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## Performance-Based Funding

A number of states have made progress in implementing performance-based funding and accountability. This policy brief summarizes main features of performance-based funding systems in three states: Tennessee, Ohio, and Indiana. The brief also identifies key issues that states considering performance-based funding must address, as well as recommendations for states wishing to implement PFB.

As a special note, this briefing paper follows the common practice of using the terms “performance-based funding” and “outcomes-based funding” interchangeably.

### Tennessee<sup>1</sup>

Tennessee was one of the early adopters of PBF. Its model has received quite a bit of national attention. Similar to the SBCTC’s Student Achievement Initiative, the Tennessee outcomes-based funding model rewards institutions whose students persist and complete degrees, instead of basing funding on enrollment. The Tennessee Higher Education Commission (THEC) implemented the new outcomes-based funding formula during the development of the 2011-2012 fiscal year budget recommendations to their Governor.

#### THEC collects prior academic year (2009-10) data showing the:

1. Number of students accumulating **24 semester credit hours**.
2. Number of students accumulating **48 semester credit hours**.
3. Number of students accumulating **72 semester credit hours**.\*
4. Number of **bachelor’s and associate degrees awarded**.
5. Number of **master’s and education specialist degrees awarded**.
6. Number of **doctoral and law degrees awarded**.
7. Total **non-state funding for external research**, service, and other sponsored programs.
8. Number of **students who transferred** to any public, private, or out-of-state institution at any time during the prior academic year, who had accumulated at least 12 semester credits prior to transferring.
9. Total number of **associate and bachelor’s degrees conferred** divided by the year-round, end-of-term undergraduate FTE generated.
- 10. Six-year graduation rate.**

\* For measures 1 through 4, THEC also reports the number of adult students (age 25 and over) and the number of low-income students (Pell-eligible at any time during their college career) who achieve these milestones. Forty percent of these totals are added to the overall total for each measure.

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<sup>1</sup> See HECB Policy Brief, “Tennessee’s Performance Funding Model,” August 5, 2010. Available from the Higher Education Coordinating Board, Olympia, Washington

Each outcome measure is standardized into a Scaled Outcome. Total Points are calculated by multiplying the points by a weight unique to each measure and unique to each type of institution to reflect the varying institutional missions based on Carnegie Classification system. Included in the formula calculations are the average faculty salary of similar Carnegie institutions within the 13-state southern region and fixed costs, which includes maintenance and operations, utilities and equipment replacement. Institutions can earn up to 5.45 percent of base in supplemental dollars through the performance funding process.

One of the positive outcomes in Tennessee has been that “Our model is not dependent on just one variable--enrollment,” says Russ Deaton of the Tennessee Higher Education Commission (THEC). “Rather, we use about 10 variables to assess performance.” Presidents of the universities were consulted at every step along the way in building Tennessee’s model, so that institutional buy-in was a key feature. A recent concern, however, is that tuition dollars are undermining the formula for PBF. Tennessee officials state that another critical feature is the need for including the *right* data in the formula. THEC relies on the institutions to provide accurate data.

In response to criticism that Tennessee’s model only works in flush times, when performance-based funding dollars are an “add-on,” Russ Deaton stated, “Tennessee’s model works the same way up and down. There’s a finite pool of state money and it’s allocated yearly. So if there’s more money generally available, there’s more money for PBF. And it’s the same process and formula when there’s less money.”

## Ohio

Ohio’s performance-based funding model has been implemented for several years. Their actual funding formula is based on a complex cost model<sup>2</sup> that operates at a micro-level and uses a significant amount of data. During the development of the 2010-11 biennial budgets, the Ohio Board of Regents implemented new SSI formulas designed to focus on student outcomes, although enrollment is still a critical underlying piece.

The formulas start with FTEs enrolled and the cost per FTE, then make adjustments for student course completion rates and, for main campuses only, degree completion. Additional adjustments are also made for enrolling low-income students, for low-income students who complete courses, and for enrollments in STEM fields. Most of the underlying data is reported by campus, by subject, and by level (e.g., undergraduate or graduate). The BOR develops a formula and recommends its use by the Legislature, which generally adopts the formula as is unless a lack of state revenue requires modification.

Part of Ohio’s formula includes calculating the average cost of instruction per student FTE for each campus for the most recent 6 years, normalizing each of the years of costs using the Higher Education Cost Index (HECA), and determining eligible FTE based on previous five years of FTE data by campus, subject, and level. Completions of undergraduate courses are weighted by campus, subject, and level, with priority weights for science, technology, engineering, mathematics, medicine and graduate programs.

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<sup>2</sup> See HECB Policy Brief, “Ohio’s Performance-Based Subsidy Formula,” August 5, 2010. Available from the Higher Education Coordinating Board, Olympia, Washington.

A key feature is that operating expenses are funded at least at 98.5 percent of the FY2007 level. There also is a stop loss component, which allows 1 percent decreases each year up to 95 percent, after which this component will be removed from the formula. This component allows the BOR to phase in the formula in a way that ensures institutions do not experience a precipitous drop in earnings from the prior year.

An advantage of Ohio's model is that it closely ties performance at a micro-level (by campus, by subject, by level) to state funding with concrete consequences, especially once the stop loss measure is phased out.

## Indiana

Indiana has aligned performance-based funding with the state's strategic master plan, entitled "Reaching Higher." Indiana allocates a portion of the operating base (5 percent, or \$61.4 million in 2011-13<sup>3</sup>) to fund its performance-based funding model and then distributes the funds based on priorities set by the Commission on Higher Education. The formula takes into consideration the different missions of each institution and uses seven common metrics.

A dashboard<sup>4</sup> displays institutional progress on reaching the state goals for higher education, expressed in seven major areas:

- 1) Successful completion of credit hours
- 2) Successful completion of dual credit hours
- 3) Early college successful completion of credit hours
- 4) Low income degree attainment
- 5) On-time degree change
- 6) Change in degrees attained
- 7) Research incentive.

The performance-based funding formula that Indiana has adopted emphasizes degree production, with 60 percent of the performance-based dollars awarded for degree completion. The remaining 40 percent is distributed based upon other focus areas, including rewards to institutions for increasing research dollars gained from other sources and increasing credit hours students earn.<sup>5</sup>

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<sup>3</sup> 2011-13 CHE Budget Recommendations. Indiana Commission on Higher Education.

<sup>4</sup> "Reaching Higher. Strategic Initiatives for Higher Education in Indiana. State-Level Dashboard of Key Indicators." Indianapolis: Indiana Commission on Higher Education. Available at [http://www.in.gov/che/files/Final\\_2010\\_Update\(3\).pdf](http://www.in.gov/che/files/Final_2010_Update(3).pdf)

## Common Concerns about Performance-Based Funding<sup>6</sup>

As states get better in developing and implementing performance-based funding systems and formulas, they are beginning to respond to criticisms of performance-based funding. Some of the common criticisms and state responses<sup>7</sup> are listed below:

1. “With the economic downturn, now is not the time to implement performance-based funding.”

The fact is that state legislators and policy-makers are reluctant to fund colleges and universities without tying funding to student progress and completion. PBF can be a way to convince policy-makers to provide *more* funding for higher education.

2. “By focusing on success, PBF threatens the access mission of higher education.”

Earlier versions of PBF did indeed have this weakness, but newer systems also reward progress, just as SBCTC’s Student Achievement Initiative does.

3. “Many aspects of student success just aren’t measured, like improving student learning and helping students get jobs.”

That was also true when we funded by FTE enrollment. Incorporating progress measures, like the SAI does, rewards institutions for retention and persistence, not just completion. Pennsylvania, for example, allows universities to select measures that reflect unique missions.

4. “Rewarding institutions for course or program completions could result in lowering standards if faculty simply pass students along.”

Having multiple measures help protect against “social promotion,” as does faculty professionalism and ethics; accrediting, licensing and employer standards; and splitting performance-based rewards on enrollment as well as progress and completion metrics.

5. “There is no evidence that performance-based funding works.”

Reasons why early PBF models failed included the fact that typically only 2 percent or less of the budget targeted performance, which was too small an amount to have much of an effect; unique institutional missions were ignored; consensus wasn’t reached on the reasonableness of targets for performance; and small categorical PBF programs were cut when legislatures cut budgets. Although newer PBF systems have yet to be evaluated, early results show promise. Pennsylvania, for example, reports a 10 percent increase in graduation rates and 15 percent increase in Latino student persistence.

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<sup>6</sup> This section summarized from Nancy Shulock, (May 2001), “Concerns about Performance-Based Funding and Ways that States Are Addressing the Concerns,” *HELP Brief*. Institute for Higher Education Leadership and Policy, Sacramento, California. Available at [http://www.csus.edu/ihelp/PDFs/B\\_performance%20funding\\_05-11.pdf](http://www.csus.edu/ihelp/PDFs/B_performance%20funding_05-11.pdf)

<sup>7</sup> Information in this section drawn heavily from the SHEEO Policy Conference session, August 8, 2011, “Outcomes-Based Initiatives.”

6. “How much of PBF is sustainable—and how much is engineered?”

A key feature in making PBF sustainable is to ensure that institutions have input into the formulas. Some “engineering” may be necessary to preserve the state’s public policy directives, such as not diverting funds for undergraduate completions to graduates, who complete at the highest rates. Kansas, Tennessee, and Pennsylvania have all paid attention to institutional input into PBF.

For example, although there has been no new money for three years in Kansas, the state is still using Outcomes Based Funding. Kansas allows institutions to craft their own agreements, resulting in 34 distinct agreements, with one part of university Presidents’ contracts tied to performance.

Tennessee queried the presidents at every step of the process. Pennsylvania uses a combination of five common core indicators and an array of other indicators from which institutions can select. Tennessee also sets specific interim targets each year, not in terms of percentages, but in actual numbers.

7. “Institutions are already ‘on it’ regarding performance and don’t need incentives.”

Overall, this criticism has validity. Faculty members do indeed get up every day concerned about their students and wanting to do the best job they can. One of the possible counterpoints to this criticism is that performance incentives are aimed at ensuring that state-level goals for student progress and degree completion remain highly visible.

8. “Colleges need stability to plan.”

Performance-based funding that is based upon seven to ten variables is more predictable than funding that is based on one variable—enrollment.

9. “Performance-based funding could have a negative impact on quality or standards of instruction.”

This concern is also somewhat valid. Time may allay that fear. Australia has had performance-based funding for a number of years. According to the Australian officials, “At first, all the conversation was about what PBF would do to quality. But you don’t hear that anymore.”

## Recommendations for States

Among the recommendations for states wishing to implement performance-based funding initiatives from policy experts at the August 2011 SHEEO Policy Conference were those listed below:

1. Tie performance-based funding measures to the public agenda for higher education. Without goals, performance-based funding is simply a technical exercise.
2. Ensure that you have good data, which is critical to the success of the initiative.
3. Use different metrics for research and comprehensive universities and community and technical colleges. Define performance for audience and levels.
4. Keep metrics simple and be very clear about how metrics will be used.
5. Hold harmless at-risk populations; incentives must be fair.
6. Pay attention to the implementation strategy as well as the design of the performance-based funding system.
7. Put enough money into performance-based funding to make a difference.
8. Determine how much of the budget will be dedicated to performance-based funding—and whether the sources will be new or reallocated.
9. Determine a mechanism for allocating performance-based funding dollars. Should it be built into the regular funding model? Or designed as an add-on or categorical bonus?
10. Don't include tuition money with state appropriations in any metrics or formulas.

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