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Interim Report of the Rice University Faculty Merger Review Committee

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This interim report, along with the two subcommittee reports it cites, can be found in the Working Groups area within the Rice-BCM website: http://rice-bcm.rice.edu/

We invite your comments. Send to: fmrc@rice.edu

Preamble

The Faculty Merger Review Committee (FMRC) intended to make a full-scale report to the faculty at the start of the semester, but that has not been possible. Merger discussions have been going slowly, and many key decisions have not yet been made: the disposition of the incomplete hospital and its debt; the resolution of a clinical plan for Baylor College of Medicine (BCM); arrangements with participating hospitals, especially adult care hospitals; securing adequate philanthropic commitments; a reliable estimate of the expenses necessary to implement the merger; the amount of investment available for program enhancement and its allocation between Rice and Baylor; and plans for additional fundraising to make possible maximum academic benefits to Rice from a merger without starving existing or future non-medical related programs at Rice. Absent the resolution of these issues, it is impossible for the FMRC to fully assess the risks and benefits of a merger.

Complicated and delicate negotiations are ongoing, and the committee has been told much that cannot be disclosed without violating confidentiality. For example: if a Rice/Baylor merger goes forward, Rice will make a substantial one-time investment to support the merger. The committee has been told the planned size of this investment. Because it is still subject to negotiations, the FMRC cannot disclose the amount. Therefore our ability to report to the faculty on the financial costs, including opportunity costs, of a merger is severely constrained. Part of Rice's one-time investment will be in academic enhancement at BCM and Rice. An important issue for Rice faculty is the academic benefits that would flow from the portion of enhancement funds spent at Rice. Despite these limitations, we are providing the following interim report of our view of the potential benefits and risks of a possible merger with BCM, along with our view of the preconditions under which a merger might be advisable.

Benefits

1. **Research.** Both fundamental biosciences and its applications are likely to provide defining scientific achievements in the coming decades. Rice is significantly underinvested in this area. A BCM-Rice merger is the clearest, but not the only way, for Rice to become a major player in these areas. Several programs at Rice are expected to greatly benefit from a merger (bioengineering, biochemistry and cell biology, statistics, health policy, neuroscience), but research collaborations could reasonably be expected to develop in fields as wide-ranging as music to physics to sociology to electrical engineering to religious studies.[1]

[1] See two reports available at the Rice-BCM website (http://rice-bcm.rice.edu/): (1) Report of the Rice University – Baylor College of Medicine Research Merger Sub-Committee, 7/31/2009 [West/Gibbs subcommittee report]; and (2) the Report of the Subcommittee on Collaborative Activities of the Faculty Advisory Committee, [Boles subcommittee report].

2. **Teaching.** Teaching benefits could be expected in a variety of forms. Certain new and emerging programs such as neuroscience and health policy could quickly become significant majors or minors for Rice undergraduates. Some Baylor faculty have expressed interest in undergraduate teaching, through entire courses or guest lectures. Some existing undergraduate courses would benefit from exposure to the clinical environment at Baylor, and undergraduate and graduate students could take courses offered in Baylor's Graduate School of Biomedical Sciences. Opportunities exist for joint graduate programs and dual-degree programs, such as M.D.-Ph.D. programs.
3. **Preservation of Baylor as a stable partner.** Many programs at Rice enjoy productive research and/or teaching relationships with BCM. One must consider the potential harm to these relationships if Rice and BCM do not merge, or if BCM ultimately merged with another institution or became significantly weaker. Merging with Rice would provide needed stability to joint Rice/BCM undertakings.
4. **Rice's place in the world.** Rice aspires to be one of the leading universities in the world. We hope to attain that status through outstanding, internationally recognized programs of research and education. A successful merger with BCM should help make all this possible, including expanding opportunities for undergraduates.

Risks

1. The merger would create one of the most unbalanced academic institutions in the US, with a very small university attached to a large medical school. This imbalance could impact Rice's academic mission, culture, and its finances.
2. The financial risks to Rice of merging with BCM are significant and are amplified by the large size differential between the two institutions. The annual operating budget at BCM, for example, is almost three times the size of Rice's budget. Consequently, small fractional changes in total revenue of the combined institution could have a large impact on funds available for Rice's traditional mission.
3. By joining with BCM, Rice will be acquiring a large exposure to a volatile industry with changing economics. Over time, e.g., NIH budgets may decline and the nation's system of payments for medical services is likely to change.
4. The recent situation at BCM has led some of its staff to leave and others to contemplate leaving. It is possible that the BCM with which Rice would merge would be significantly weaker than the BCM of a few years ago.
5. Inadequate execution could limit anticipated benefits. (See Condition 6 below.)
6. Because BCM is in a turnaround situation, its financial future and the future of its institutional relationships are less predictable.

Conditions

❖ We believe a Rice/Baylor merger should take place only if the following conditions are met:

1. Baylor must be on a credible path to eliminate its operating deficit.
2. A strong, stable relationship with one or more adult private hospital partners must be found, comparable to that found at top-ranked medical schools.
3. A satisfactory outcome must be found for the McNair campus and its associated debt that does not result in Rice's owning a hospital or having liability from it.
4. The majority of funding for the merger should come from sources other than the Rice endowment or borrowing.
5. The potential for additional research and education collaborations between Rice and BCM is impressive. Realizing the potential for non-science, small-science, and large-science collaborations will be expensive. Non-biomedical related aspects of Rice must not be starved in order to support programs directly related to BCM. In addition to maintaining the pre-merger inflation-adjusted budget for these programs, funds must remain available for growth, innovation, and achievement in non-biomedical programs at Rice. Therefore, in addition to any investments made in BCM, we believe that a minimum of $250 million of additional endowment must be raised in the next 5 - 8 years to support both one-time seed funding and recurring expenses such as salaries for new positions at Rice. [2]
6. Clear and firm arrangements for execution and implementation are essential:
    a. The Rice top-level administrative team is currently very lean and will need to expand.
    b. An external, independent advisory team of experienced academicians and administrators must be brought to Houston to advise on the academic issues of implementation.
    c. The Rice faculty and administration need to keep in mind that without a large commitment of faculty time and attention, this merger will not succeed.
    d. Faculty must be engaged meaningfully with deans in planning a clear academic strategy for the merged institution, including both research and teaching initiatives.

❖ Even if all the above conditions are met, there is room for debate whether the benefits of a merger to Rice are worth the significant remaining risks. On this, there is a range of opinions within the committee. The ultimate responsibility for this decision resides, of course, with the Rice University Board of Trustees.

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[2] See the Boles subcommittee report for a conservative estimate of $150 million for a portion of these costs.

Further thoughts

1. Rice has not yet conducted a comprehensive nationwide study of the academic relations between medical schools and the rest of the university, in order to discover cases of success and failure from which Rice could learn. We recommend that such a study be undertaken before a decision to merge is made. In any case, we strongly recommend that this analysis be done before the academic implementation of a merger begins.
2. A carefully conducted impact analysis on rankings (USN&WR, NRC, etc.) is needed to determine the likely effect of this merger on Rice and on BCM.
3. After thinking through the issue for some months, we believe that many (although not all) of the benefits of expanded cooperation that might result from a merger could also be realized without a merger. The key element needed is an Office of Cooperation. If a merger does not occur, we recommend that Rice move immediately to establish a strong, effective, and well-funded Office of Rice-TMC Cooperation.
4. The committee agrees with the thesis that over the coming decades, Rice's standing as a major research university is in danger. This is a serious issue that deserves more thought and investigation. Joining with a medical school is one way to expand our research profile and visibility. Whether or not Rice merges with BCM, other strategies for enhancement need to be explored.
5. Many Rice faculty are concerned about issues of faculty governance, such as tenure and the Senate. The committee and the Senate leadership believe that the faculty governance issues are solvable.

Financial Information from the Rice Administration
In Response to the Committee's Questions

Financial issues that must be addressed as part of a merger with BCM include the costs of integrating the two institutions, resolving the future of McNair campus and its associated debt, rebuilding the BCM endowment, ensuring a financially viable and academically productive clinical solution with hospital partners and developing a credible plan for bringing the BCM operating budget into balance.

Rice will also incur indirect costs. These might include: 1) higher financing costs on future debt and current variable rate debt; 2) limited flexibility to fund extraordinary opportunities; and 3) limited flexibility in the operating budget should there be an extended, severe economic downturn.

What investments will Rice make?
Rice will make a one-time investment over a 5-8 year period to support the merger. Such one-time costs include: 1) an investment in the continued excellence of BCM; 2) the academic integration/collaboration (where appropriate and desirable) of Rice and BCM (e.g., collaborative seed grants); 3) transaction and integration costs (e.g., legal fees, consultant fees, administrative integration costs such as information systems).

What are the principles for allocating Rice's investment?
Rice's investment will be allocated in a way that does not impose unintended liabilities on Rice's operating budget. Rice's investment will also include a contingency to provide flexibility to address unanticipated costs.

What is the impact of a merger on the endowment and endowment distribution available to support Rice programs?
Rice will likely borrow 30-year taxable debt to finance the Rice costs of implementing a merger. The costs of borrowing are expected to be less than the long-term growth potential in the endowment. The financing costs would be paid through an extraordinary distribution from the endowment that would not impact the payout for ongoing Rice programs.

What is the risk to Rice from BCM's on-going operations?
BCM reported operating losses in FY 2000 and every year since then with the exception of FY 2001 and FY 2003, including the $68 million deficit in FY 2008. A sustainable plan for the elimination of BCM's operating deficit is one of the conditions that must be met before a merger agreement is finalized and there must be a credible plan for execution. Once the merger occurs, BCM would come under the full governing control of the Rice Board of Trustees and the Rice President who must approve the BCM annual budget.

What is the impact of the financial crisis on Rice's budget planning with and without BCM?
The impact on the endowment of the financial decline in FY 2009 and the uncertainties

about future market returns requires Rice to take further actions to cut expenses and increase revenues to ensure balanced budgets in FY 2011 and future years. This is the case whether or not a merger with BCM goes forward.

What are the sources of funding for the merger other than Rice?
The merger as contemplated requires strong philanthropic support, stable and robust hospital commitments, as well as Rice's one-time investment. The majority of the necessary investments will come from non-Rice sources.