On behalf of the UCLA Academic Senate Chair Ann Karagozian, please review and comment on the attached proposal for Financial Self-Sufficiency from the Anderson Graduate School of Management. This is specifically requested of the following committees and councils:

- Council on Planning and Budget
- Faculty Welfare Committee
- Council on Academic Personnel
- Council on Research
- Graduate Council
- All FECs

All other committees and councils are not required to opine, but they are welcome to do so.

Responses to the above would be most useful if they were to include one of the following responses: (1) the committee endorses the proposal as written, (2) the committee endorses the proposal contingent upon revision (please state the revisions), (3) the committee does not support the proposal (please give explicit reasons why).

Background Information:

Attached is the latest version (dated September 12, 2010) of a proposal from the Anderson School of Management for Financial Self Sufficiency, distributed for comment by Executive Vice Chancellor and Provost Scott Waugh. EVC Waugh has indicated that the proposal “is the result of 18 months of thoughtful analysis, discussion, and preparation to develop a model of financial self-sufficiency. The Chancellor and I support the concept and process, and the faculty in Anderson recently voted strongly in favor of the framework.” Because the EVC&P has set a due date of November 1, 2010, the Academic Senate requests responses from committees and councils by October 20, 2010, so that the Executive Board will have time to synthesize the views of the various committees.

The Academic Senate Leadership has conducted a preliminary review of the proposal and has posed a number of questions to Dean Judy Olian, requesting clarification and elaboration on a number of features of the proposal (please see attached memo). Once we have received a response from Dean Olian, we will forward that response to the reviewing committees, for your information and analysis.
TO: Chancellor Gene Block
FROM: Judy Olian, Dean
CC: Executive Vice Chancellor Scott Waugh
Chairman Charles Corbett
RE: Financial Self Sufficiency for UCLA Anderson
DATE: September 12, 2010

It gives me great pleasure to submit for your approval a proposal for the financial self sufficiency of UCLA Anderson. This is a landmark proposal for the school that has been in preparation for the last 18 months.

We believe that with every crisis comes an opportunity. The decline in State support for UC has been ongoing for several decades, forcing UCLA Anderson into entrepreneurial approaches to fund its continued excellence and growth. The economic crisis of the last two years has further reduced the school’s ability to rely on State funding.

We believe that now is the moment to forge this momentous path, and in so doing free critical resources to enable the University to support other unfunded undergraduate priorities at the University. In turn, the school will benefit from the flexibility to invest its own resources in critical student, program and faculty support, and from the direct incentives for entrepreneurial programs in the school.

This proposal is widely supported by our faculty and by the school’s Board of Visitors. It has been vetted extensively by the senior administration of the University. Upon your approval of this plan, I look forward to working with you to obtain the President’s approval and successful implementation of this exciting new model for UCLA Anderson, and for other parts of UC.

I am available to answer any of your questions.
FINANCIAL SELF SUFFICIENCY FOR UCLA ANDERSON

The Context

It is widely understood that the University of California faces unprecedented financial challenges to its standing as the leading public institution for higher education in the world. California’s shifting economic conditions have resulted in radical cuts to the UC budget, accelerating a decades-long trend of declining state support, and leaving UC with the prospect of a very uncertain future. These cuts, which have necessitated steep hikes in student fees as well as faculty and staff furloughs, threaten to erode the long-standing research and learning excellence of UCLA and its global attractiveness to the best students and faculty.

But this challenge also presents a profound opportunity. President Mark Yudof and Chancellor Gene Block have stated that development of innovative financial and operating models is essential to the future independence and distinction of the University. Reducing our financial reliance on the State will provide more predictability and force greater self-reliance in the years ahead. Despite the compelling arguments for financial self-sufficiency, few schools are able to make it work. Fortunately, we believe that UCLA Anderson School of Management is in a position to do so.

Financial self-sufficiency (FSS) will change the way we compete at UCLA Anderson for top students and faculty. UCLA Anderson will be able to offer more financial aid to students to offset the costs of higher tuition; it will acquire greater managerial and financial autonomy when it comes to faculty hiring decisions and compensation; it will generate more resources to retain and recruit the best faculty; and with a stronger endowment raised to support FSS the school will enjoy a larger cushion against financial risks. Given the condition of the state of California’s budget, these risks are substantial, with the prospect of dire cutbacks to every one of the university’s units. As one of the few units that operate in an environment where FSS is feasible, FSS helps protect UCLA Anderson from these risks while enabling limited state support to be redirected towards undergraduate and other underfunded priorities.

This new funding model encourages innovation and nimbleness in programming and operations. It enables proactive award of competitive fellowships to attract the highest-quality MBA and Ph.D. candidates and to maintain UCLA Anderson’s diverse student population. It secures the continued distinction of the quality of education and thought leadership associated with UCLA Anderson. And it enables UCLA to redirect funds previously used to support UCLA Anderson into alternative areas of critical need. Finally, although formalizing this funding model would be a first at the University of California, in practice UCLA Anderson and several other units operate largely on self-generated funds already. FSS is the last step in a 20-year-long change in the funding model, not the first step in that direction.

Administrative and funding restrictions have been cited as concerns by both the 2005 and 2010 accreditation teams as hindrances to the continued excellence and competitiveness of UCLA Anderson.

To quote from the 2005 AACSB Maintenance of Accreditation report:

“Seek to obtain greater control over key Anderson decisions. The extraordinary competitive pressures characterizing business schools place a premium on speed and flexibility. Anderson needs greater flexibility to protect top research faculty who are frequent targets of competitive offers ... Anderson does not control the size of its faculty complement, restricting its flexibility in
servicing its various degree programs or in introducing innovations that require greater faculty involvement.

Develop a sustainable funding model. The accreditation team is concerned that the gap between Anderson’s funding needs and available resources is growing, jeopardizing the continued excellence of Anderson’s scholarship and programs. ... Anderson has proposed a self supporting model to achieve greater resource competitiveness without burdening the University. Whether this becomes the funding model, or whether a centrally allocated funding model continues, Anderson and the University must create better and sustainable funding for faculty and programs to protect the excellence for which the Anderson School is renowned.”

And from the 2010 AACSB Maintenance of Accreditation report:

“The provision of financial resources to ensure the sustainability of the quality of degree programs hinges on the completion of the current capital campaign and on the negotiation with the leadership of the University of a financial self-sufficiency (FSS) agreement for the Anderson School.”

As a critical and essential corollary of FSS, the school seeks to implement a faculty compensation plan along the lines of the Health Sciences Plan. Fully funded through the school’s revenue streams, this plan will provide the necessary nimbleness and flexibility in setting faculty salaries at market without university-wide salary thresholds, or layers of decision making that slow down the process and result in unpredictable outcomes, hampering retention and recruitment discussions.

The school’s endowment is markedly small compared to its peers. A critical priority in shifting to FSS will be to radically increase the school’s endowment. FSS will motivate and inspire alumni to give back to, and support their alma mater. Today, many alumni incorrectly assume that the school is largely state supported as it was in their era, thus removing in their mind a compelling rationale for supporting their alma mater.

Rationale for Financial Self-Sufficiency

- UCLA Anderson School of Management has experienced significant cuts in State funding as part of the general shift away from public support for UC. Hence, the school’s continued excellence is critically dependent on alternative revenue streams in order to invest significantly in students, faculty and programs.

- In 2009/10, nominally almost 20% of UCLA Anderson’s budget came from UC General Funds ($17.9 M), with over 80% of the budget self-generated through revenue streams from degree and non-degree programs, and from private support. However, the net (imputed) State support for UCLA Anderson was actually much lower in 2009/10, at 6.2% (or $5.6 M) of the total budget, after accounting for fees paid by UCLA Anderson students ($8 M), and the costs incurred by the school for teaching and the support attributable to the undergraduate accounting minor for Economics undergraduates ($4.3 M).

- UC-wide funding cuts and salary reductions have come at a time when peer MBA programs are making unprecedented investments in programs, faculty, students, and facilities, and when the market for top research faculty in business is extremely tight.
• As a leading school of management, UCLA Anderson must be nimble in investing in and supporting its programs, and in attracting faculty from the very best business schools, almost all of which are private. A shift to FSS will enable the school greater flexibility and autonomy to make key managerial decisions regarding program investments, student fees, faculty compensation and recruitment, and resource management.

• Currently, the FEMBA, EMBA, MFE, UCLA-NUS and the proposed UCLA-UAI programs are fully self-supporting. UCLA Anderson School of Management is proposing to add the full-time MBA and PhD programs to the self-supporting model. As is true currently for the other Masters programs at UCLA Anderson, the School would retain all student fees, and receive no state support for those programs.

• As an integral and essential feature of the shift to FSS, a new faculty compensation plan will be implemented (see Appendix B). It is modeled after the Health Sciences Plan and fully consistent with the principles outlined in the report of the Joint Senate-Administration Compensation Plan Steering Committee, with the key exception that it does not rely on UC General Funds to fund components of the plan. The plan will be funded by the FSS model. The shift to the faculty compensation plan is vital since it will afford greater flexibility in responding to market levels of faculty compensation.

Features (see Tables 1 and 2 for financial projections, and Appendix A for further details)

• Under FSS the School will receive no State funds for its degree programs, and will be entirely reliant on its self generated funds from degree and non-degree student and program fees, research center activities, and private support.

• The school will assume full accountability for all faculty, staff, program, and facility costs. This will include the costs of all fringe benefits, debt service, fees for centrally provided services, and facilities maintenance costs. [The School will remain unchanged in its commitment to the public mission of UCLA, affiliation with the University and academic units across the University, and adherence to Academic Senate procedures with regard to all faculty and curricular matters.

• The governance of the school will remain unchanged, adhering to Anderson governance bylaws and Academic Senate rules.

• To bridge the funding gap as UCLA Anderson transitions to FSS, the school will launch a vigorous fundraising campaign to grow its endowment, expand its self supporting programs as added sources of revenue, engage in careful cost containment, and raise student fees.

• In order to maintain the school’s quality and as a result of State cuts to the budget of UC, MBA student fees over the last four years have been increasing at annual rates of 6% – 14% for residents and non-residents, depending on the year. Cumulatively, over the last four years, MBA fees have increased for non-residents by 36% to almost $49,000 in 2010/11, and for residents increased by 52% to almost $41,000 in 2010/11.
• Under FSS, tuition will continue to increase towards market levels but more modestly than in recent years. The target level for non-resident fees is approximately the median tuition level of the leading private schools (currently between $53,000 - $58,000); this is the eventual target irrespective of FSS. The school will maintain a discount of $5,000 for residents of California relative to non-residents, funded by the School.

• To assure continued diversity and access of economically disadvantaged students, student-aid will increase by nearly 30% under FSS.

• FSS will be phased in through a multi-year implementation plan, starting July 1, 2011, featuring a gradual decline of State support, followed by gradual ramp-up of the school’s payment to the University for services rendered. The steady state FSS funding model will be achieved no later than 2016/17.

• UCLA and UCLA Anderson will re-evaluate FSS after 3 years of its introduction to determine if corrections are needed in light of initial experiences.

Benefits

• UCLA benefits through redirection of the imputed State support ($5.6 M) currently received by UCLA Anderson -- that which is not derived from student fees and services to the accounting program -- to unfunded or underfunded undergraduate mandates at UCLA. The school will also pay the University a fee for facilities use and services rendered (estimated to be $4.1 M annually). Between these two sources, the net gain to the University is estimated to be $9.7 M annually after the steady state is reached.

• FSS provides an operating model that is consistent with the “new UC” vision that the President and UC’s Commission for the Future are espousing, which includes a call for self sufficiency models where they can work.

• FSS provides a financial model that can be followed by a select few schools within UC – those with significant self supporting programs and a small State supported portion of their budget. That said, the UCLA Anderson FSS model is viable only for a very few schools in the UC system, so it is not the answer to UC’s funding crisis.

• As a school with 40% entering students from California, and about 80% ending up placed in California within a few years after graduation, UCLA Anderson is a major ‘importer’ of talent, and contributor to the region’s leadership pipeline. The school’s continued excellence and attractiveness to prospects from in and out of the State is an essential driver of the vitality and readiness of the leadership ‘bench’ within California’s business and community organizations.

FSS is an innovative solution that protects the excellence of UCLA Anderson using its own resources, while freeing State funds to financially benefit other parts of the campus. In sum, FSS enables UCLA Anderson to:

• advance its excellence despite escalating reductions in state support;
• maintain its public mission;
• obtain managerial autonomy over key decisions;
• assume accountability for all costs;
• bring financial benefits to UCLA;
• realize a new academic funding model within UC;
• spur growth in private giving.
Table 1:
“STATUS QUO” BUDGET PROJECTIONS *

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<td>$71,786,380</td>
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* Based on a scenario of no further budget cuts to the school if the State supported model is continued.
Table 2:

**FSS BUDGET PROJECTIONS**

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<td>UC General Fund Allocation *</td>
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<td>TOTAL EXPENSES PROJECTED</td>
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<td>REVENUES minus EXPENSES</td>
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<td>$2,568,426</td>
<td>$2,075,318</td>
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APPENDIX A

FRAMEWORK FOR THE FINANCIAL SELF-SUFFICIENCY AGREEMENT BETWEEN UCLA AND UCLA ANDERSON

The principles of the proposed financial self-sufficiency (FSS) arrangement between UCLA and UCLA Anderson School of Management are outlined below. A majority of the UCLA Anderson faculty (80% of those who voted), and the entire UCLA Anderson Board of Visitors, voted in favor of these principles indicating support of the FSS approach, providing authorization to the dean’s office to reach closure on the administrative agreement with the campus. The principles for the FSS framework are summarized below.

Summary

- Under FSS, all programs of the Anderson School with the exception of the accounting minor will become self-supporting. The Anderson School will receive no central funds to support any of these programs other than for the accounting minor.

- The UCLA campus will retain the $5.6 M in imputed State support currently allocated to UCLA Anderson, and over time will be paid an additional $4.1 M in overhead payments from UCLA Anderson for centrally provided services to the School, funds that can be redirected toward other University priorities.

- In exchange, Anderson will gain substantially greater autonomy with regards to program investments, faculty hiring and salaries and, to the extent possible, setting tuition.

Financial aspects

- In 2009-2010, UCLA Anderson received an estimated $13,591,023\(^1\) in UC general funds to support the MBA and PhD programs, while UCLA Anderson MBA and PhD students paid $7,981,429 in net fees and tuition to UCLA, resulting in imputed state support of $5,609,595 for those programs. Support for servicing the undergraduate Accounting program was estimated to be an additional $4,301,849. Starting in 2011-2012, all fees and tuition paid by UCLA Anderson graduate students will accrue, in full, to UCLA Anderson. To support the transition to self-sufficiency, the general fund allocation will decrease gradually over the period of five years, to $5,228,338 in 2011-12, to $3,921,254 in 2012-13, to $2,614,169 in 2013-14, and $1,307,085 in 2014-15, reaching zero in 2015-16.

- Support to compensate UCLA Anderson for servicing the Accounting minor would continue based on current levels ($4,301,849) and will increase annually according to an agreed-upon COLA or other indexation factor, as long as the number of students served remains comparable to current numbers.

- UCLA and UCLA Anderson will agree on an appropriate overhead allocation for central services received from the campus and not paid for by UCLA Anderson, such as registrar and foreign accounting.

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\(^1\) Imputed, based on weighted student FTE. Shown without effect of temporary cuts in effect 09-10 (furlough salary savings).
student administration, payroll and benefit administration and “city services” such as the Police Department, mail services and building maintenance. This allocation is based on the direct consumption of central services by UCLA Anderson or, where direct consumption cannot be measured, an agreed-upon allocation algorithm representing a proxy for actual consumption. Payments will be phased in beginning in 2014-15 and will increase gradually to reach full levels in 2016-17. Assuming that overhead allocations will be approximately $4,100,000 when fully implemented, payments would equal $1,353,000 in 2014-15, $2,747,000 in 2015-16, and reach the full amount of $4,100,000 per year thereafter. This will convert to a lump sum overhead commitment to be increased by indexation to an agreed upon inflation adjuster, e.g., COLA or the University’s annual planning adjustment factor.

- UCLA Anderson will be entitled to build and retain its own reserves, and will be immune from imposition of any overhead fees that are not strictly tied to services rendered.

- UCLA Anderson will build into its permanent budget model sufficient current revenue streams to cover the equivalent of 15% of base faculty compensation plus benefits, in addition to each year’s expenses. That will serve as a minimal annual reserve for carry forward.

- The overhead for external grants administered through UCLA Anderson will be substantially below the campus rate of 54%, and will be based on the actual utilization of campus services in connection with the grant.

**Increased autonomy**

- Academic Senate oversight of academic matters, and of the academic appointment process, will not change under FSS.

- Under FSS, UCLA Anderson will no longer seek UCLA approval to hire faculty since all faculty hires will be self-funded. UCLA Anderson will continue to submit a budget to UCLA with anticipated total faculty salary expenses, but UCLA Anderson will have full authority over individual hiring slots.

- Under FSS, similar to current practice, the Dean and the Chair jointly determine faculty salaries and additional compensation (summer support, stipends, and other), based on the UCLA Anderson School compensation plan, with input from the Staffing Committee and the Research Committee. UCLA Anderson faculty can determine whether and in what form additional faculty oversight might occur. AACSB benchmark data and internal comparisons will continue to be important determinants of salary decisions.

- All salaries will be reported to the UCLA VC for Academic Personnel and the Vice Chancellor for Finance and Budgets, but no approval will be needed from UCOP or the UC Regents, including for “above-threshold” salaries or stipends. The VC for Academic Personnel will be consulted for salary-setting purposes only in exceptional circumstances.

- Under FSS, UCLA Anderson will establish the fees for FEMBA, EMBA, UCLA – NUS, UCLA-UAI (when approved), and MFE in the same way as it does now. These fees are established by UCLA Anderson, approved by UCOP, and do not require approval from the UC Regents.
The fulltime MBA program, as an academic program within a self funded unit, will have the flexibility afforded to self supporting academic programs for all compensation-related matters, including payment for overload teaching.

The intent is to establish MBA fees following the same process as is true now for UCLA Anderson’s other self supporting programs, that is, approval from UCOP but not from the UC Regents.

For purposes of maintaining a special affinity between California residents and UCLA Anderson, California residents will receive a $5,000 fee discount in the MBA Program funded by the school.

UCLA Anderson will be free to offer Faculty Recruitment Allowances and SHLP loans to all highly-recruited employees, using school funds, without needing UCLA or UCOP approval, regardless of level.

**Faculty and staff matters**

- Ladder faculty at UCLA Anderson will continue to be members of the UCLA Academic Senate with all corresponding privileges and obligations. Under FSS, UCLA Anderson faculty will be treated no differently than faculty anywhere else at UCLA.

- Tenure is with UCLA, and upon exhaustion of other measures, UCLA is the ultimate guarantor of UCLA Anderson faculty 9-month salaries.

- The academic personnel process, including but not limited to criteria for appointment, promotion, and merit decisions, will continue to be as described in the APM, the CALL, and the UCLA Anderson bylaws, and will not be affected by FSS.

- UCLA Anderson faculty will continue to be eligible for MOP loans from UC funds.

- UCLA Anderson faculty and staff will continue to be members of the UCRP, and will enjoy the standard package of benefits available to similarly placed UC faculty and staff. UCLA Anderson will make required departmental contributions to UCRP and other employer-funded benefits using school funds at a level commensurate with the contribution of other UC units. Covered compensation for purposes of UCRP will equal the X factor within the proposed UCLA Anderson compensation plan; furthermore, stipends will continue to be covered compensation.

- Non-ladder faculty and staff at UCLA Anderson will remain subject to the same academic and staff personnel policies and collective bargaining agreements as they are currently.

**Governance of UCLA Anderson**

- Governance of UCLA Anderson will not be affected by FSS. UCLA Anderson faculty can determine whether and in what form additional faculty oversight might occur under FSS.

- The roles and responsibilities of the FEC and of the Staffing Committee remain as described in the UCLA Anderson FEC bylaws and the UCLA Anderson bylaws.
• Dean appointment and reporting procedures continue unchanged under FSS -- the dean is appointed by the Chancellor and reports to the Executive Vice Chancellor.

Relations between UCLA Anderson and UCLA

• UCLA Anderson will continue to participate in joint research, teaching and service with the rest of UCLA. To the extent that such participation has financial implications, the Dean’s office will make appropriate arrangements with other units at UCLA.

• Joint degrees and access to courses across UCLA (in both directions) will continue. Appropriate mechanisms for transfer of fees for joint degree programs will be developed.

• UCLA will continue to pay the same course releases, summer support, or stipends for UCLA Anderson faculty who take major administrative roles on the campus. UCLA Anderson will pay all such compensation for major administrative roles within the school (Dean, Department Chair, Vice-Chair, Senior Associate Deans).

• UCLA Anderson faculty will no longer be eligible for funding for research, conference travel or Early Career Development awards from the Academic Senate’s Council on Research. UCLA Anderson will provide at least the same level of additional support to its faculty as was awarded by COR in 2009-2010.

• UCLA Anderson faculty will continue to be eligible for funding from all non-Senate sources of research support, and for all campus-wide awards and recognitions.

• All current support and funding principles around University External Affairs will remain intact, including the gift tax and UCLA’s External Affairs funding and support for development professionals and activities. UCLA Anderson will support and participate in the existing procedures for donor vetting and allocation among campus units.

Governance of this agreement

• This agreement will be reviewed after 3 years by UCLA and UCLA Anderson. Revisions to the FSS agreement will occur with mutual agreement of UCLA and UCLA Anderson.

• In the event of disagreement, the parties will agree on a mutually satisfactory mechanism for resolution.
APPENDIX B
BLUEPRINT – UCLA ANDERSON LADDER FACULTY COMPENSATION PLAN

- Guiding Principles
  - Plan components and administration are designed to recognize faculty contributions in research, teaching and service
  - Faculty remain subject to the campus academic promotion and review processes
  - The plan is predicated on adoption of Financial Self Sufficiency for UCLA Anderson
  - The plan provides flexibility to recognize extraordinary achievements
  - No change is contemplated in the treatment of outside consulting income earned by faculty members – it does not flow into the plan and remains subject to current UC policies regarding faculty outside activities, similar to the proposed treatment of such income as outlined in the “Report of the Joint Senate-Administration Compensation Plan Steering Committee, June 2010”
  - Plan members may additionally retain honoraria, prizes, and royalties for text books

- Advantages
  - Increased flexibility to reward activities that are otherwise insufficiently compensated
  - Ability to perform salary adjustments that may be more frequent than the 3- and 4-year intervals applicable to full and above scale professors, without abandoning the protections and review mechanism associated with the step system.

- Revenue Sources and Compensation
  - Revenues available for inclusion in the Compensation Plan include UC allocations (if any), income from fees and tuition, endowment income, executive education revenues, departmental summer session revenue sharing, and contract and grant income/overhead
  - Unlike other proposed plans that continue to rely on State funds to cover the “X” equivalent of their respective models, the Compensation Plan is designed to be fundable entirely from self-generated revenue sources.

- Plan Components
  - The plan incorporates three components: X, Y and Z
    - X = the individual’s base compensation, reflecting scale or off-scale, and individual merit compensation
    - Y = compensation for individual contributions that vary annually, including summer ninths, executive education, overload teaching payments, and administrative stipends
    - Z = non-recurring recognition for unusual and seldom recognized contributions to the several missions of the Anderson School
• **Plan Membership - Impact**
  o Summer ninths are incorporated in Y
  o In internal discussions, summer ninths, compensation for additional teaching and executive education, and stipends, will be awarded using the current mechanisms and terminology
  o Base compensation (X) will be considered covered compensation for UCRP purposes
  o Administrative stipends will be part of Y, and treated as they are now, as covered compensation
  o Z is a new form of recognition, awarded only in rare circumstances and in modest amounts that are not base-building

• **External Presentation of Plan**
  o For purposes of external presentation, the UCLA Anderson plan may be formatted to approximate the medical school plan, where the key differences from above are separation of X from X’ (where X is scale and X’ is merit), and the revenue sources that fund the plans.
### BLUEPRINT -- Faculty Compensation Plan

<table>
<thead>
<tr>
<th>Description</th>
<th>“X Component” -- Base Salary –</th>
<th>“Y” Component -- Extras</th>
<th>“Z” Component – Extraordinary recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Base compensation, reflecting scale or off-scale and individual merit valuation against market.</strong></td>
<td><strong>Additional compensation earned individually by faculty member on an annual basis</strong></td>
<td><strong>Extraordinary compensation</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Applicability</strong></td>
<td>Individually applied with input of merit review</td>
<td>Individually determined</td>
<td>Individually allocated</td>
</tr>
<tr>
<td><strong>Basis for Allocation</strong></td>
<td>Attainment of academic rank and step, and outcome of regular merit review. Subject to campus academic process.</td>
<td>Summer ninths, teaching in Executive Ed, overload teaching, extra-mural research ninths, and administrative stipends.</td>
<td>Modest amounts may be awarded for unusual and seldom recognized contributions to the several missions of the Anderson School.</td>
</tr>
<tr>
<td><strong>Variability</strong></td>
<td>Dependent on merit review. Added adjustments may follow campus policies (e.g. COLAs). Base-building</td>
<td>Determined annually</td>
<td>Non-recurring. Dean and the Chairman make decisions on Z component and inform FEC annually on average award.</td>
</tr>
<tr>
<td><strong>Covered Compensation for UCRP purposes</strong></td>
<td>Yes</td>
<td>No, with the exception of administrative stipends which are covered</td>
<td>No</td>
</tr>
</tbody>
</table>
September 24, 2010

Judy D. Olian
Dean, Anderson Graduate School of Management

Re: Anderson Graduate School of Management Proposal for Financial Self Sufficiency

Dear Dean Olian:

The Senate is in receipt of the Anderson Graduate School of Management’s proposal for Financial Self Sufficiency, which was forwarded to us by EVC/Provost Waugh. We understand that you wish to expedite the review of this proposal, and will do all that we can to bring the Senate deliberations to an expeditious conclusion. We are now submitting this proposal for review by relevant Senate committees, and are asking that the committees place the matter high on their fall agendas.

In reading over the FSS proposal, however, a number of issues and questions have arisen for which we seek clarification from you and your colleagues in AGSM. These issues/questions are listed below. As soon as we receive your school’s responses we will forward them to the Senate committees currently considering the proposal. We hope that your responses can be sent to us prior to 8 October 2010. Here are the issues/questions:

1. As required for any UC proposal that involves significant organizational or operational change, the Senate faculty within AGSM should formally vote on the complete proposal that is under consideration. We understand that the AGSM faculty saw and opined on a preliminary version of Appendices A and B in June of 2010, but that they have not been given the opportunity to review the main proposal document, which includes relevant data such as those in Tables 1 and 2. The ballot itself and the outcome of the vote by AGSM faculty on the complete, final FSS proposal should be conveyed to the Senate as soon as possible.

2. We have questions about the financial data in Table 1 (for the “status quo”) as compared with the data in Table 2 (for “FSS budget projections”). The faculty/staff salaries each year (2009-2015) are assumed to be the same in each of these two scenarios. This appears to contradict the proposal’s statements (and likely the faculty’s understanding when they voted in June) that faculty compensation would increase upon implementation of the FSS, at the discretion of the Dean, Chair, and AGSM staffing and research committees. Furthermore, it
appears that even with this very conservative estimate of equivalent faculty salaries in these two Tables, and with optimistically projected increases in fees from MBA programs and increased endowments and gifts under FSS, the Tables still show lower net revenues with the FSS proposal as compared with the status quo during 2012-14, and substantially lower net revenues for FSS in the 2014-15 academic year (in this case, $1.27M net revenues with the FSS compared with $2.14M net revenues with the status quo). These numbers are not discussed to any significant extent in the proposal. At what point in time is the FSS actually projected to bring in more funds to AGSM than the status quo, on a sustained basis? And at what point in time would faculty salaries be expected to be higher than in the current system? As you can see, there appear to be inconsistencies between the statements in the proposal/Appendices and the data presented in the Tables. We believe that AGSM faculty and certainly Senate committees will want additional details and clarification of these projections, and corrections to possible inconsistencies, before they vote on the final version of the proposal.

3. A basic premise for this proposal is that the FSS approach would enable the school to have greater flexibility in increasing faculty compensation without UCLA or UC oversight, and that this flexibility would permit AGSM to be more competitive with peer institutions. Please provide data comparing Anderson faculty compensation (mean and median, if possible) with that of their peers at the top 8-10 business schools, including UC Berkeley’s Haas School. Please ensure that the assumptions are the same (i.e., 9, 11 or 12-month basis), and provide information on base salaries, stipends, summer ninths, etc. Information on course loads and course releases for UCLA faculty as compared with faculty at peer institutions would also be helpful, to provide a sense of the magnitude of the problem and why FSS is a logical solution for Anderson and for UCLA.

4. With respect to the benefits to UCLA outlined on page 5 of the main proposal, it is stated that the imputed state support ($5.6M) currently received by Anderson plus the fee that the school will pay to UCLA for facilities use and services rendered ($4.1M), will yield a “net gain” of $9.7M to UCLA after steady state is reached. This calculation does not appear to take into account the actual costs that UCLA incurs in providing facilities and services for Anderson. What are the costs of such services not currently covered by AGSM? Our specific concern is that the net gain to UCLA could be substantially lower than $9.7M. Moreover, the loss of revenues to UCLA due to reduction or elimination of overhead from contracts, gifts, etc., should be projected and subtracted from the net gain in this estimate. Please provide updated or clarified data with respect to the estimated benefits for UCLA. It would also be helpful to indicate whether there are any contingencies in the plan for UCLA vis-à-vis the assumption that the state will continue to provide the $5.6M to UCLA. At present there appears to be an unmitigated risk that this amount could be recaptured by UCOP or the Legislature.
5. On pp. 10-11 (Appendix A), the FSS proposal makes it clear that UCLA campus approval would not be required for either the number of new AGSM faculty hires or for faculty salaries. Yet the proposal states that because tenure is with UCLA, “upon exhaustion of other measures, UCLA is the ultimate guarantor of UCLA Anderson faculty 9-month salaries”. How is “exhaustion of other measures” specifically defined, and what would trigger the situation in which UCLA would have to be responsible for the salaries that have been put in place by Anderson? **Clarification and elaboration are needed here.** It should also be clarified whether the “9-month salary” noted here is the X component alone or X + X’ (additional merit base).

6. On a related matter to #5, **how will the “scale” for the X base compensation be determined (third bullet from the bottom on page 13), and will the scale be tied to faculty step and rank?** How will open information on this new scale be made available to AGSM faculty? Will shared governance play any role in the relationship between pay and step, e.g., by elected committees?

I trust that all of the above issues can be easily addressed by you and your colleagues very quickly. The Senate stands ready to receive and review these clarifications as soon as you can provide them, and to work with you and your faculty to move your proposal forward as expeditiously as possible.

Yours very truly,

Ann R. Karagozian  
Chair, UCLA Academic Senate

cc: Scott L. Waugh, Executive Vice Chancellor & Provost  
    Charles Corbett, Chair, AGSM  
    Christopher Tang, Chair, AGSM FEC  
    Andrew Leuchter, Vice Chair/Chair-Elect, UCLA Academic Senate  
    Robin L. Garrell, Immediate Past Chair, UCLA Academic Senate  
    Jaime Balboa, CAO, Academic Senate Office  
    Dottie Ayer, Executive Assistant, Academic Senate Office
October 7, 2010

Ann R. Karagozian
Chair, UCLA Academic Senate

Re: UCLA Anderson Graduate School of Management Proposal for Financial Self Sufficiency
Response to Questions and Comments from the Academic Senate

Dear Ann:

Thank you for your thorough review and your thoughtful questions. We very much appreciate your sensitivity to our tight timeline. Below please find our responses to the questions and comments raised in your September 24, 2010 memo about our proposal for Financial Self Sufficiency (FSS).

1. As directed, we are asking our faculty to vote once again on FSS, on the specific proposal sent to the Chancellor. We will forward the results to you as soon as they are available. The ballot will be conducted online between Friday, October 8 through Friday, October 15, 2010.

2. As with any financial model that seeks to project revenues and expenses several years into the future, our projections require that we make certain assumptions about future developments, and inevitably the uncertainty around these projections is wider the more distant the projections. We do not consider a projected financial difference of less than 1 percent in our projected net revenue for 2014-15 as material or worrisome, especially since our tradition has been to make conservative projections and to come in under budget. One other clarification – the apparent significant increase in MBA tuition revenue accruing directly to Anderson is attributable primarily to the FSS model per se, and only marginally to tuition increases. Tuition revenue that was previously captured by UC – and embedded within the UC General Fund or “State” allocation – will now accrue directly to the School’s budget, and that accounts for the lion share of the increase in that line item and the corresponding reduction in UC General Fund allocation.

The projections for faculty and staff salaries – including the fact that they follow the same growth pattern in each scenario – were made quite deliberately. As we explained during our faculty meetings in response to much the same question the Senate raised, we do not expect financial self sufficiency to result in broad, across-the-board increases for our faculty. That is not the intent of this proposal. Instead, FSS is meant to give us the flexibility to make individual
salary decisions within the context of our specific competitive and budgetary environment, and to react more nimbly in recruitment and retention cases. Since our focus is on flexibility and responsiveness rather than on broad-based increases, we do not foresee a material difference in the salary growth of faculty as a whole as a result of implementing financial self-sufficiency. In fact, we were careful not to create an inappropriate expectation on the part of faculty that might lead them to prefer the FSS model for that reason. Remember, too, that the compensation category includes many line items that will remain subject to the same decision processes as they are now, such as staff salaries and benefits, TAs, fee remissions, and contract employees. UCRP contributions are also projected to increase equally under both scenarios.

In terms of specifics, we have had four instances so far in which salary requests at the upper end of our salary distribution have been turned down by UCOP despite strong market arguments in each of these cases. In one instance UCOP did approve the same salary request a year later, and in another instance UCOP approved a higher salary request than the one they had previously turned down after the faculty member involved received a formal outside offer. Over time, as the general salary distribution moves up in the School, more faculty salaries are bumping up against the local campus salary approval threshold, and therefore run the risk of being turned down by UCOP. Under the status quo scenario we anticipate that the frequency of being turned down by UCOP will increase in the future. That will cause serious and unnecessary retention risks for us, and will significantly hamper our ability to recruit in the competitive marketplace. Accordingly, removing the salary cap will allow us to pay selected salaries more quickly and with less uncertainty, and in targeted instances when the market requires it, will enable us to pay above threshold salaries.

As to overall projections, you noted correctly that FSS is initially not expected to bring in more funds than the status quo. That would be unrealistic, given that we would lose state support and become responsible for a share of campus overhead allocation. FSS is not presented as a panacea that would suddenly result in greater revenues. It is meant to position us for the future -- creating greater stability in, and control over, revenue streams for our degree programs and continued competitiveness in the marketplace for the medium to long term. We expect the proposed funding model to generate support equal to or greater than the current model, within a reasonable time after the current multi-year planning horizon. Given the difficulty of forecasting all relevant variables many years into the future, we cannot precisely predict when FSS will surpass the current funding model.

Part of the projection difficulty is due to the uncertainties surrounding the status quo, which we have projected as continued ‘flat’ state funding, stabilizing in 2011-12, without further declines. Most observers would regard that as overly optimistic, whether for reasons of declining State funding or because of internal UCLA re-allocation to other unfunded priorities in the College. Given the likely diminution of that support -- whether in the form of outright State cuts, redistribution of previously centralized costs to schools, internal re-allocation of funds within UCLA, or sharp increases in system wide mandatory student fees that essentially shrink the portion of professional fees flowing to the schools -- the assumption of constant state support in
the status quo model might be considered just as optimistic as the “optimistically projected” increases in fees and endowments noted by the Academic Senate under the FSS scenario. Keep in mind also that the State of California just approved its budget for the 2010/11 fiscal year that began three months ago. That said, our budget projections represent a dynamic process and we expect to continue refining both models as new information becomes available.

I thought it would be instructive to note also the comments made in the extensive sensitivity analysis performed by a task force consisting of Professors Longstaff, Leamer and Sarin, that drew the following conclusions (page 7, full document attached):

First, the FSQ (financial status quo) and FSS scenarios result in financial outcomes that are not materially different from each other. The projected budgets for the two scenarios imply net income numbers for the school that are within one percent of the total operating budget of the school. Neither scenario dominates the other in terms of its financial impact based on the assumptions reflected in the projections in the proposal.

Second, the largest financial risk of the FSQ scenario relates to the level of future State support under the FSQ scenario. A further unanticipated cut of 10% or 20% would have a serious impact on our budget. This risk, however, is difficult to quantify.

Third, the largest financial risk of the FSS scenario appears to be its dependence on an increased level of fundraising. The impact of not being able to achieve the assumed level of endowment growth would reduce the school’s net income by $1 or $2 million out of a budget of about $120 million.

In summary, the projections in the two scenarios are based on assumptions that appear reasonable and we have confidence in the budgeting process at Anderson. From a financial perspective, the expected outcomes of the two scenarios are similar. Where the two scenarios differ, of course, is in their implications for upside and downside events. It is important to recognize, however, that there are some degrees of freedom that could be brought to bear on the budget if things don’t go well under either scenario. For example, the assumption of 5% faculty salary increases might need to be scaled back. There may be some flexibility in how student support is funded, etc. The point here is that budgets can adapt as needed, which can blunt the downside risk to the school of any financial proposal.

3. As stated above, our intent is to gain managerial flexibility with respect to hiring and salary administration, and to align decision-making authority with those in the best position to make those judgments, following the model established in the School of Medicine. Currently, certain salary decisions require multiple levels of approval from entities that lack an intimate knowledge
of our competitive marketplace and academic disciplines. Even when the ultimate outcome results in approval, the process is risky and time-consuming, and introduces great uncertainty in our quest for talent. So far, with the exceptions noted above, most of our salary requests have ultimately been approved, but sometimes after many months, a second attempt a year later, or after the faculty member in question generates an outside offer higher than the salary we had initially proposed. We believe that a compensation system that so explicitly encourages the pursuit of outside offers severely damages the institution. In addition, the State’s well-known financial woes have made our faculty a ripe target for overtures by competitive schools that seek to capitalize on the perceived weaknesses of a state-funded institution.

One more byproduct of the current financial model is that certain program investments and overload faculty compensation are tied to the underlying revenue stream. Accordingly, while there is greater flexibility to invest in, and compensate for overload teaching in the self-sufficient FEMBA and EMBA programs, that flexibility does not apply to the MBA program which is construed as State-supported. That has hampered our ability to invest in the MBA, thus disadvantaging our flagship professional degree program.

Given the very low level of State support for the School, we are now in a position to contemplate voluntarily going to zero State support in order to preserve and enhance our competitiveness, become more agile with respect to individual decisions, and create more predictable revenue streams that are not subject to the vagaries of the State’s budget situation. Over the last four years, we have worked diligently to correct the market inequities that previously existed, with the result that our faculty compensation is now commensurate with that of our peer institutions, as indicated by AACSB market surveys.¹ Now that we have brought our faculty up to market, we expect future increases to be more moderate than in recent years, in line with market patterns.

4. The FSS model includes line items for certain costs that will be delegated to the School as our financial responsibility, such as utilities in a metered building. Note that these decentralized costs are in addition to the $4.1 million in estimated service fees that will be paid to the University. Other costs, such as the value of the Chancellor’s Office or of the Police Department, are harder to ascertain since they do not involve specific transactions or units of consumption.

To arrive at a reasonable projection of these campus indirect costs, we worked closely with the office of Academic Planning and Budget. That office performed a thorough analysis of all central services, their current actual costs and their applicability to UCLA Anderson, and developed reasonable allocation algorithms that are meant to serve as proxies for consumption. For example, the costs for the Office of the AVC of Faculty Diversity were allocated based on UCLA Anderson’s relative share of the campus’ total faculty, while the OMP allocation was based on the school’s assignable square footage (ASF) as a percentage of total campus ASF. Similarly,  

¹ See Table 1 for a comparison of faculty salaries to market.
indirect library costs used Anderson’s percentage of faculty and students, while research administration costs were allocated based on Anderson’s share of total research awards. Costs for services directly paid for by UCLA Anderson were excluded, as were costs for services that are not directed at the Anderson community, such as some undergraduate services. This analysis resulted in the $4.1 million estimate. As stated in the FSS Blueprint (page 12 of the proposal to the Chancellor), the current gift tax, and other forms of financial participation with External Affairs, will continue as is.

As to contingencies regarding the transfer of imputed state support to the rest of UCLA, that is a matter that the campus leadership will determine and manage.

5. We view the prospect of UCLA serving as guarantor of faculty nine month total salaries (X and X’) as a last resort, applicable only in the most extreme of circumstances. Total faculty salaries, including nine-month (X and X’), summer ninths, non-ladder faculty, and overload payments, typically constitute less than 30 percent of our expenses. So before we arrived at the ‘dooms day’ scenario of the University having to realize its guarantee, there would be a large set of options available to Anderson to contract the budget. We would first look to appropriate cost cutting targets within the remaining 70% percent of the budget -- more, if one considers non-ladder faculty and overloads. We expect to make decisions involving significant financial impacts, such as faculty hiring decisions, in careful consideration of our overall and projected financial health, frankly as we do now. Our permanent annual projections and budgets would be constructed such that they would include a “place holder” or contingency item equivalent to fifteen percent of our committed faculty salaries, with a commensurate annual reserve to support that budget item. It is important to note that under the status quo, UCLA is also the guarantor of faculty salaries, including the salaries of faculty at the high end of the reward spectrum.

And of course, budgets would continue to be subject to review by campus leadership. Since this involves campus commitments, this matter is also appropriately left to resolution by the campus leadership.

6. We expect that the scale will be patterned after current compensation levels. Despite the fact that we are now subject to the Business-Engineering scale, almost all of our faculty are already paid off-scale. We expect to follow the same Business-Engineering scale which will serve as the X factor in our compensation plan, moving up in tandem with University adjustments. Actual nine month salaries (X and X’) will be tied to faculty step and rank, and to assessment of internal and external value, as is currently the case. Under FSS, the current involvement of the elected staffing committee in approving advancements and promotions will continue, as will the role of the appointed research committee in recommending levels of summer support for each faculty
Again, Ann, thank you for your careful interest in our proposal for FSS. I hope that these clarifications address your questions and concerns.

With best wishes,

Judy Olian, Dean and John E. Anderson Chair
UCLA Anderson School of Management
Table 1 – Comparative Faculty Salaries by Rank

<table>
<thead>
<tr>
<th>Year</th>
<th>UCLA Anderson</th>
<th>Associate Professor Average Salary</th>
<th>Assistant Professor Average Salary</th>
</tr>
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<tr>
<td>2004-2005</td>
<td>$155,200</td>
<td>$127,500</td>
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<td>$187,200</td>
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<td>$158,400</td>
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<td>$202,500</td>
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<td>$184,900</td>
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<tr>
<td>COMPARISON GROUP</td>
<td>$207,100</td>
<td>$175,800</td>
<td>$160,000</td>
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</tbody>
</table>

Source: The Association to Advance Collegiate Schools of Business (AACSB).

1. Introduction.

On February 25, 2010, Dean Judy Olian asked Ed Leamer, Francis Longstaff, and Rakesh Sarin to form a committee to review some of the financial aspects of the current self-sufficiency proposal being considered by the Anderson faculty. Specifically, the committee was asked to provide input regarding four questions:

1. What is the financial impact of alternative scenarios for endowment growth under the two scenarios: financial self sufficiency (FSS) and financial status quo (FSQ)?

2. What is the financial impact of alternative growth projections in total staff costs (3% under both scenarios) and total faculty costs (5% under both scenarios)?

3. What is the financial impact of alternative rates of decline in general support funds for Anderson under FSQ?

4. What is the impact under FSQ of UC fee increases that may further squeeze the financial differential fees flowing to Anderson?

As part of this assignment, the committee was charged with providing a report on our findings within a one week period. Thus, it is important to recognize that, given the time limitations placed upon the committee, our review should be viewed as cursory and far from comprehensive. This brief report summarizes our thoughts and findings with respect to the questions we were asked to study.
2. Some Perspective.

In approaching this task, we found it helpful to put the implications of the different scenarios into perspective relative to the total budget for the Anderson School. Table 1 shows the projected budget for the school under the FSQ scenario; Table 2 shows the projected budget under the FSS scenario.

2.1 How Much Money is at Stake?

The current budget (expenditures) for the school under either scenario is $90.5 million. Of this total, $17.9 million comes from UC General Funds. The FSS proposal would only impact the portion of this that relates to the MBA program, which is roughly $12.3 million. But of this $12.3 million, $7.1 million represents student fees, which we would receive directly under the FSS proposal. The bottom line is that the actual amount of State support we would lose under the FSS proposal is $5.2 million. Thus, the total amount of State funding at issue here is only 5.7% of the current annual Anderson budget.

2.2 Impact on Total Sales

The total tuition to be paid by students is the same under both scenarios (in actually, it increases a little faster under FSS for the first several years, but is then the same as under FSQ after five years). Thus, the size of the “pie” is the same under both scenarios; the only difference is in how the pie is to be divided.

To cut through the confusing process of how funds flow from students to the UC system and back to Anderson, we took the step of simply adding together the MBA program revenues and the UC general fund for the two scenarios. The sum of these two items can be viewed as the school’s gross sales (at least from the MBA perspective, the other programs are the same under both scenarios).

Here are the projections under the two scenarios (dollars in millions) for the sum of MBA fees and UC general funds.
### Sum of MBA Fees and UC General Funds

<table>
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</tbody>
</table>

The total revenues under FSS are larger in the short term. There are two reasons for this. First, to jump start our self sufficiency plan, the UCLA campus is willing to let us continue to keep the $5.2 million State funding the first year, then decrease it to zero over the next four years. Second, under the FSS proposal, we are able to raise our tuition slightly faster than under the FSQ. By the fifth year of the plan, however, tuition is the same in both plans and the subsidy is gone. Even in the fifth year, however, total revenues to the school are $3.8 million higher. The reason for this is that the forecasts anticipate that the UC system will need to take a larger “slice” of the pie in the future (in the form of fees), leaving us with less of the total tuition and fees paid by the students.

Perhaps a more accurate perspective is given by focusing on net sales, given by gross sales minus the student support and scholarships the school is expected to give back to the students. The following table shows the sum of MBA fees and UC general funds, minus student support for both scenarios.

### Sum of MBA Fees and UC General Funds Minus Student Support

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>FSQ</td>
<td>27.8</td>
<td>28.5</td>
<td>29.6</td>
<td>31.2</td>
<td>31.8</td>
<td>32.4</td>
</tr>
<tr>
<td>FSS</td>
<td>27.8</td>
<td>31.4</td>
<td>32.4</td>
<td>33.0</td>
<td>32.8</td>
<td>32.7</td>
</tr>
</tbody>
</table>

This table shows that by the fifth year, both proposals provide the same amount of net revenue to the school. Thus, the two scenarios are equivalent from the perspective of net sales.

### 2.3 Impact on Costs

Excluding student support, there are some minor cost differences between the two
scenarios. The projected budgets anticipate that the FSS plan will generate roughly an additional $2 million in costs (program fees, faculty, support, campus fees, etc) by the fifth year. On the other hand, the FSS proposal forecasts that the school will be able to generate an additional $2.4 million per year in donations and income from our endowment by the fifth year.

2.4 The Bottom Line

Since the total revenues are the same under the two scenarios, and since the additional costs of the FSS plan are forecast to be largely offset by the additional donations and endowment income, it is not surprising that the two scenarios have the same net financial impact on the schools.

By the fifth year, the school is anticipated to have a budget of roughly $120 million. The differences between the two scenarios are very small relative to the total budget. Given the inherent uncertainties in any budgeting/forecasting exercise, the two scenarios are “statistically indistinguishable” from each other.

Issue 1. Endowment Growth

The FSQ scenario assumes that by the end of the fifth year, our current expenditure gifts grow from $1.9 million per year to $2.6 million per year. This is a growth rate of about 6.5%. In contrast, the FSS scenario assumes that current expenditure gifts grow to $3.5 million by the fifth year, implying an annual growth rate of 13%.

To provide some perspective on this, we observe that during the previous five year period from 2004 to 2009, current expenditure gifts increased from $1.1 million to $1.9 million, implying an annual growth rate of 11.5%. Thus, the growth rate assumption underlying the FSS proposal does not seem to be unrealistic or unattainable given recent experience.

Turning to the endowment assumptions, the FSQ scenario assumes that the endowment increases from its current value of $90.9 million to $123.2 million by the fifth year. This is a growth rate of 6.3% per year. Note that returns in investments are included in the endowment balance; positive returns increase our endowment, and vice versa. Under the FSS scenario, the endowment is assumed to increase to $153.2 million by the fifth year, implying an growth rate of 11.0% per year. Thus, the FSS scenario assumes that the school is able to add an incremental $30.0 million
to our endowment relative to the FSQ scenario.

Roughly speaking, the assumption in the FSS scenario translates into an incremental increase in endowment giving of $6 million per year over the next five years. How realistic is this? To address this, we note that total cash-in-the-door gifts to the school (excluding the current expenditure gifts and unpaid pledges) during the past six years were $6.4, $8.1, $14.4, $15.4, $10.8, and $15.7 million, respectively. This averages to $11.8 million per year. Thus, the FSS scenario assumes that annual giving could be increased by roughly 50% on average relative to recent trends.

It is difficult to assess how likely it is that this higher giving rate would be achieved under the FSS scenario. Ultimately, this issue revolves around the question of whether alumni and donors would be willing step up their contributions if the school was self sufficient and no longer receiving State funds for the MBA program. Our Anderson development team view the self sufficiency story as one that would resonate well with donors. Anecdotal evidence suggests that giving increased at Virginia and Michigan when they moved to a self sufficiency model. We have no objective way to quantify this assumption about endowment growth.

To put this into perspective, however, we note that if the assumption about increased endowment growth was not realized, then the impact on the total budget would be relatively modest. Specifically, the total amount of incremental funding provided by the endowment under the FSS scenario is only $1.5 million (a 5% spending rate on the incremental $30.0 million endowment amount). This would represent only about 1.2% of the total operating budget of the school in the fifth year.

**Issue 2. Staff and Faculty Salary Growth Rates**

The current proposal assumes that under both the FSS and FSQ scenarios, faculty salaries increase at 5% per year and staff salaries increase at 3% per year. Thus, there is no difference between the two scenarios in terms of total salary costs.

It is important to consider, however, whether there is a possibility that salary costs might need to rise more rapidly under the FSS than under FSQ scenario. In other words, would having local control of salaries in the Anderson school result in higher overall salary costs? Has all of the discussion about increased salary flexibility under the FSS proposal raised expectations about future salary growth that would put pressure on the budget?
While we cannot provide a definitive answer to this question, we feel it is important to emphasize that the school could implement the policy of simply not spending more on salaries than it could afford. Under the FSS scenario, salaries and the budget are under the school’s control and there is nothing externally that would require the school to adopt a salary growth rate in excess of what we could afford. We view as very unlikely the scenario that salaries would be able to grow faster under the FSQ scenario than under the FSS scenario.

Currently, faculty and staff salaries total to $59.3 million, representing 65.5% of the total school budget. A one-percent incremental growth rate for the FSS scenario relative to the FSQ scenario would translate into an incremental cost of $0.655 million cost for one year, and would compound to an incremental difference in costs of about $4 million after five years. Note that the effects of increases of salaries on the budget are essentially linear; an increase in salary costs by $1 million under one scenario makes that scenario less profitable relative to the other scenario by $1 million.

**Issues 3 and 4. Decline in State Support.**

To evaluate the impact of a decline in State support under the FSQ and FSS scenarios, we compute the bottom line net income for the school under the assumptions that State support (from any source) is cut by 0%, 5%, 10%, and 20% from that reflected in the current proposal (net income is shown in millions of dollars).

**Net Income Under Various State Budget Cut Scenarios**

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>FSQ</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0%</td>
<td>+1.1</td>
<td>−0.9</td>
<td>−0.7</td>
<td>−0.7</td>
<td>−1.7</td>
<td>−2.3</td>
</tr>
<tr>
<td>5%</td>
<td>+0.2</td>
<td>−1.8</td>
<td>−1.6</td>
<td>−1.6</td>
<td>−2.6</td>
<td>−3.2</td>
</tr>
<tr>
<td>10%</td>
<td>−0.7</td>
<td>−2.6</td>
<td>−2.4</td>
<td>−2.5</td>
<td>−3.5</td>
<td>−4.1</td>
</tr>
<tr>
<td>20%</td>
<td>−2.4</td>
<td>−4.4</td>
<td>−4.2</td>
<td>−4.3</td>
<td>−5.3</td>
<td>−5.9</td>
</tr>
<tr>
<td>FSS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0%</td>
<td>+1.1</td>
<td>−0.3</td>
<td>+0.3</td>
<td>−0.4</td>
<td>−1.6</td>
<td>−2.5</td>
</tr>
<tr>
<td>5%</td>
<td>+0.2</td>
<td>−0.7</td>
<td>−0.1</td>
<td>−0.8</td>
<td>−1.9</td>
<td>−2.7</td>
</tr>
<tr>
<td>10%</td>
<td>−0.7</td>
<td>−1.2</td>
<td>−0.5</td>
<td>−1.1</td>
<td>−2.2</td>
<td>−3.0</td>
</tr>
<tr>
<td>20%</td>
<td>−2.4</td>
<td>−2.2</td>
<td>−1.3</td>
<td>−1.8</td>
<td>−2.8</td>
<td>−3.5</td>
</tr>
</tbody>
</table>
These numbers show that the FSQ scenario is much more sensitive to a cut in State funds. This is not at all surprising given that the FSQ scenario assumes State support of roughly $17.5 million per year while the FSS scenario has State support declining to about $4.8 million by the fifth year.

**Conclusion.**

Based on our limited review of the self sufficiency proposal and our conversations with Anderson faculty and staff members, we have three general conclusions.

First, the FSQ and FSS scenarios result in financial outcomes that are not materially different from each other. The projected budgets for the two scenarios imply net income numbers for the school that are within one percent of the total operating budget of the school. Neither scenario dominates the other in terms of its financial impact based on the assumptions reflected in the projections in the proposal.

Second, the largest financial risk of the FSQ scenario relates to the level of future State support under the FSQ scenario. A further unanticipated cut of 10% or 20% would have a serious impact on our budget. This risk, however, is difficult to quantify.

Third, the largest financial risk of the FSS scenario appears to be its dependence on an increased level of fundraising. The impact of not being able to achieve the assumed level of endowment growth would reduce the school’s net income by $1 or $2 million out of a budget of about $120 million.

In summary, the projections in the two scenarios are based on assumptions that appear reasonable and we have confidence in the budgeting process at Anderson. From a financial perspective, the expected outcomes of the two scenarios are similar. Where the two scenarios differ, of course, is in their implications for upside and downside events. It is important to recognize, however, that there are some degrees of freedom that could brought to bear on the budget if things don’t go well under either scenario. For example, the assumption of 5% faculty salary increases might need to be scaled back. There may be some flexibility in how student support is funded, etc. The point here is that budgets can adapt as needed, which can blunt the downside risk to the school of any financial proposal.
Finally, we note that this analysis is based solely on the financial dimensions of the proposal. In particular, our report does not address any of the nonfinancial implications of the proposal.

Francis A. Longstaff, Chairman

Ed Leamer

Rakesh Sarin
<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenues</th>
<th>Total Current Year Expenditures</th>
<th>Projected</th>
<th>Multi-Year Model - &quot;Status Quo&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-15</td>
<td>$2,009,120</td>
<td>$1,192,460</td>
<td>$1,212,350</td>
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<tr>
<td>2013-14</td>
<td>$2,009,120</td>
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<td>2012-13</td>
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<td>$1,192,460</td>
<td>$1,212,350</td>
<td>$2,009,120</td>
</tr>
</tbody>
</table>

- **Total Revenues**: The total revenue generated over the specified years.
- **Total Current Year Expenditures**: The total expenditures for the current year.
- **Projected**: The projected figures for the upcoming years.
- **Multi-Year Model - "Status Quo"**: The model used for projecting future revenues and expenditures.
### Multi-Year Model – Self-Sufficiency

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Expenses</th>
<th>Net Income</th>
<th>Total Current Revenue/Expenses Projected</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-12</td>
<td>3334.071</td>
<td>2727.229</td>
<td>606.842</td>
<td>390.561</td>
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<tr>
<td>2012-13</td>
<td>3334.071</td>
<td>2727.229</td>
<td>606.842</td>
<td>390.561</td>
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<tr>
<td>2013-14</td>
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<td>606.842</td>
<td>390.561</td>
</tr>
</tbody>
</table>

- **Revenue**: Contributions, Gift, Endowment Interest, Fees, Investment Income, Investment Realization, Investment Management Fees, etc.
- **Expenses**: Student Support, Fellowships, Rewards, Direct Costs, Building Debt, Technology, Equipment, Communications, Program & Faculty Support and Services, Faculty & Staff Salaries, Including Fringes.

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**Notes**:
- **Endowments & Annual Gifts**: General Fund Allocation, Centers Activity (non-org), Executive Education, Professional Programs Fees & Tuition, Other.
- **Other**: General Fund Allocation, Centers Activity (non-org), Executive Education, Professional Programs Fees & Tuition, Other.