

# Essential Elements of State Policy for College Completion

SREB

*Policy Brief*

## Outcomes-Based Funding

State policy-makers across the nation are looking for more effective ways to support their public colleges and universities. At the same time, they want assurance that institutions are helping the state achieve its goals: increasing the educational attainment levels of residents, supporting the state's workforce needs and stimulating economic development. To advance these goals, many lawmakers are exploring the potential of performance-based funding for higher education and, specifically, outcomes-based funding, a more targeted type of performance funding.

In fact, both state needs and national priorities are fueling renewed interest in performance-based funding. These include:

- efforts to stabilize funding for higher education and reassess how to finance public colleges and universities
- greater focus on postsecondary degree and certificate completion, and
- the continuing need to increase *access* (more students pursuing postsecondary education) as well as *success* (more students completing credentials).

States also are facing the larger issue of rethinking how they finance their postsecondary institutions, as most have reduced fiscal support for public colleges and universities while asking more from them in productivity and quality. Outcomes-based funding — a form of performance-based funding — will not resolve a state's budget problems, but it is an effective tool for clarifying what a state expects from its public postsecondary institutions. To achieve long-term stability in higher education, policy-makers and education leaders need an aggressive agenda to strengthen the reliability, sustainability and adequacy of funding for the nation's public postsecondary education institutions.

This paper — one in SREB's series on the essential elements of state policy to increase college completion — provides a framework for policy-makers to develop effective, statewide outcomes-based funding policy through legislation or other forms. It suggests several questions for policy-makers to consider as they explore outcomes-based funding as a state strategy. It provides a context for outcomes-based funding as a public policy issue, with examples of state actions and existing policy. The core of the paper contains SREB's recommended *essential elements* of effective public policy for outcomes-based funding to increase college completion. A summary of related policy that needs to be reviewed during design and implementation concludes the paper.

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*This paper was written by Cheryl D. Blanco, vice president, Special Projects, Southern Regional Education Board. It is part of SREB's Essential Elements of State Policy series, which is supported by grants from the Bill & Melinda Gates Foundation and Lumina Foundation. The conclusions presented here are those of SREB and do not necessarily reflect positions or policies of the funders.*

September 2012

Southern  
Regional  
Education  
Board

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## Key Policy Questions

Outcomes-based funding offers policy-makers a fiscal tool to concentrate resources on *state* goals and to support postsecondary institutions in realigning and redirecting their efforts to achieve those goals. Policy-makers should ask these key questions to better understand the role of an outcomes-based funding approach:

- *What are the specific goals and outcomes the state wants to achieve?*
- *How can outcomes-based funding help achieve these goals?*
- *What will it take for the state to reach a level of consensus and commitment to sustain outcomes-based funding?*
- *Which stakeholders are critical to achieve sustainability?*
- *How can existing funds be reallocated to reward institutions for gains on college completion measures?*
- *What percentage of state funds is needed to make significant progress on college completion goals?*
- *What are the specific momentum points and metrics to use in outcomes-based funding?*
- *How will outcomes-based funding be reported and monitored for effectiveness to ensure accountability?*

## Outcomes-Based Funding in Context

Outcomes-based funding policy is not new to postsecondary education, but it has seldom been a sustainable budget approach primarily because it accounted for a small percentage of institutional budgets and because campuses resisted attempts to move away from funding tied to enrollment.

Performance- and outcomes-based funding approaches have reemerged in public policy as a significant strategy to increase college completion numbers and rates. States and institutions are shifting toward rewarding institutions and programs for increasing the numbers of completions and away from enrollments. At the same time, many states are raising the percentage of the budget that supports outcomes-based funding.

In past efforts, performance-based funding operated like a bonus on top of state funding and was based on indica-

tors such as numbers or percentages of graduates, job placement, retention and transfer. Recent versions also emphasize some of these indicators; more important, the funding is not a bonus but part of the state base funding formula for higher education.

Given states' experiences over several decades using variations of performance funding, with shifts toward as well as away from performance funding, researchers have looked at the effectiveness and sustainability of this funding approach. The results are mixed. A few states have eliminated performance-based funding, while others have retained and expanded it. For example, Florida established two performance funding systems in 1994; the state has since abandoned the Workforce Development Education Fund but retained performance-based budgeting.

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“A review of past experiments suggests that it's not the idea that failed, but the design and implementation of the strategies that derived from the idea.”

— Dennis Jones, president, NCHEMS

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The effectiveness also has varied. Tennessee found that a small amount of funds had a large impact, with all institutions showing positive learning gains, and Florida community colleges found that while enrollments increased by 18 percent, degrees and certificates increased by 43 percent from 1996 to 2007. Ohio reported the median time-to-degree for bachelor's degrees decreased, while persistence and completion (especially for at-risk students) increased steadily.

States' experiences provide useful lessons for policy-makers on this funding approach. Eric Fingerhut, former chancellor of the Ohio State Board of Regents and lead architect of that state's new performance-based funding system, recommends that states considering a performance-based funding plan take these steps:

- Move quickly on the basic decision to shift to performance-based funding.
- Be clear, inclusive and patient in the process of shifting to performance funding.

- Proactively make the case for the need for performance-based funding and its potential benefits.
- Calculate the formula and publicize it in Year One, even if the impact only phases in gradually.
- Remember that presentation and process are critical to winning the debate.

Lumina Foundation includes performance-based funding as one of four steps to increase college productivity, suggesting that “states should provide technical assistance to help struggling institutions do better, incentives for institutions to serve students who require extra help academically, and rewards for improvements in closing specific academic gaps highlighted by disaggregated achievement data.”

SREB’s position on outcomes-based funding, specifically, is grounded in the report *No Time to Waste: Policy Recommendations for Increasing College Completion* and several meetings with members of SREB’s Board, Legislative Advisory Council, Legislative Work Conference, participants in SREB’s National Advisory Panel on college completion, and many representatives from the K-12 and postsecondary education communities.

## State Actions on Outcomes-Based Funding

It is estimated that over half the states nationally have some form of performance-based funding. In developing state policy for outcomes-based funding, lawmakers make many decisions. Three key areas are the *kind of policy*, the *level of funding*, and the *indicators or measures* to use in determining allocation of the funds.

Several states have outcomes-based funding language in legislation or other statewide policy; others have used postsecondary education master plans as the vehicle. As states have moved toward funding outcomes, their actions have ranged from interim studies to comprehensive legislation and restructured funding formulas. The landscape changes frequently on these issues, but a snapshot of activity around the nation highlights the many variations in the *kind* of performance-based funding policy.

- **Arkansas** legislation directs the Department of Higher Education, in collaboration with the institutions, to develop funding formulas “consisting of a needs-based component and an outcome-centered component.”

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“The new funding models reflect the needs  
of the state and its citizens, not merely  
the needs of the institution.”

— Mary McKeown-Moak and Christopher Mullin  
*Methods in Postsecondary Finance: Concepts and Calculations*

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The outcome-centered component begins in the 2012-2013 school year. (Act 1203, 2011)

- **Florida** passed legislation requiring the state’s university system governing board to reward institutions using a series of performance metrics. The governor vetoed the bill.
- **Indiana** grounded its performance-incentive funding approach in the higher education strategic plan and has been working with the Legislature to tie base funding to performance.
- In 2012, **Kentucky’s** Council on Postsecondary Education (CPE) tried unsuccessfully to use its Strategic Agenda as a basis for recommending a \$25 million Performance Funding for Student Success program.
- **Louisiana** will grant postsecondary institutions “limited operational autonomy and flexibility” in exchange for achieving “specific, measurable performance objectives aimed at improving college completion and at meeting the state’s current and future workforce and economic development needs.” (House Bill 1171, 2010)
- **Oklahoma** legislators considered, but did not pass, legislation to create a Higher Education Outcomes-Based Funding Task Force to study issues and make recommendations, with a final report due in May 2013. (House Bill 2517)
- In 2009, **Ohio** policy-makers moved to end enrollment-based funding for four-year universities, and they are phasing in performance-based funding for the state’s community colleges.
- The **South Dakota** Board of Regents adopted a performance funding model framework for piloting in 2012-2013 that rewards public universities for producing college graduates. A weighted point system

gives priority for completers at higher degree levels and for those earning degrees in high-priority workforce development fields.

- Legislation requires the **Tennessee** Higher Education Commission (THEC) to develop a statewide master plan that holds higher education accountable for increasing the educational attainment levels of Tennesseans. Policies and formulas or guidelines “shall result in an outcomes-based model.” (Complete College Tennessee Act of 2010)
- **Texas** legislation directs the Texas Higher Education Coordinating Board (THECB) to consider undergraduate student success measures in devising its base funding formulas and making its recommendations to the Legislature relating to institutional appropriations of base funds. (House Bill 9, 2011)
- **West Virginia’s** Senate Bill 436 from the 2012 session called for a Select Committee on Outcomes-Based Funding Models in Education. Members from Education and Finance Committees are charged with analyzing outcomes-based funding models in higher education and providing recommendations for the 2013 session on incorporating one or more of the models in the state’s financing policy. Legislation is expected for the 2013 session.

In addition to outcomes-based funding policy for state higher education agencies and institutions, states also need to determine the amount of funding available to institutions. States vary greatly on the *level* or percentage of funding that supports performance funding. For example:

- **Arkansas** law requires that 25 percent of public postsecondary funding be outcome-centered by 2017-2018.
- **Indiana** expects to base enrollment funds entirely on completed credit-hours by 2014. The state’s institutions also are funded on five other performance priorities, including increases in students graduating on time and completion by students from low-income families and transfer students.
- The **Pennsylvania** System of Higher Education started allocating part of the state appropriation

based on performance in 2002 and now dedicates about 8 percent of the total state appropriation for institutions based on performance criteria.

- **Ohio** instituted significant changes in the funding formulas for higher education in 2009. Now, 95 percent of funding for main university campuses is tied to course completion and 5 percent to degree completion. Since 2011, 5 percent of a community college’s funding has been linked to student progress on “momentum points.”
- **Tennessee** is two years into allocating 100 percent of base funding on outcomes, with enrollment no longer factoring into institutional allocations. Included in the total is the opportunity for institutions to earn up to an additional 5.45 percent from traditional performance funding.
- **South Dakota’s** model requires public universities to draw from their base budgets to match a one-time \$3 million allocation from the Legislature.

The third important decision that policy-makers consider relates to the specific performance *indicators* for allocating funds. While state funding historically has been linked primarily to enrollments, the current interest in college completion and raising educational attainment rates has reduced that emphasis. State and higher education systems are now promoting *student success*, and this approach is commonly found in legislation and other policy to describe the overall focus of outcomes-based funding efforts. Specific measures often include improvements in:

- the numbers of students who complete courses, programs, degrees and certificates
- reducing the number of credit-hours accrued by completers
- graduation rates
- transfer
- reducing achievement gaps for low-income students, those from underrepresented populations, and returning students
- pass rates on licensure and certification examinations
- progression and successful completion of a certain number of credits
- timely graduation, and
- successful completion of developmental education courses.

# Essential Elements of State Policy for College Completion: *Outcomes-Based Funding*

The success of outcomes-based funding relies on several factors. SREB recommends the following *essential elements* of an effective, statewide outcomes-based funding policy to increase college completion. These elements are found in most outcomes-based funding state policy.

## I. State Commitment

A clear and concrete commitment to pursue specific statewide priorities — manifested in a formal, statewide public agenda — is the necessary foundation for a successful outcomes-based funding model. A goal to increase the percentage of adults who hold postsecondary degrees or certificates is the central element of most such public agendas. Other goals include responsiveness to workforce needs and economic development initiatives. This commitment is best contained in forceful and specific legislative or statewide board policy. For some states, legislation is the policy lever. For others, statewide master plans for postsecondary education are the primary tool.

Success depends on key policy and education leaders embracing the commitment to outcomes-based funding, regardless of the state's funding situation. Equally important: Maintaining state priorities as the basis of outcomes-based funding should be the *first* funding objective protected when budgets are cut. This means that financing procedures may need to combine enrollment-based and outcomes-based funding.

## II. Source of Funding

Policy-makers must be very clear in identifying the source of monies that will support outcomes-based funding. Institutions may argue for new or additional state money, especially in periods of budget reductions. Others may argue that base funds should be used in addition to new funding, or even in the absence of new money. Since it is highly unlikely that new state funds for postsecondary education will be available in the near future, policy-makers need to look at existing allocations and how they are used.

As states develop financing procedures that combine enrollment-based and outcomes-based funding, they need to take into account that tuition is a form of enrollment-based funding. In those states where tuition revenue stays at the institution, states have leverage over an ever-decreasing share of institutional budgets. The greater the share of institutional funding from tuition, the more important it is for the state to be very strategic about how it invests its funds; e.g., the proportion of state money going to outcomes has to increase in order to influence institutional actions.

## III. Level of Funding

The outcomes-based funding model should claim the greatest share of current and new state appropriations to

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## Definitions

**Performance-based funding:** State funding to postsecondary institutions tied to specific, pre-determined goals or intermediate objectives. The funding may be awarded either as an *incentive* to work toward a particular objective or as a *reward* for having reached it.

**Outcomes-based funding:** A type of performance funding that intentionally rewards institutions for producing specific, pre-determined outcomes.

**Metrics:** The data and information by which progress is measured.

**Momentum points or success milestones:** Intermediate outcomes in a student's progress that have a high likelihood of predicting the student's completion of a program, certificate or degree. Students who attain momentum points are more likely to progress to certificate and degree completion or transfer.

higher education. The size of the outcomes-based funding pool as a percentage of state appropriations (not including tuition proceeds) needs to be significant — at least 25 percent — to influence the institutions' actions.

To reflect the role that enrollment-based funding should continue to play, three key factors need to be considered when determining the level and share of funding:

1. Enabling a smooth *transition* to the new outcomes-based funding model. Policy-makers need to look carefully at how to initiate the new funding process and how to deal with potential decreases in allocations to individual institutions as dollars flow from outcomes results rather than enrollments. Most states have elected to phase in new formulas and processes over a few years for incremental change, especially if the fiscal stakes are high. This gives institutions an opportunity to adjust and incorporate new funding models more smoothly and mitigates potential negative shifts in funding levels to institutions. Including stop-loss provisions in policy puts everyone on notice that there is a defined grace period for institutions, but that period will end and some may see reduced funding if they have not achieved specified benchmark levels on outcomes.
2. Recognizing that greater access to postsecondary education — and higher enrollments — should still be a major goal. If states are to meet ambitious completion goals, they need to foster both more access *and* successful completion.
3. Mitigating any negative effects on quality that could emerge with an emphasis on completion. The higher the share of funding that is outcomes-based, the more concern there should be that administrators and faculty may feel pressure to relax standards for degree completion.

#### IV. Agreement on Goals

For outcomes-based funding to work, states need policy that is comprehensive and specific in direction. The challenge for policy-makers is to reach consensus on the kind and nature of the policies that will maximize effectiveness and target the needs of the state, rather than only those of individual institutions.

Some states have narrowed their goals for outcomes-based funding to student success, focusing on increasing the number of students who complete certificates and degrees. Others have included additional aspirations, such as economic and workforce development goals, research needs and efficiency goals. For all public institutions, the state's master plan for postsecondary education should reflect the specific state goals for outcomes-based funding and contain parallel objectives.

#### V. Differentiation by Institutional Mission

Outcomes-based funding gives the state an opportunity to drive resources to different kinds of public institutions to achieve statewide goals. To strengthen differentiation among missions, the funding model should include all public postsecondary institutions and create opportunities for each kind of institution to earn outcomes-based funding within its mission, without pushing all types of institutions into the same actions.

Maximizing mission differentiation allows policy-makers to align funding strategically with goals and make the most efficient use of limited resources. The outcomes-based funding model can effectively recognize and support different institutional missions through *separate* outcomes-based funding pools for each kind of institution, along with a set of priority outcomes for each institutional category. Additionally, weights or consequences can further emphasize mission distinctions across categories. For example, a state may prefer one outcomes-based formula for community colleges, a similar but different formula for research universities, and another for regional institutions.

#### VI. A Limited Number of Straightforward Outcomes

To achieve transparency, simplicity and focus, policy should limit the number of outcomes it rewards and monitors. This will help keep the lens on statewide goals and greatly reduce the influence of goals that serve only the interests of individual institutions. States also can monitor a smaller set of outcomes more efficiently. One of the significant benefits of outcomes-based funding done well is the communications value of engaging key stakeholders in clearly stated goals. A proliferation of outcomes diminishes this important side benefit.

Specific outcomes should be intentional, clearly grounded in the state goals and focused primarily on final, downstream results, especially in credential completion. When the overall goal is to increase the percentage of a state's population with postsecondary credentials, funding emphasis should be on increases in *numbers* and/or increases in *proportion* of a state's total credentials from a given institution — rather than increases in *percentages* or *rates*. To reach statewide educational attainment goals, for example, institutions need to graduate *more* students. Simply graduating a higher *percentage* of students may not contribute to a goal of higher educational attainment as a percentage of the state's population.

## VII. Intermediate Momentum Points

While outcomes should focus primarily on final results, rewarding short-term *momentum points* or *success milestones* is effective in transitioning into outcomes-based funding and encouraging institutions to achieve specific levels of results in designated areas. Such intermediate, upstream measures add complexity and, depending on their role, could divert focus from actual completion. On the other hand, they can be applied immediately and ease the transition to outcomes-based funding in the early stages of implementation.

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“A value-added funding approach ensures that limited resources are invested in the results the state seeks. With value-added, students are assigned a value (e.g., 1 for a freshman, 1.2 for a sophomore, 1.4 for a student with an associate's degree), and a college computes an index for its base year. It can improve its performance and increase financial support each time it adds a freshman or a transfer student and whenever it advances a student toward graduation.”

— Complete College America

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When designing outcomes-based funding formulas, policy-makers should give more weight to degree completion by at-risk students, those from low-income backgrounds, returning students, and those transferring from two- to four-year public institutions. Even if the transferring student has not yet earned a credential, this acknowledges the important role effective transfer plays in producing more degrees.

Some states are using the attainment of certain levels of course credits as momentum points to encourage institutions not only to retain students but to have them earn credits toward a credential. Other variations might include linking education with workforce and economic development, especially in STEM or other priority fields.

## VIII. Unambiguous Metrics

Appropriate, easy-to-understand metrics are essential to avoid manipulation and uncertainty and to enable policy-makers to monitor the progress of outcomes goals as well as the effectiveness of the goals and funding levels. Identifying the right metrics at the beginning of the process helps ensure that adequate collection, reporting and analysis protocols are in place when the outcomes are agreed on and before funding is awarded.

To determine which institutions earn specific amounts of outcomes-based funding, policy-makers should emphasize positive change, growth or improvement in the outcomes over the setting and meeting of absolute goals. For example, states might award a given amount per additional degree across all institutions, determined by dividing the total number of new credentials earned in a year into the total outcomes-based funds available statewide for this outcome. Metrics for degree and certificate completion goals should measure increases in numbers and/or increases in the *proportion* of the state's total credentials awarded by an institution. Because graduation rates have a high potential for manipulation, they are less reliable as a metric.

## Overlapping Policies

Depending on decisions about the issues raised here, states may need to reexamine existing policies concerning access, at-risk students or other specific groups, workforce and economic development goals, and research. These critical, related policies will need further attention:

- **Budgets, allocations, and funding formulas.** Outcomes-based funding requires a hard look at existing budget and allocation policies: funding sources, levels and formulas — as well as how and when funds are awarded, for what purpose and by whom.
- **Data collection, analysis and reporting.** Accountability is central to outcomes-based funding, and data systems play a central role in supporting budget and award decisions. Decisions about the types of metrics that will be used to monitor progress, as well as the way information will be collected and analyzed (and by whom) are all open for discussion. A state-level entity should be charged with reporting progress and achievements annually at the system and individual institutional level, as well as the effectiveness of outcomes-based funding in reaching the intended goals.
- **Institutional missions.** Targeting state funds toward very specific goals and objectives — especially during stressed economic conditions and budget reductions — opens the opportunity for state and education leaders to look closely at the public higher education

system and the missions of different institutions. “Mission creep” has long been a concern of policy-makers; outcomes-based funding tied to state goals requires a review of missions and rewards institutions for making greater gains in achieving both their missions and state priorities.

- **Tuition and fees.** Tuition and fees policies in most states may vary by institution, depending on factors such as an institution’s mission, level, location or programs. When considering outcomes-based funding, policy-makers need to review how tuition and fees are determined, who sets them, and how much they contribute to the total funding for each institution.

Outcomes-based funding offers policy-makers a fiscal tool to concentrate resources on *state* goals for postsecondary education and to support institutions of all types in realigning their efforts to achieve those goals.

Successfully managing the transition to an outcomes-based funding model is a process requiring buy-in and engagement of policy-makers, as well as many stakeholders in the institutions and their communities. Achieving stability is critical.

Considering the essential elements presented in this paper should allow policy-makers to design statewide policy that will be effective in significantly increasing the percentage of their population who has earned postsecondary credentials.

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