

The University of North Carolina at Chapel Hill
Efficiency and Effectiveness Project
Scope of Work
February 2009

Background

The University of North Carolina at Chapel Hill is one of the nation's oldest and most respected public universities. It is the second largest school in the North Carolina university system, with more than 28,000 students enrolled across 13 different colleges.

UNC Chapel Hill has enjoyed strong financial health from 2002-2007, as total revenue grew from \$1.5B to \$2.5B in that time period. This revenue growth has been driven in large part by non-operating revenue, which has increased from 37% of total revenue to 47%. Particularly impressive has been the 43% compounded annual growth in investment income, which has helped reduce the University's reliance on state appropriations. Although state appropriations grew 6% in this time period, they have decreased from 24% of revenue to 20% of revenue due to investment income growth.

Despite its strong performance in recent years, UNC-CH faces significant financial headwinds in the next few years. The global economic crisis will significantly impact the University's revenue stream. The state is expected to cut appropriations as much as 7% or more next year instead of the originally planned 2.3% increase, a net swing of ~\$50M. Although this is labeled a temporary reduction, it is likely to become permanent. In addition, investment income is likely to dramatically decrease given the sharp decline of financial markets. Assuming that investment income declines 25% (not unreasonable in today's environment), that could mean an additional ~\$80M decline in revenue. Finally, tuition and fees per student FTE has averaged a 9% annual increase over the past five years. Given the current economic and political environments, however, it is unlikely that the University will be able to continue this trend.

Assuming other sources of revenue remain flat, UNC-CH would need to cut 6-7% of its \$1.9B operating expenses to offset the estimated revenue decline from state appropriations and investments. This equation is complicated, however, by challenges on the cost side. For example, the University has already announced the goal of increasing faculty salaries to the 80th percentile versus peer universities in order to improve faculty recruitment and retention. The annual impact of this increase

is expected to be ~\$21M for tenure-track faculty. While some of this increase has already been realized, it could continue to put pressure on the University's cost structure. In addition, the University is in the middle of a \$2.1B capital construction program, is increasing student enrollment, and plans to grow its research capabilities.

Given these looming financial pressures, it is critical that UNC-CH develop an action plan to proactively reduce cost without negatively impacting the university's core mission.

Project Objective and Scope

The primary goal of this initiative is to identify options to reduce the University's addressable operating cost structure (i.e. the ~\$900M General Institutional Support Funds) by 5-10% through more efficient and effective operations. It is imperative that options to achieve this goal be within the constraint of several guiding principles:

- Identified options must comply with regulatory, statutory and policy environments under which the University operates
- Academic quality must be maintained
- UNC-Chapel Hill's reputation as a leading public research institution must be preserved
- Must sustain sound internal control and compliance environment
- Costs must be evaluated against the relative value they generate in return

As we examine the operating cost structure, we have been directed to include the University Administration and all 13 colleges. However, we have been told that the UNC Health Care System and UNC Physicians & Associates will be out of scope.

Given that salaries and benefits represent nearly 60% of operating expenses, significant focus must be put on this cost pool. The scope must include all of the various labor pools within the University, including faculty, non-teaching professionals, administrative staff, and plant/operations personnel. Within each labor pool, consideration will be given to a number of different potential options, including productivity improvement through process and tool enhancements, new operating models (e.g. creation of shared services across the colleges), outsourcing of non-core activities, and changes in the mix of people in different job classes (e.g. full-time vs. part-time).

The remaining 40% of operating costs are primarily made up of various purchased goods and services. This group of expenditures will be quickly examined to determine which are addressable and which are not in the near term. Other opportunities will be explored to reduce demand for the goods and services, decrease cost by reducing complexity/specifications of goods and services purchased, and reduce prices by improving procurement practices and capabilities.

Although new sources of revenue could also play a role in offsetting the University's financial challenges, we have been asked to leave them out of scope for this project. Substantially raising tuition would likely be difficult in the current economic and political environment and developing new sources of revenue (e.g. new programs) typically takes longer to materialize and requires investment. All agreed that the University will be in a better position to pursue revenue opportunities once it has sufficiently streamlined its cost structure.

Path to Results

Cost structure transformations of this magnitude are inherently complex and present many opportunities for failure. In order to manage this risk and have a successful outcome, it is important to establish up-front how we will collectively define success and create a path to results.

Success for the diagnostic and option development phase of work can typically be defined by the magnitude of the savings opportunities identified, the pragmatism of the options created, and the degree of organizational “buy-in” generated. Given the 5-10% savings objective set by the Administration, we would expect the team to identify 10-15% in savings opportunity that the University could choose to pursue. This potential savings opportunity will need to be grounded in realistic options that a broad group of stakeholders believes may actually work and generate savings without violating any of the project’s guiding principles.

Successful implementation can typically be measured by the yield on the potential savings opportunities. It is extremely rare for any client to realize 100% of potential savings opportunities identified. In general, clients should expect to realize 60-80% of the potential savings once they have decided which options to pursue and successfully implemented the solutions: some opportunities may not be pursued, others may have overlapping impact (i.e. duplicate savings counted), some assumptions won’t turn out to be perfectly accurate, and compromises get made during implementation that dilute results. Given the culture and complexity inherent in a not-for-profit university, UNC could potentially yield less than we typically see in a corporate setting.

To ensure that we are all aligned around how to define success for this project, we propose holding a “Results Workshop” very early in the process to agree on the specific criteria—both qualitative and quantitative—that we will jointly use to measure the project’s success.

Experience has shown us that one of the most important factors in generating sustainable results is the degree of executive engagement, ownership, commitment and visible leadership. Because of this, we believe that it is absolutely critical to have regular interaction with University Administration and the project Oversight Committee.

More details on how the University Administration and the Oversight Committee will engage in this is included in the Project Governance and UNC-CH Resources section of the scope of work.

Approach

We propose a four-stage approach to develop options for the University to choose from in making operating cost reduction:

1. Build baseline
2. Identify opportunities
3. Design options
4. Vet Options

This four-stage approach will take five months to complete. Goals, activities, and timing for each stage are outlined in more detail below. These stages will be performed sequentially with some overlap.

1- Build Baseline

The goal of this stage is to build the detailed fact-base upon which the University Administration and the Oversight Committee will draw conclusions and we will develop potential options in stages 2-3.

The first step in building the baseline is to make sure the Administration has the full factbase that appropriately sets the context for the project. It is critical that we fully understand the University environment, including the organization structure, the operations of the 13 colleges and related departments, economic structure and dynamics (including budget process), politics and organizational sensitivities, and key policies and regulations. It will be important in this stage to have meaningful, private discussions with various stakeholders in order to get their perspectives on the University and how it functions.

The second step in building the baseline for the Administration is constructing the “cost cube”. This is a detailed database that will enable cross-tabulating the college or department (e.g. Arts & Sciences), the functional area (e.g. Admissions) and the type of expense (e.g. salaries). The cost cube will provide full transparency for the University into where the largest pools of cost reside for both labor and purchased goods and services.

In conjunction with building the cost cube we will also establish a headcount baseline to provide greater detail to the University Administration and the Oversight Committee around the labor cost pool. This database will allow an evaluation of the reporting relationships, spans of control, organizational redundancy, job class mix and productivity.

Finally, we would compile a set of operating metrics in order to allow the analysis of the productivity across each of the different cost pools. For labor, these metrics would encompass areas such as employee to staff ratios for administrative functions such as HR and IT, square feet per employee for facilities management, etc. For purchased goods and services, these metrics would encompass cost/unit for purchased goods and output or value delivered per dollar spent for purchased services.

Together these sets of data will allow prioritization of focus, provide a basis for benchmarking, and enable quantification of the benefits of potential options.

We expect this stage of work to take approximately 4-5 weeks.

2- Identify Opportunities

The goal of this stage is to develop a set of optional opportunities for the University to reduce its cost structure. This will happen through detailed analysis of the baseline built in Stage 1, benchmarking, and workshops with relevant stakeholders.

The baseline analysis will evaluate the many data sets and metrics outlined above. The data will identify the largest cost pools and then “deep-dives” can be performed to understand the underlying drivers of those costs. Simultaneously, the relative value being derived from each cost pool will be evaluated in order to develop a balanced perspective on where opportunities may reside.

Benchmarking will also be an important tool to identify potential opportunities for cost reduction.

External benchmarking will compare the University's performance on key metrics against a set of peer universities. This will enable the University Administration and the Oversight Committee to identify areas where the University could potentially perform better. Internal benchmarking will enable the University Administration and the Oversight Committee to compare the performance of different groups performing similar functions within the University; for example, looking at the number of Admissions personnel per admitted student across colleges. While there can be great value in looking at external benchmarks—particularly if innovative best practices are also identified—organizations typically align around internal benchmarks and best practices more quickly.

It is also important to note that benchmarks must always be evaluated in the context of management judgment. It is the triangulation of the three elements—external benchmarks, internal benchmarks and management judgment—that ultimately leads to the best answers. Therefore a series of workshops will be conducted with relevant stakeholders in order to review the findings and solicit input on where the greatest opportunities for productivity improvement and cost reduction reside. Not only will these workshops provide the third leg for our triangulation, they will also provide an opportunity for stakeholders to engage in the process and develop a sense of ownership for the outcomes.

We expect this stage to take approximately 5-7 weeks.

3- Design Potential Options

The goal of this stage is to refine the high priority opportunities and develop a set of potential options for how to address each cost opportunity. The expected benefits, costs, risks and other relevant factors will be outlined for each option. University Administration will need to evaluate the options associated with each cost opportunity and decide on the appropriate course of action for the University. It will be incumbent on University Administration to ensure that any option it chooses to implement fully complies with the appropriate statutes, regulations and policies that govern the University.

Potential options will take the form of both “quick-hit” and “long-term”. Quick hit options are those that can be implemented very quickly without significant implementation planning and effort. Quick hits often come in the form of policy changes, such as hiring freezes, travel policy changes, etc. These will be reviewed by University Administration as they emerge. University Administration and the Oversight Committee can then vet the options and decide whether or not to take action.

Long-term options will require more in-depth design and planning. The team will develop more detailed scenarios around how the University could operate differently in the future. These potential options will come in the form of operating model changes, process changes, organizational changes, and tool and capability enhancements. University Administration will review potential long-term options at the end of this phase of work.

For every option the team will develop a high-level business case. These business cases will include the rationale for change, expected cost impact, expected productivity impact, estimated implementation cost, estimated implementation timing and complexity, and likely barriers to success. These high-level business cases will serve as an input into the University's decision process on which course of action to take.

Throughout this phase it will be important for us to work closely with relevant stakeholders. We want to ensure that we leverage the knowledge and expertise of the organization while at the same time building a sense of ownership for the results. We would expect stakeholders who play a significant role in option development to serve as champions during the implementation phase once the University decides on the appropriate course of action.

We expect this stage of work to take 7-9 weeks.

4- Vet Options

The goal of this stage is to solicit feedback from key stakeholders on each of the potential options in order to better understand pros, cons, and likely barriers to success, including organizational reaction. Although we will involve stakeholders throughout every stage of the project, it will be critical in this phase of work to engage stakeholders in constructive dialogue around the potential options in order to provide transparency and give them a voice in the process before the University decides on a course of action. We will also take input from this group of stakeholders to refine the options as appropriate.

We expect this phase of work to take 3-4 weeks.

Bain Resources and Timing

Two partners will lead this project for Bain and both have relevant expertise in large-scale cost reduction programs. The Bain partners will work with University Administration and the case team to ensure that the project is appropriately scoped, the team is focused on the right issues, and identified options are pragmatic and will drive real value for the University.

Bain will staff a standard case team to this assignment. A standard case team consists of an experienced full-time Manager and four full-time consulting staff. The Manager will be responsible for project execution and managing the team on a day-to-day basis. The consulting staff will be responsible for building the fact base, conducting analysis and developing options with guidance from the Partners and Manager.

The total duration of the project is expected to be five months.

Project Governance and UNC-CH Resources

As previously noted, it will be important throughout the project to have relevant stakeholders from the University participate in the process. We would expect you to assign an internal Project Manager to serve over the life of this project. The UNC-CH Project Manager will manage UNC-CH resources assigned to the project, facilitate data collection, help coordinate interviews and workshops, etc. The UNC-CH Project Manager will interact with the Bain Manager on a daily basis to drive alignment and successful execution of the process.

In the Baseline stage of work it will be critical to have a Finance analyst and HR analyst assigned to the team. We would expect to use roughly 50% of their time during this stage. We will also rely on Finance and HR as we develop options in stage 3 in order to help us develop savings assumptions, screen options for regulatory implications, etc. We expect the time requirement during this phase to

be closer to 20%.

We also think it would be helpful to have designated liaisons from each of the 13 colleges and University Administration to help us better understand their respective environments and operations, gather relevant data, and introduce us to relevant stakeholders for interviews and workshops. We would expect these liaisons to spend a few hours per week working with us on the project. Interactions with this group will be on an individual and ad hoc basis, but we would expect the intensity to be greatest during the Baseline and Vet Options stages.

We believe it makes sense to develop an Oversight Committee to provide overall governance for the project. The Oversight Committee will set direction for the team, vet findings and options, resolve issues and conflicts as they emerge, and make all decisions regarding the project. The Oversight Committee should be comprised of a small set of University managers.

We envision at least three update meetings with the Oversight Committee. The first meeting would be to agree to the issues, scope, approach and success criteria. We would prefer to have this meeting as soon as possible in case we need to redirect the project based on their feedback. The second meeting would be after we complete Stage 2- Identify Opportunities. The objective for this meeting would be to review findings and discuss savings targets. The final meeting would occur during Stage 4- Vet Options. The objective for this meeting would be to review potential options so that the Oversight Committee can vet the options.