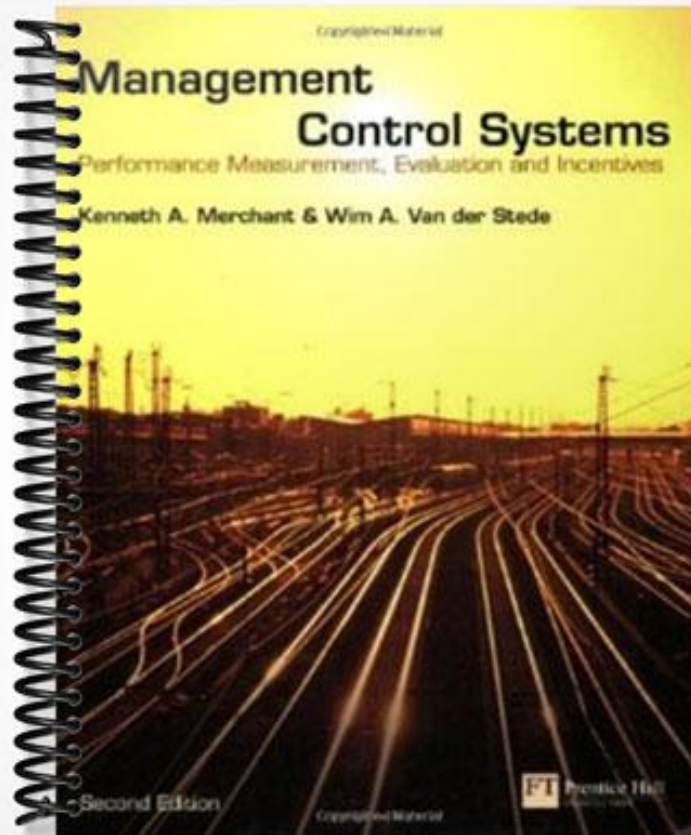


# SOLUTIONS MANUAL



# **University of Southern California: Revenue Center Management System**

## **Teaching Note**

### **Purpose of Case**

This case was developed to illustrate some of the differences (and similarities) involved with the design and use of management control systems within non-profit organizations. A university provides a good illustration because students are familiar with the setting. The students know, intuitively, that a university's organizational goals and the methods of both generating revenues and allocating the available resources are different from those found in profit-making organizations. What they may have not thought about is that non-profit organizations such as universities face many of the same managerial problems as a for-profit organization in the area of controls.

At the time this case was written, a subcommittee of the University of Southern California's (USC's) faculty Research Committee had raised the issue that the university's Revenue Center Management (RCM) system had the tendency to create "perverse incentives" and led to gameplaying by some departments. By analyzing the system, the students should have the opportunity to discuss the pros and cons of RCM as well as ways in which it could be improved. The criticisms raised at the end of the case provide the students with some possible areas that may need to be addressed.

The case can be used with a 29-minute segment of the videotape attached to this instructor's manual. On the videotape, two principal parties involved in the RCM debate—John Curry (USC's vice president of budget and planning) and Ward Edwards (chair of the faculty Research Committee's subcommittee which had been critical of RCM)—make summary statements of their views regarding RCM. Then they answer questions from students.

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*Professor Kenneth A. Merchant wrote this teaching note as an aid to instructors using the University of Southern California: Revenue Center Management System case.*

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### **Suggested Assignment Questions**

1. Does the RCM system create “perverse incentives”? If so, how? If not, why not?
2. Are the criticisms of RCM valid? Why or why not?
3. Are the nine management principles appropriate for a university setting? Is there an overemphasis on financial performance?
4. Does the system work as intended? What changes, if any, should be made?

### **Case Analysis**

#### *Discussion of Questions 1 and 2*

I suggest presenting this case in a fairly direct format, following the assignment questions. Start with the first two questions: Does the system create “perverse incentives”? and, Are the criticisms of RCM valid?

I suggest pushing the students to support their answers with specific examples concerning the design of the system. Discuss the various criticisms listed on page but also ask the students for additional criticisms, again backing their answers with specific examples that support their opinion.

It is important to recognize that during our research, certain deans did not feel that some criticisms of RCM were necessarily a result of RCM specifically but perhaps part of a larger corporate culture at USC.

For example, Jack Borsting, then-dean of USC's School of Business Administration, pointed out that the rules of not being able to transfer funds from one budget area to another as well as not being able to move funds from restricted to unrestricted are not a function of RCM. These are special rules that give central administration more control over the University's profit or loss.

However, some deans did indicate that the system did cause gameplaying. Mike Diamond, then-Dean of the School of Accounting, made the following comments: “The incentive is to spend your budget. If you do not, the remainder goes back to the University. The system encourages you to play games. The game is whether you spend restricted funds or unrestricted funds, as restricted funds carryover from year to year.”

David Shawaker, CFO of the School of Engineering made the comments: “There is no revenue or expense shifting between periods but we do try and manage our expenses. We prefer not to have a surplus in the Intercenter Bank. This causes you to transfer expenses from restricted funds to unrestricted funds in order to lower your surplus. For example, last year we transferred (department) chair expenses from restricted to unrestricted.”

#### *Discussion of Question 3*

Next, I feel it is important to give the students the opportunity to critique the principles used while developing the system. This should flush out thoughts and perceptions the students may have when it comes to managing a non-profit organization vs. a for-profit organization. It also raises the issue of decentralization vs. centralization and when it is appropriate to use each form or some combination of the two.

I found it interesting in our discussions with John Curry, USC's vice president of Budgeting and Planning, when he commented “Systems really only matter at the margin. If marginal revenue did not equal marginal expense, we would never have optimality of the economy. Look at Harvard

and MIT as examples. Harvard is the most decentralized university; MIT is the most centralized. Both are top universities and are operating well under both systems.”

#### *Discussion of Question 4*

This question comes back to the issue Dennis Dougherty and the central administration were currently facing when this case was written. What action should they take, if any, or are these frustrations intentional? It seems that changing the system may require central administration to relinquish more control; would that be beneficial or detrimental to the university? Again, the students could come back to whether the nine management principles have truly been applied and if so, are they appropriate?

It would be useful throughout the discussion to steer the students into looking at these issues from various perspectives, i.e., faculty member, dean, central administration, provost, as each of these positions has different goals and management tasks to accomplish. Making the students take on different roles allows them the opportunity to understand the complexities involved in managing any organization—your view depends on where you sit.

#### **Summary**

This case presents the students with a number of issues regarding decentralization vs. centralization as well as controls. I do not know that there is any one right answer and therefore I think the discussion and thought process used by the students to reach their own conclusions is more important than obtaining a consensus by the end of the class period. It is important that they consider the goals of the administration and whether RCM assists or inhibits them in obtaining those goals. It is also critical that the suggestions made for improving the system be realistic as far as implementation, general acceptance, and cost are concerned.