would buy-in to.

Federal and State Governments

1 We need to make a strong case in Washington DC that the **Federal Government** can and should do more to preserve and enhance the nation's greatest public research universities. At a time when knowledge workers are the underpinning of economic growth across the globe, when America's economic rivals are investing massively in **national universities**, our federal government must consider it a national priority to educate and empower our children. We have developed a plan that we are sharing among our peers and in the nation's capital: a federal-state-private partnership based on a "matching contribution" model, whereby additional funding from the federal government is matched by both the state and the private sector. Over the next 10 years, this would create 10,000 endowed chairs for the nation's leading public teaching and research universities. We need freedom and flexibility to shape this plan for us and for the other UC campuses that will be eligible for such a program.



2 We should continue to argue for a partial restoration of the unrestricted **state appropriations** we receive. The economic/social return on this type of investment to California and the US more generally are well proven. These funds are still significant (10.5% of Berkeley's revenues, equivalent to an additional endowment of $5 billion) and the funds are more fungible than many other source of revenue.

3 In addition to a general appeal for state appropriations, we should push even more strongly for the state to reestablish the prior practice of contributing to **UC pension** costs. We project that benefit expenses for Berkeley will increase by roughly $200 million over the next seven years, due to increases in the employer pension contribution and health care. Currently, although the state does contribute to the pension plans of both the community colleges and CalState system, the state continues with its twenty year practice of taking a contribution "holiday" with respect to the UC system. This should be stopped. The State could make a major impact upon higher education with this approach at a much lower cost than an across the board increase for all higher education institutions.

The UC System

4 It would be useful if there was more **latitude** and **certainty** with respect to the setting of both in-state and out of state tuition. One proposal is to establish a UC-wide “band” for in-state tuition and leave it up to campuses to determine where they fit within this band. Determination of out of state tuition, professional fees, and charges related to other degrees or certificates should be fully decentralized because these charges should be primarily market determined. The cost structure of each of the ten UC campuses is very different for a host of obvious reasons, as is the demand side of the equation. In addition, the pace of change is more rapid and there is greater volatility than the system has seen since the Master Plan was conceived. Given this, each campus needs to be able to **adjust prices** quickly to suit specific needs; this can only be done at the campus level.

5 Each campus needs to be able to determine its own salary and benefit structure for faculty and non-represented staff. We also need more latitude to determine the structuring of labor contracts to permit more flexibility. As noted above, Berkeley needs to be given the flexibility to compete for talent against its public/private peers if it is to retain its current standards of excellence.

6 Berkeley needs to be able to set the parameters of the financial **aid package** it can offer its students and offer more assistance to the college bound middle class students. Currently, financial aid is coordinated at the UC system level, with the result that approximately $6 million is “redirected” away from Berkeley to other UC campuses. Financial Aid should not be kept outside the “**funding streams**” reform, which set the goal of allowing “funds raised on campus to stay on campus.” In addition, a strategy predicated on a steady increase in student tuition, absent a reform of our approach to financial aid, will undermine our ability to provide access to those students that are not protected by Pell and Cal grants. We need the funds and the flexibility to address this problem. Berkeley has taken a very important step in this direction by being the first public university in the US to introduce a financial aid program specifically for the middle class: The Middle Class Access Program (MCAP).

7 In a similar vein, we need to be able to undertake capital projects and clear the serious backlog of deferred maintenance more quickly and be able to explore different financing structures. Our own campus based **decision making** and vetting is extremely rigorous, enabling us to comply with all the necessary standards. We should consider appropriate ways of reducing UCOP’s workload by eliminating further central review.

8 Berkeley needs to be able to invest its reserves in a more varied range of **financial instruments** than is offered under the current UCOP foundation model or the short term alternatives. Currently, all financial reserves (except gifts that are explicitly made payable to the Berkeley foundation) must be sent to the UCOP foundation because the legal interpretation of the regulations suggests that reserves are the property of the Regents. As a consequence, we are unable to invest in financial instruments that could be structured so as to meet our campus specific needs.

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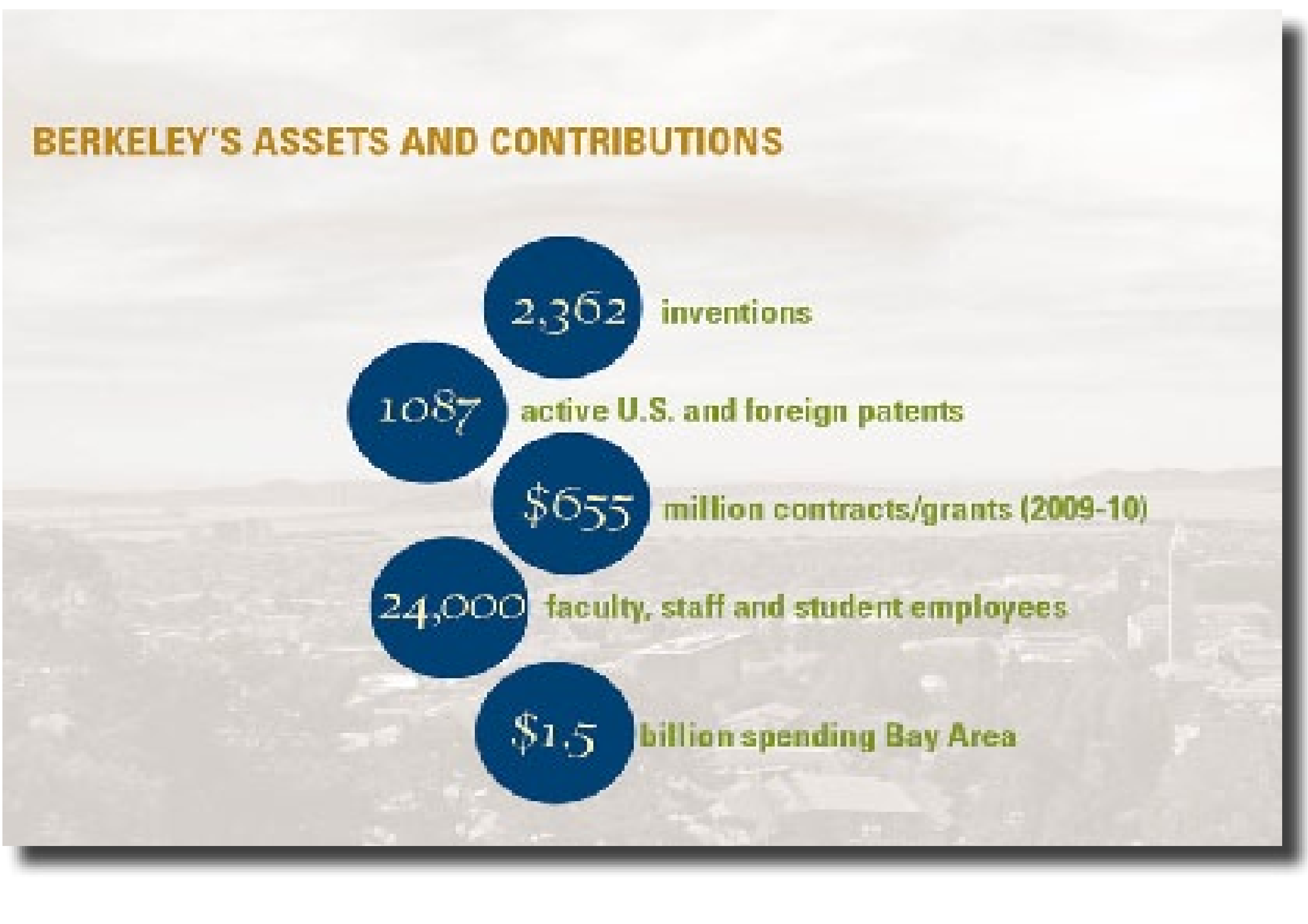
9 We need to tap in to the high caliber of our alumni in a more meaningful way to benefit from their immense experience and their willingness to support our institution. This will require a campus **governance structure** that engages them more directly in important strategic decision making, as opposed to the advice-only role that they have played in the past. Our key alumni want to be a larger part of the solution, but in exchange these successful decision makers are requesting more meaningful involvement.



UC Berkeley

10 Berkeley needs to continue to invest in building a **world-class development** function. University Relations has made significant strides in developing information systems and staff, as reflected in the success of our recent campaign. But relative to our private peers, Berkeley remains under-invested in its fundraising infrastructure. Of particular importance is **building fundraising capability** within individual Schools, who are best positioned to engage with individual donors around specific fundraising opportunities and areas of interest.

The VCAF Student Advisory Group "wordle" above was created from a discussion about issues that concern students and is in alignment with many of the priorities identified in this paper.

11 Berkeley needs to retain its position as a pre-eminent research university and look for ways to make research a stronger contributor to our financial position. This involves two parts: 1) more carefully managing the **recovery of research costs**, and 2) enhancing the financial contribution from **technology transfer**. We need to be in a position to continue to grow our research without that growth representing an increasing drag on our finances. In the area of tech transfer, we believe we can do more to drive financial impact through our innovation and entrepreneurship. Berkeley has invested significantly less than peer institutions in the cultivation and management of valuable intellectual property, including fully-supporting promising opportunities, managing equity positions, and maximizing the value of our relationships with the corporate and investment community. We are an institution where entrepreneurship thrives primarily through individual initiative with relatively modest institutional support.

12 Delivery of education through **digital channels** (e.g., online) represents an enormous opportunity for Berkeley. Given our global reputation, digital delivery represents an enormous opportunity for us to expand our mission of access and excellence and enhance our financial position at the same time. The opportunity in this area is not being first-to-market, but rather to thoughtfully define a strategy that will create superior long-term value in what will soon be a crowded landscape of providers. We also need to retain Berkeley's essential character and brand by leveraging the full creative power of our faculty and campus resources.

13 **Financial visibility,** and the usability of financial data, lies at the heart of better financial decision-making at all levels of the campus. A critical aspect of our strategy is thoroughly redesigning the budgeting, metrics, and financial reporting processes at all levels of the organization. Historically, our Deans and Vice Chancellors have made decisions with extremely limited financial information. We have a project to provide our leaders the financial **tools** they need to plan for growth, understand the drivers of their costs, pursue revenue-growth opportunities, see the impact of potential courses of action, and take full advantage of the funding resources before them.

14 The role that Deans, Department Chairs, and individual faculty members play in our collective financial future cannot be underestimated. We are proud of the degree to which Berkeley remains a culture founded on individual initiative, academic freedom, and entrepreneurship. Campus stewardship is also an essential value, that the vast majority of our **faculty and School leadership** deeply share. The changes in our environment, however, require that we collectively expand our leadership capabilities and embrace new priorities and new ways of working together. More strategic growth, and growth in areas such as development, recovery of research costs, management of intellectual property, and digital education will require us all to work outside our comfort zone and systematically develop new skills.

15 The **Richmond Bay Campus** offers a once-in-a-generation opportunity to grow in new ways that support our long-term financial stability. We have seen the ways that our peers have created tremendous value out of the "**ecosystems**" that they can create around their campuses. We need to develop a comprehensive, long-term plan that looks both at the tremendous academic potential of the site, but also looks at the site as an opportunity to enhance our long-term financial security, and to make bold investments commensurate with those opportunities.