

## Recommendations for the Effective and Equitable Implementation of Performance-Based Funding for Wisconsin Higher Education

By Nicholas Hillman, Robert Kelchen, and Sara Goldrick-Rab

### KEY POINTS

1. Performance-based funding seeks to switch the focus from enrollment to completion.
2. Successful performance-based funding starts small and is developed via collaboration.
3. Colleges with different missions should have different performance metrics.
4. Multiple measures of success are necessary to reduce the possibility of perverse incentives.

### ABOUT THE AUTHORS

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### I. Context

A sagging state economy coupled with significant budget constraints, along with a national push for market-driven education reform, has brought discussions of performance-based funding approaches to Wisconsin public higher education to the forefront this year. Historically, the state's colleges and universities have received state appropriations based on funding formulas that reflect a combination of student enrollment at the beginning of the fall

semester, mission-specific funding, and funding received in past budget cycles. While this approach helps provide stability and fiscal certainty for educational institutions, it also includes a potentially perverse incentive to focus on enrolling students rather than graduating them. To address this concern, 16 states or state systems currently use a

model based on "pay for performance" approaches to reforming education, tying state appropriations for higher education to educational outputs (i.e. degree production, retention, enrollment rates and completions for traditionally disadvantaged students, cost-effectiveness, research productivity, and job placement) rather than inputs (i.e. number of students enrolled).<sup>1</sup>

Wisconsin policymakers are exploring the feasibility of adopting a performance-based funding (PBF) model for higher education in the current legislative session. Tim Sullivan, special consultant to Governor Scott Walker on Economic, Workforce, and

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Education Development, developed the initial blueprint for a Wisconsin model in a report issued in Fall 2012.<sup>2</sup> His report emphasized the importance of good design to the success of a PBF model. Therefore, we offer this policy brief in an effort to help policymakers, educators, and the public understand the goals and development of previous PBF models. Drawing on the latest empirical evidence, we aim to provide a fair treatment of the potential benefits and costs of a PBF approach to funding higher education in Wisconsin. Then, we put forth several recommendations aimed at ensuring the effective and equitable implementation of a PBF model, with the hope that a carefully designed and thoughtfully executed effort will lead to successful outcomes for all adults seeking a postsecondary education in the state.

## II. The Coming of Age of Performance-Based Funding

Concerned with low graduation rates and rising tuition prices, policymakers in southern states initially developed performance-based funding models for higher education institutions during the mid-1990s.<sup>3</sup> Proponents believed PBF models would encourage colleges to become more efficient and effective in delivering educational opportunities. Their thinking was popular: Tennessee initiated the trend, and by the year 2000, 15 states had followed suit.

At that time, approaches to the actual design of PBF varied widely across states. South Carolina was among the most aggressive, employing 37 performance indicators to allocate nearly all of that state's higher education appropriations.<sup>4</sup> But in most cases, PBF accounted for a small portion of a state's total appropriations (often 1% to 5%) and few measures of performance were used. The efforts were generally short-lived; for example, South Carolina abandoned its model in 2004 after several years of tight state budgets. The rapid demise of PBF led some observers to question whether PBF was a fad, rather than a sustainable trend.<sup>5</sup>

Today, PBF is back, refreshed in version "2.0" which seeks to avoid the pitfalls of the earlier version. This time the effort includes 16 states, and several others are in active development (including Wisconsin). As Figure 1 and Table 1 indicate, most of these programs began very recently. However, Tennessee (1979) and Pennsylvania (2000) stand out as two of the longest continuously running performance-funding states, whereas several other states adopted, dismantled, and then readopted their

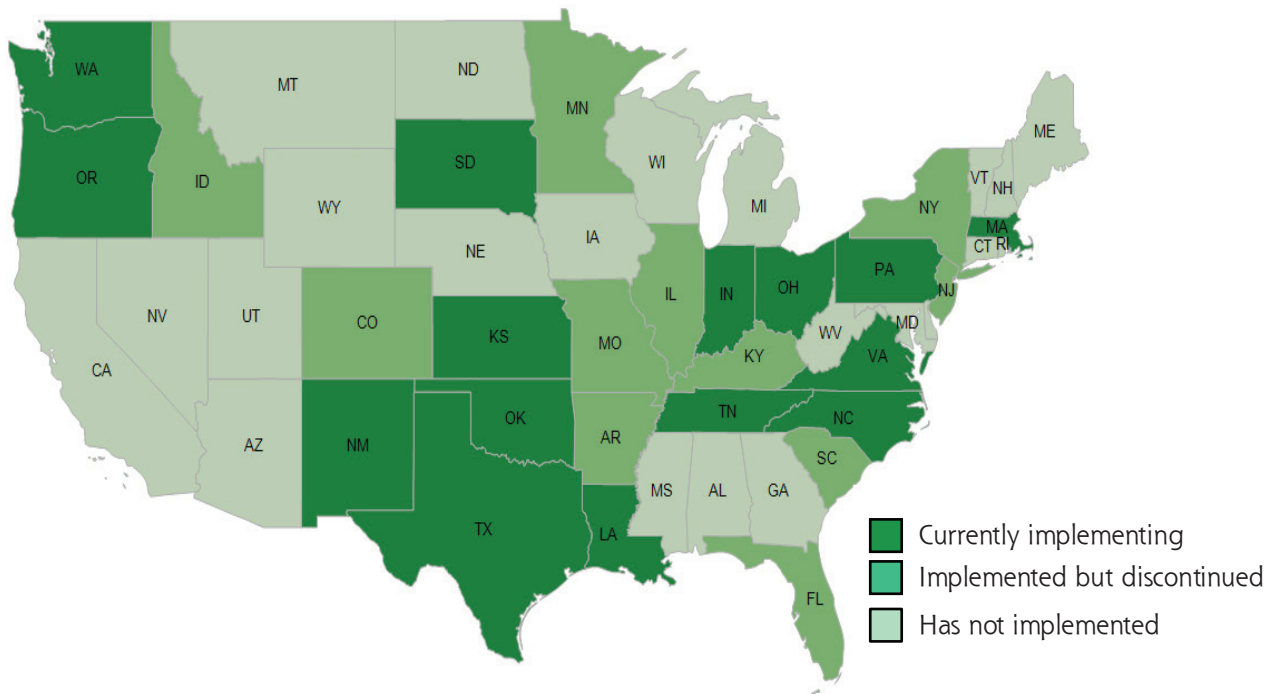
...the overarching theory remains: by linking funding to performance goals, advocates believe colleges are provided with stronger incentives to improve educational outputs, build collaborative higher education policy environments, and become more accountable for tuition prices.

models over several years. In the states with the longest duration of PBF, the design criteria and implementation strategies have evolved over time. One key change is that states have integrated PBF into their base budgets, moving away from PBF as a budgetary “bonus.”<sup>6</sup> Since bonus funds dried up quickly during tight budgetary times, state commitment to PBF waxed and waned according to budget conditions.<sup>7</sup> In addition to building PBF into base budgets, new efforts also weight funds according to institutional mission and student populations, utilize simple performance metrics, and reward

intermediate (as well as long-term) successes.<sup>8</sup>

Even with these policy changes, some states dismantled PBF due to lack of legislative support, changes in party control of the statehouse, and lack of institutional buy-in.<sup>9</sup> Regardless of these factors, the overarching theory of action remains: by linking funding to performance goals, advocates believe colleges are provided with stronger incentives to improve educational outputs, build collaborative higher education policy environments, and become more accountable for tuition prices.

Figure 1. Status of performance-based funding for public higher education



### III. Positive Attributes of Performance Funding

Given the importance of state appropriations to public institutions of higher education, observers believe that many benefits could emerge from a well-designed PBF model. While there is limited available evidence to assess the success of PBF, the positive results observed thus far appear to include:<sup>10</sup>

- *Increased rates of college completion.*

Faced with high rates of dropout among college-goers, an explicit aim of policymakers is to focus colleges and universities

on retaining and graduating the students they enroll. In other words, PBF encourages campuses to prioritize student success; implicitly this would need to occur by realigning resources to facilitate student success. Campuses in PBF states are shifting resources away from research-related activities and investing more in teaching/instruction, which in turn may lead to greater levels of college

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completion.<sup>11</sup> In the only national analysis of the impacts of PBF, researchers found evidence that this appears to be happening: over the past two decades, PBF states have experienced significantly greater gains in the number of bachelor's degrees awarded.<sup>12</sup> Notably, these gains are greatest in states that have operated PBF for at least five consecutive years.

- *Collaborative impact.*

Performance funding models are both a budgetary tool to measure impacts and guide resource allocation and a model to promote collaboration and innovation among various stakeholder

groups. When the governor's office, state legislature, system officials, campus leaders, and faculty work together, they have a greater chance of agreeing upon shared educational goals. Stakeholders may be surprised to find that they share more educational goals than they initially suspect. Through patient, persistent, and participatory efforts, these groups can work

towards identifying, measuring, and achieving these goals.<sup>13</sup>

Tennessee, where researchers found that collaboration was a key feature underlying the program's long-term stamina, stands out as an example of how this can happen.<sup>14</sup> It seems that collaboration allows state policymakers to understand and respond to changing campus concerns, which in turn garners more institutional support and buy-in.<sup>15</sup>

- *Improved accountability:* By scrutinizing the performance of public higher education, colleges are expected to become more accountable and responsive to students and taxpayers. Given tight fiscal constraints and the rising price of college tuition, there is an increasing need to become more accountable to these groups. Measuring and incentivizing performance can create more awareness about what colleges are doing to fulfill their educational missions. Similarly, it can increase transparency by encouraging campuses to share and publicize data.<sup>16</sup> Building this data/performance culture will take time to evolve, so recognizing the importance of intermediate steps towards greater accountability

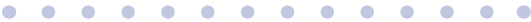
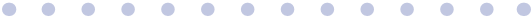
seems an important feature of sustainable PBF models.

#### IV. Pitfalls of Performance Funding

Accountability systems are inherently difficult to design and implement in higher education, and performance funding is no exception to this rule. Drawing from examples in several states, we observe the following pitfalls, which might be avoided when designing and implementing performance funding in Wisconsin.

- *Narrowing of purpose.* What outcomes does a performance funding model aim to achieve? The answer to this question usually varies across stakeholder groups and evolves over time. In many cases, states have failed to ensure that goals cut across stakeholder self-interests and emphasize broader shared goals to help make the effort achievable and sustainable. Ohio, for example, is trying to avoid this by establishing college completion as the central performance goal, aligned with the state's broader college completion agenda. But even this type of focus can serve to nudge institutions to emphasize one aspect of education (i.e. attainment and job placement) over another (i.e. academic rigor and critical thinking).



- *Institutional resistance.* The process through which performance metrics are crafted can facilitate institutional buy-in or generate substantial resistance that reduces its effectiveness. In general, mandated goals have met with less success compared to benchmarks established through a collaborative process involving both campuses and state officials.<sup>17</sup> Long-term sustainability of a performance based system without substantial gaming on the part of institutions appears to depend on collaboration. Kentucky learned this the hard way when the state's Higher Education Review Commission established performance criteria on its own. Even though institutions were allowed to tailor the weights associated with each metric to their own needs, they found ways to get around the state's goals by setting targets that (in some cases) were even lower than pre-reform levels of performance.<sup>18</sup> Kansas provides an example of the opposite approach, where the state initially asked institutions to propose their own performance contracts that include metrics for past performance as well as "stretch" goals.<sup>19</sup> These examples are telling: The Kentucky PBF experiment was one of the most short-lived, while Kansas remains one of the longest.
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- *Metric proliferation.* After establishing mission-based goals, how should states measure progress towards these goals? And how many metrics are necessary? In some cases, states have a tendency to "measure everything that moves." The more indicators used, the less important any one of them becomes; also, adding more indicators can send mixed messages about conflicting priorities.<sup>20</sup> For example, South Carolina measured 37 indicators, Kentucky measured 26; in both cases, politicians lost faith in these multiple metrics and eventually dissolved the programs altogether. The more successful programs utilize well-targeted and well-defined metrics that build upon past achievement

while also striving towards long-term goals.<sup>21</sup> Tennessee initially began with several metrics, but now uses five broad categories. The Pennsylvania State System of Higher Education (PASSHE) originally utilized 17 performance measures, but is now reevaluating its metrics to form a more concise set of indicators.<sup>22</sup>

- *Mission inflexibility.* Should funding vary across institutional sectors and missions? While improving college completion may be an important goal for all campuses, some campuses are better-positioned for achieving this goal. As a result, the funding model frequently benefits some institutions at the expense of others. To avoid this pitfall, Tennessee customized performance goals according to the educational mission and enrollment profile of each campus. For example, six-year graduation rates are the main measure for the University of Tennessee at Knoxville, while at Middle

Tennessee State University the main measure is the total number of bachelor's and associates degrees awarded.<sup>23</sup> Similarly, due to mission differentiation across educational systems, some states (e.g. Texas and Ohio) give extra points to campuses that increase participation and completion for low-income and adult students.<sup>24</sup>

- *Insufficient or counterproductive incentives.* While many states want to tie funding to performance, they lack good evidence about how much money is required to elicit the desired response. In the 1990s, some states allocated small portions of their budgets towards performance funding, hoping that small rudders would move large ships. In Missouri, PBF peaked at 1.6% of total higher education funding and this was a common story for many other states; PBF typically accounted for 1% to 5% of total higher education budgets.<sup>25</sup> Today, the trend is toward higher percentages. For example, Indiana allocates just 5% of its budget towards PBF, while Louisiana has proposed 25%,

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and Ohio is working towards 100%.<sup>26</sup> The National Center for Higher Education Management Systems (NCHEMS) recommends a minimum of 10% as a “reasonable target.”<sup>27</sup> Also, many of the new programs build performance funding into the base budget (rather than supplemental) and incorporate the funding model into state statute (rather than budget proviso). These can be effective ways to sustain and promote output-oriented performance. One of the keys to success, however, is to hold institutions harmless by using incentives to *build capacity rather than penalize colleges*. Ohio does this by incorporating a stop loss provision guaranteeing institutions do not lose more than 1% of their funding per year.<sup>28</sup>

- *Cheating*. Like all rational actors, colleges and universities tend to find ways to shorten the route to success. Researchers have carefully documented the various ways colleges game the performance funding system, which typically include setting low goals and using deceptive compliance strategies. While colleges may successfully receive high performance funding scores by engaging in these practices,

they do not improve institutional performance.<sup>29</sup> For example, some Florida community colleges have encouraged students to take full sequences of courses (even if they did not need them) in order to score more performance points.<sup>30</sup> Similarly, an audit of South Carolina’s program revealed that colleges set artificially low performance goals in order to guarantee progress on performance goals.<sup>31</sup> One way states can avoid this pitfall is by clarifying what constitutes as “valid” progress towards performance goals; similarly, creating shared-goals that campuses and state officials value can also reduce institutional temptations to game the system.<sup>32</sup>

## V. Recommendations for Performance Funding in Wisconsin

With these promises and pitfalls in mind, PBF may help Wisconsin make gains on various educational outcomes. At the same time, a poorly designed system may also hurt the most vulnerable residents and further damage the state’s economy. To that end, we make the following recommendations for those designing a PBF system for Wisconsin:



**Recommendation 1: Clearly define goals and objectives, and make a lasting commitment.**

In order for a PBF system to be effective in changing colleges' behaviors, institutional leaders must understand the goals of the system and how they can strive to meet those goals given their available resources. Legislators should recognize that colleges cannot immediately affect all of the desired outputs, so the funding portion of the system should be phased in over several years. This requires making a long-term commitment to the program, which may be difficult to require through state statutes. Legislators must convince college leaders that PBF will become a permanent part of state higher education funding. In order to do this, college leaders, faculty and staff, and students must be included in the public discussion and decision-making regarding the design and implementation of the PBF system, along with legislators and members of the general public. If all parties have a voice in the discussion, the resulting product will be viewed in a more

favorable light and may be more likely to succeed.

**Recommendation 2: Employ multiple measures of success, including both short-term (retention rates) and long-term (degree completions) metrics.**

The public benefits to higher education extend well beyond those who eventually graduate. There are substantial economic benefits to

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completing even one year of college, so retention and credit attainment rates should be included as shorter-term outputs. Longer-term outputs should include degree completions (rather than graduation rates) and they may also include labor market

outputs (such as initial employment or earnings). We encourage the state to avoid using graduation rates because this is an ambiguous measure of student success; alternatively, the number of degrees awarded is a much less ambiguous measure.<sup>33</sup> To measure these items, we encourage the state to track all initially enrolled students over the course of their academic careers and into the workforce. Notably, *Wisconsin cannot measure institutional performance with the*



*inadequate data systems currently in place.* It is not currently possible to examine rates of meaningful college enrollment for high school graduates or estimate the earnings of UW graduates. If it aims to rigorously assess institutional performance, Wisconsin must invest in substantially upgrading and linking its K-12, higher education, and workforce data systems.

**Recommendation 3: Differentiate metrics and weights by institutional type to reflect diverse goals, student populations, and missions of Wisconsin’s institutions.**

Given the various missions and service regions of each college in the state, the PBF system should account for these unique missions and markets. For instance, colleges with the mission of serving working adults or lower-income students should receive a premium for enrolling and graduating more displaced workers or Pell Grant recipients. The PBF system should be structured in order to induce all colleges to improve their mission-specific goals. This can be accomplished in several ways.

For outputs for which years of prior data are available (such as degree completions), the target for receiving PBF funds can be set based on existing administrative data. For other outputs without previous data (such as workforce data), predicted outputs could be estimated given student and institutional characteristics. If a college’s actual output is better than its predicted output, then it could qualify for PBF funds.

**Recommendation 4: Start small and provide support.**

An outcomes-based approach to funding higher education will be a major change for Wisconsin’s colleges and universities. Significant capacity issues at both the state and institutional levels threaten to diminish its success. The widespread failure of colleges and universities to meet metrics will not benefit

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Wisconsin residents, who rely heavily on the public system to provide postsecondary education. Therefore, we recommend that the initial fraction of funding based on performance be small, serving mainly as a performance bonus

to those who embrace the approach early on. Providing technical assistance (or leveraging external opportunities for such assistance) to help institutions achieve their goals would go a long way toward ensuring that they are prepared to successfully perform when the amount of funding distributed in this way grows.

**Recommendation 5: Reduce or eliminate incentives for colleges to “cream” students in order to succeed.**

A college or university can easily improve its performance by simply increasing the selectivity of its admissions requirements or focusing on serving the wealthiest students, but this means that fewer Wisconsin students will be served and those most in need of postsecondary education will be disproportionately affected. The concern of “cream skimming” can be addressed by giving extra weight to enrollment and completion patterns for rural or ethnic/minority students, students from lower-income families, and/or students from the most disadvantaged public high schools. A “mission-adjusted” approach at worst eliminates the benefits of creaming, and at best (with substantial weight placed on expanding enrollment) helps to open new opportunities.

## **VI. Moving Forward**

Our intention in this brief document is to provide an overview of the challenges Wisconsin faces should it choose this particular pathway. Clearly, it is a popular one, but also fraught with challenges. There is no proven strategy to ensure the success of performance funding models, and many such approaches amounted to little more than fads. With these caveats in mind, our main recommendation is the careful and thoughtful consideration of this and every approach to higher education policy reform, given the consequences for the state’s future.



## Appendix

### Adoption and Duration of Performance Funding Programs

<b>Currently Operating Performance Funding (first year adopted)<sup>34</sup></b>	<b>No Longer Operating Performance Funding (operation years)</b>
Hawaii (2011)	Arkansas (1995–1997)
Indiana (2007)	Colorado (1994–1996, 2000–2004)
Kansas (2002 <sup>^</sup> )	Florida (1996–2010)
Louisiana (2009)	Idaho (2000–2005)
Massachusetts (2011)	Illinois (1998–2002)
New Mexico (2007)	Kentucky (1995–1997)
North Carolina (2001)	Minnesota (1995–1998)
Ohio (1998 <sup>^</sup> )	Missouri (1993–2002)
Oklahoma (1998 <sup>^</sup> )	New Jersey (1999–2002)
Oregon (2000 <sup>^</sup> )	New York (2000–2007)
Pennsylvania (2000)	South Carolina (1996–2004)
South Dakota (1998 <sup>^</sup> )	
Tennessee (2009)	
Texas (2009)	
Virginia (2007)	
Washington (2007)	
<sup>^</sup> denotes states that discontinued and then readopted the policy	

## Notes

<sup>1</sup> Rabovsky, T. M. (2012). Accountability in Higher Education: Exploring Impacts on State Budgets and Institutional Spending Patterns. *Journal of Public Administration Research and Theory*.

<sup>2</sup> Sullivan (2012). The Road Ahead: Restoring Wisconsin's Workforce Development.

<sup>3</sup> Tennessee was the first state to fully adopt PBF in 1979, but we are referring to the states that eventually followed Tennessee's lead during the 1990's. See the Appendix for the years states adopted (and dismantled) their efforts.

<sup>4</sup> Layzell, D. T. (1999). Linking performance to funding outcomes at the state level for public institutions of higher education: Past, present, and future. *Research in Higher Education*, 40(2), 233–246. And Alexander, F. K. (2000). The changing face of accountability: Monitoring and assessing institutional performance in higher education. *Journal of Higher Education*, 411–431.

<sup>5</sup> Burke, J. C., & Minassians, H. (2001). Linking State Resources to Campus Results: From Fad to Trend—The Fifth Annual Survey.

<sup>6</sup> HCM Strategists (2011). Tracking Momentum: Four Steps to Finishing First, Edition 6.

<sup>7</sup> Dougherty, K., Natow, R., Hare, R., Jones, S., & Vega, B. (2011). *The Politics of Performance Funding in Eight States: Origins, Demise, and Change*. New York: Community College Research Center. And Dougherty, K., Natow, R., & Vega, B. (2012). Popular but unstable: explaining why state performance funding systems in the U.S. often do not persist. *Teachers College Record*, 14(3), 1–41.

<sup>8</sup> Center for American Progress (2012). Performance-Based Funding of Higher Education: a Detailed Look at Best Practices in 6 States.

<sup>9</sup> Dougherty, K. J., & Reddy, V. (2011). The Impacts of State Performance Funding Systems on Higher Education Institutions: Research Literature Review and Policy Recommendations. *Community College Research Center Working Paper No. 37*.

<sup>10</sup> Dougherty, K. J., & Reddy, V. (2011). The Impacts of State Performance Funding Systems on Higher Education Institutions: Research Literature Review and Policy Recommendations. *Community College Research Center, Working Paper No. 37*. And Hillman, Gross, and Tandberg (2013). Performance funding in higher education: do financial incentives impact college completions? Working Paper.



<sup>11</sup> Rabovsky, T. M. (2012). Accountability in Higher Education: Exploring Impacts on State Budgets and Institutional Spending Patterns. *Journal of Public Administration Research and Theory*.

<sup>12</sup> Tandberg & Hillman (2012). State higher education performance funding: data, outcomes, and causal relationships. *Working Paper available upon request*.

<sup>13</sup> Bogue, E. G., & Johnson, B. D. (2010). Performance incentives and public college accountability in the United States: a quarter century policy audit. *Higher Education Management and Policy*, 22(2), 9–30.

<sup>14</sup> Dougherty, K.; Natow, R.; Vega, B. (2012). Popular but unstable: explaining why state performance funding systems in the United States often do not persist. *Teachers College Record*. 114(3).

<sup>15</sup> Ibid.

<sup>16</sup> AASCU (2011). Performance-based funding: A re-emerging strategy in public higher education financing. *Policy Matters*.

<sup>17</sup> Burke, J. C., & Modarresi, S. (2000). To keep or not to keep performance funding: Signals from stakeholders. *Journal of Higher Education*, 432–453.

<sup>18</sup> Long, Bridget (2010). Higher Education Finance and Accountability. In *Accountability in American Higher Education*. K. Carey & M. Schneider (Eds.), Palgrave MacMillan, New York, NY.

<sup>19</sup> Ibid.

<sup>20</sup> Layzell, D. T. (1999). Linking performance to funding outcomes at the state level for public institutions of higher education: Past, present, and future. *Research in Higher Education*, 40(2), 233–246.

<sup>21</sup> Long, Bridget (2010). Higher Education Finance and Accountability. In *Accountability in American Higher Education*. K. Carey & M. Schneider (Eds.), Palgrave MacMillan, New York, NY

<sup>22</sup> Cavanaugh, J. & Garland, P. (2012). Performance Funding in Pennsylvania. *Change Magazine*, May/June.

<sup>23</sup> Sanford, T., & Hunter, J. M. (2011). Impact of Performance Funding on Retention and Graduation Rates. *Education Policy Analysis Archives*, 19, 33.

<sup>24</sup> NCHEMS (2011). Performance Funding: From Idea to Action. And Achieving the Dream & Jobs For the Future (2012). Tying Funding to Community College Outcomes: Models, Tools, and Recommendations for States.

<sup>25</sup> Dougherty, K., Natow, R., Hare, R., Jones, S., & Vega, B. (2011). The Politics of Performance Funding in Eight States: Origins, Demise, and Change. Community College Research Center. And Dougherty, K., Natow, R., & Vega, B. (2012). Popular but unstable: explaining why state performance funding systems in the U.S. often do not persist. *Teachers College Record*, 14(3), 1–41.

<sup>26</sup> National Conference of State Legislatures (2012). Performance Funding for Higher Education website: <http://www.ncsl.org/issues-research/educ/performance-funding.aspx> (as of 1/23/2013). And Indiana Commission for Higher Education (2012) *2013-15 Higher Education Budget Recommendation-Committee Report to the Commission*.

<sup>27</sup> NCHEMS (2011). Performance Funding: From Idea to Action. And Achieving the Dream & Jobs For the Future (2012). Tying Funding to Community College Outcomes: Models, Tools, and Recommendations for States.

<sup>28</sup> National Conference of State Legislatures (2012). Performance Funding for Higher Education website: <http://www.ncsl.org/issues-research/educ/performance-funding.aspx> (as of 1/23/2013).

<sup>29</sup> Dougherty, K. J., & Reddy, V. (2011). The Impacts of State Performance Funding Systems on Higher Education Institutions: Research Literature Review and Policy Recommendations.

<sup>30</sup> Bell (2005) Changing organizational stories. The effects of performance-based funding on three community colleges in Florida. Doctoral Dissertation.

<sup>31</sup> South Carolina Legislative Audit Council (2001). A review of the higher education performance funding process.

<sup>32</sup> Long, Bridget (2010). Higher Education Finance and Accountability. In *Accountability in American Higher Education*. K. Carey & M. Schneider (Eds.), Palgrave MacMillan, New York, NY.

<sup>33</sup> NCHEMS (2011). Performance Funding: from Idea to Action.

<sup>34</sup> This list is assembled from various sources including Joseph Burke's surveys, Kevin Dougherty's case studies, the Education Trust's "Ready to Assemble" report, American Federation of Teachers "What Should Count" database, NCHEMS personal communication and various reports, AASCU's policy brief on performance funding, and Vanderbilt University doctoral candidate Alexander Gorbunov's comprehensive list from his dissertation research. Additionally, state websites, statutes, and administrative rules/policies were used in our verification process. See Tandberg & Hillman (2012) *State higher education performance funding: data, outcomes, and causal relationships* (Working Paper) for more detail.





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