# Align in Higher Education

**Financial sustainability in a volatile landscape**
February 2020

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# Agenda



# Introduction

In 2017 we stated that "the financial stability of higher education is under significant strain". Since then, society in general, and Higher Education in particular, has operated in a climate in which uncertainty has become the norm.

Ranging from political impasse to the new world of the Office for Students, universities are having to respond to an ever changing operating landscape; continuing to manage increasing operational and people costs and challenges to traditional income routes all against the backdrop of the need to demonstrate value for money.

Our recent publication, 'Managing Risk in Higher Education'[1] considered the top risks facing universities in 2019. Three of the top five risks related to student recruitment, with pensions and cyber security rounding out the list.

These risks highlight the perfect storm that is putting the financial sustainability of many Higher Education Institutions (HEIs) under intense pressure; with challenges to income streams and increasing cost pressures impacting their ability to maintain a positive balance sheet.

Add to the equation the pressures of having to compete in an increasingly global market, and it is apparent that the way universities operate must evolve, as must the approach to budgeting and funding core activities.

Many HEIs recognise the need to take pre-emptive action to reduce costs and better align them to strategic goals in order to have confidence that their financial models are fit for the future, can support value for money provision as well as respond to increasing operational complexity and cost. Only then can they have confidence in developing a sustainable, balanced budget regardless of the climate within which they are operating.

1 – www.pwc.co.uk/government-public-sector/education/documents/higher-education-sector-risk-profile-2019.pdf

# A volatile landscape

Higher Education Institutions (HEIs) continue to face a volatile and increasingly competitive landscape. The 'traditional customer' is a thing of the past, replaced by an increasingly diverse and informed student base that expects a personalised experience to meet their financial investment.

## Applications and demographics

The competition for students continues to intensify; domestic applications in the standard cycle have dropped by 1% (despite hitting the symbolic 50% of young people entering Higher Education)[1] but there are early signs of a resurgence in Non-EU students applying to the UK, after the disastrous changes to international student visas have been reversed[2], with latest UCAS figures showing a 9% increase in Non-EU applications[3]. EU applications have stagnated over the last few years and the impact of the UK leaving the EU remains an unknown for these potential students.

Applications through clearing continue to rise[4] – with total applications in 2019 up by 15% on 2018. Whilst an encouraging remedy to the standard application cycle figures; the uncertainty this creates for universities in their financial planning creates its own challenges.

It is also clear that growing numbers of potential students are moving straight into employment with a cross-section of organisations offering attractive pay and developmental opportunities through apprenticeship schemes and other incentives.

## Fees and value for money

The long awaited review into fees by Augar has seemingly been kicked into the long grass, with the Conservative manifesto stating that fees will be 'considered carefully'[5]. In the meantime, a freeze of undergraduate fees at current levels means a real time cut that will add further financial pressure for universities over the coming years.

In October 2019, the Office for Students (OfS) published its value for money strategy for the next three years[6].

It is reported that only 38% of students thought their tuition fees represented value for money[7], with 88% indicating a breakdown of how fees were spent would help judge value. The impact of the OfS prioritising transparency of fees and funding could be significant for the way in which HEIs both allocate and report their finances.

## A global market

Overseas students contribute significantly to the UK economy. In March 2017 Universities UK estimated that international students were worth £25 billion to the UK economy. Dame Julia Goodfellow, President of Universities UK, commented that, "the UK has the second largest share of the global market, behind only the USA."[8]

The rise of Asian universities has continued in 2019, with the number of Chinese universities making it into Global rankings rising to 72 from 63 – making it the fourth most represented nation[9].

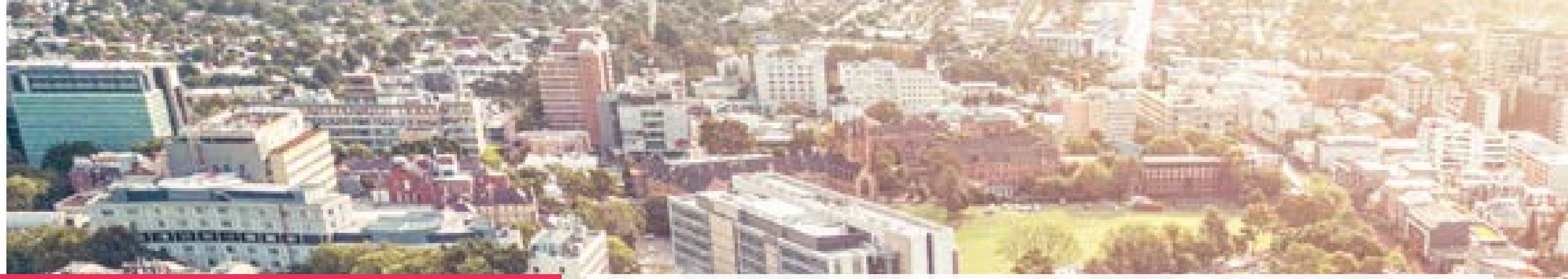
The global standing of UK universities is complicated. There has been a rise from 76 to 84 in the global rankings which should be celebrated; however, the number of universities making both the Top 100 and 200 has decreased slightly[10].

The emergence of high quality institutions in Asia, and a perceived lack of highly qualified staff and research funding in UK HEIs, suggests students will be attracted elsewhere. It is therefore unsurprising that some sector commentators are questioning whether the financial future of some HEIs could be in jeopardy.

In summary, the Higher Education landscape both domestically and globally is fundamentally changing. HEIs are fully exposed to market forces as well as the march of technology[11]. As former Universities Minister Chris Skidmore indicated, a well-functioning university culture needs sustainable institutions"[12].

1 – www.bbc.co.uk/news/education-49841620
2 – www.timeshighereducation.com/news/uk-reintroduce-two-year-post-study-work-visas
3 – www.ucas.com/data-and-analysis/undergraduate-statistics-and-reports/ucas-undergraduate-releases/applicant-releases-2019-cycle/2019-cycle-applicant-figures-january-deadline
4 – www.ucas.com/data-and-analysis/undergraduate-statistics-and-reports/statistical-releases-daily-clearing-analysis-2019
5 – assets-global.website-files.com/5da42e2cae7ebd3f8bde353c/5dda924905da587992a064ba_Conservative%202019%20Manifesto.pdf
6 – www.officeforstudents.org.uk/news-blog-and-events/press-and-media/office-for-students-publishes-value-for-money-strategy/
7 – www.officeforstudents.org.uk/annual-review-2019/#vfm
8 – www.universitiesuk.ac.uk/news/Pages/International-students-now-worth-25-billion-to-UK-economy---new-research.aspx
9 – www.timeshighereducation.com/news/world-university-rankings-2019-results-announced
10 – www.topuniversities.com/university-rankings/world-university-rankings/2020
11 – www.hepi.ac.uk/2019/11/29/trust-in-university-finances-requires-both-sides-to-put-the-work-in/
12 – www.gov.uk/government/speeches/universities-minister-gives-speech-at-universities-uk-conference

# The financial need to evolve



In April 2019, the OfS reported that higher education was “in reasonable financial health” but warned that this general picture “masks considerable variations in financial performance between individual providers”[13]. While the sector saw a 7.4% increase in income, surpluses fell from £1.12 billion (2016-17) to £1.02 billion (2017-18).

Figures from Higher Education Funding Council for England (HEFCE) in 2017[14] showed that across individual institutions the gap between the lowest deficit (7.2%) and the highest surplus (32.1%) grew by 26%, with 27 HEIs recording reductions in income. While a small number had maintained strong financial positions (three reported surpluses of over 20% in 2015-16), the majority are potentially facing some tough financial decisions. To compound matters, these uncertain market conditions are also expected to lead to “greater focus from investors” which is likely to “lead to a rise in the costs of borrowing”.

HEIs have known for sometime that an income and funding squeeze was coming. Between 2012-13 and 2015-16 Governmental income reduced by 44%[15].

To compensate, HEIs have generated increased income through tuition fees, but fees levels are now also coming under increased political scrutiny with the rise of unconditional offers and the value for money agenda.

In such a volatile landscape, how do institutions deliver efficiencies to reduce increases in operational costs without detrimentally impacting strategic goals?

Understandably, institutions can often be drawn to operational cost reduction interventions that are quick to implement without fully considering the wider issues they may inadvertently cause. A case in point is ‘salami slicing’ whereby individual areas are instructed to deliver arbitrary savings targets by either reducing staff or non-staff costs. While this approach is uncomplicated and can be done at pace, it can also expose individual institutions to unnecessary risk as most neglect to subsequently rebalance outputs and outcomes to meet strategic goals.

Additionally, unless stringent financial controls are in place, cost will often creep back in as areas try to maintain current (or increased) outputs with less resources.

Costs will also commonly increase in other departments as the knock-on effect of reduced funding is passed to them. This form of cost reduction may service short-term needs but it won’t deliver enduring financial security – plus most HEIs have already tried it!

Other common cost reduction approaches include process improvement and medium to large scale staff reductions. Although each can deliver operational efficiencies, both (as stand-alone interventions) also have the potential to increase costs too.

Process improvement can achieve savings of between 5% to 10%. The risk is that without first reviewing services (i.e., inputs, outputs and outcomes) in line with strategic goals, there is a high chance that scarce resources will be used to drive efficiencies across activities that do not in fact meet organisational needs and should really be stopped.

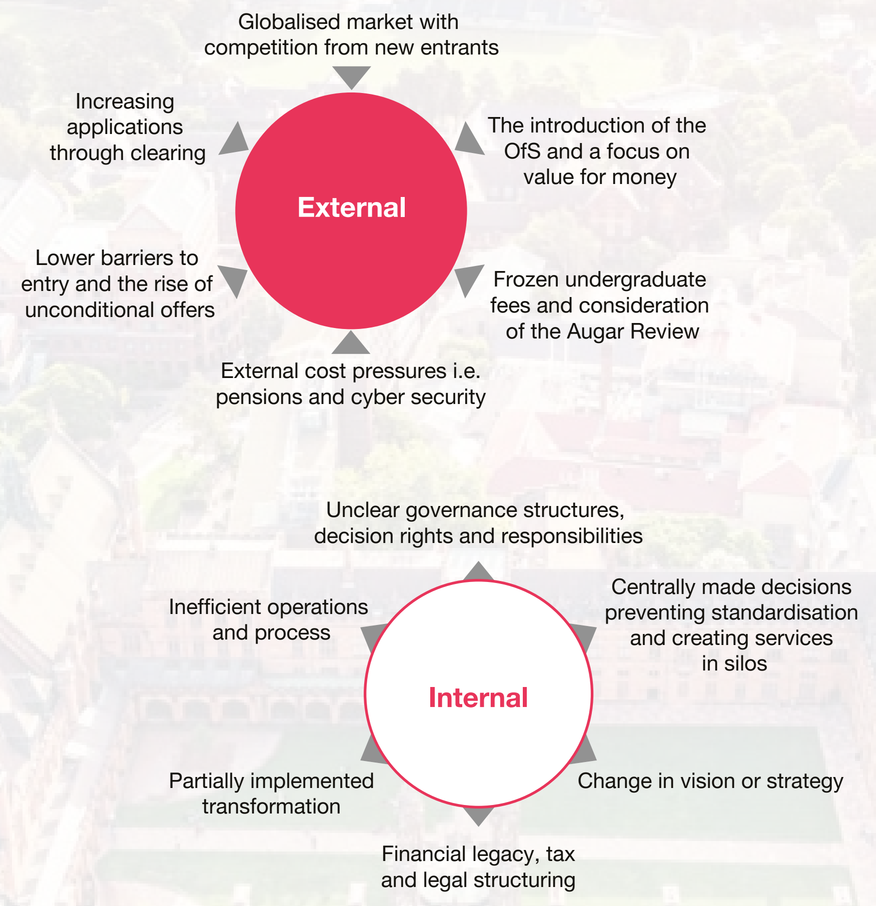
Likewise, staff reductions can offer savings of between 25% to 40%, dependent on organisational appetite.

However, this option requires skills and processes to implement that most universities do not have. It is also extremely time and staff intensive.

In addition, if reductions are not carefully managed, and new structures not appropriately designed to meet the institutional needs from an operational and customer perspective, this could have the reverse financial outcome and be extremely costly.

Individual universities need to be smarter in how they approach cost reduction. Arbitrary target setting is crude and will not address this complex problem. Similarly, both process improvement and restructuring run the risk of unintentionally increasing operational costs. Besides, none of these common approaches will help a university to make more informed decisions as to how it can most effectively align cost to strategic goals.

**Figure 1. The drivers for change in Higher Education**




13 – www.officeforstudents.org.uk/news-blog-and-events/press-and-media/office-for-students-says-higher-education-in-reasonable-financial-health-but-warns-of-over-ambitious-student-number-forecasts/
14 – www.hefce.ac.uk/pubs/year/2017/201702/
15 – www.ucu.org.uk/article/5858/Government-funding-for-university-teaching-and-research-to-fall-to-lowest-proportion-in-over-a-century-report-warns?list=5852

# Prioritising what matters

## Spotlight on cost reduction

By 2015-16 academic staff numbers (168,000) had been overtaken by professional and support staff across English institutions[16]. As organisations organically upscale capabilities it is a common side effect that supporting costs increase disproportionally with scale. Indeed staff numbers continue to increase by approximately 2% per year on average[17]. The result can be that cost is frequently sunk on low value, low impact activities rather than being effectively aligned to the delivery of strategic priorities.

How has this happened? To put it simply: many universities do not have a detailed enough understanding of what their professional and support departments actually do (i.e., measurable outputs). This makes enforcing suitable operational and financial controls challenging and is often exasperated by the following:

- Silo working causing duplication;
- Absence of agreed, regularly monitored key performance indicators and poor management information;
- A lack of service level agreements or similar measurable service delivery references.

This basic awareness is critical if universities are to deliver realistic risk-based savings that do not negatively impact operational output. Equally as important, if savings are to be enduring, is the need to identify and address both system and behavioural failings that prevent enduring cost reduction.

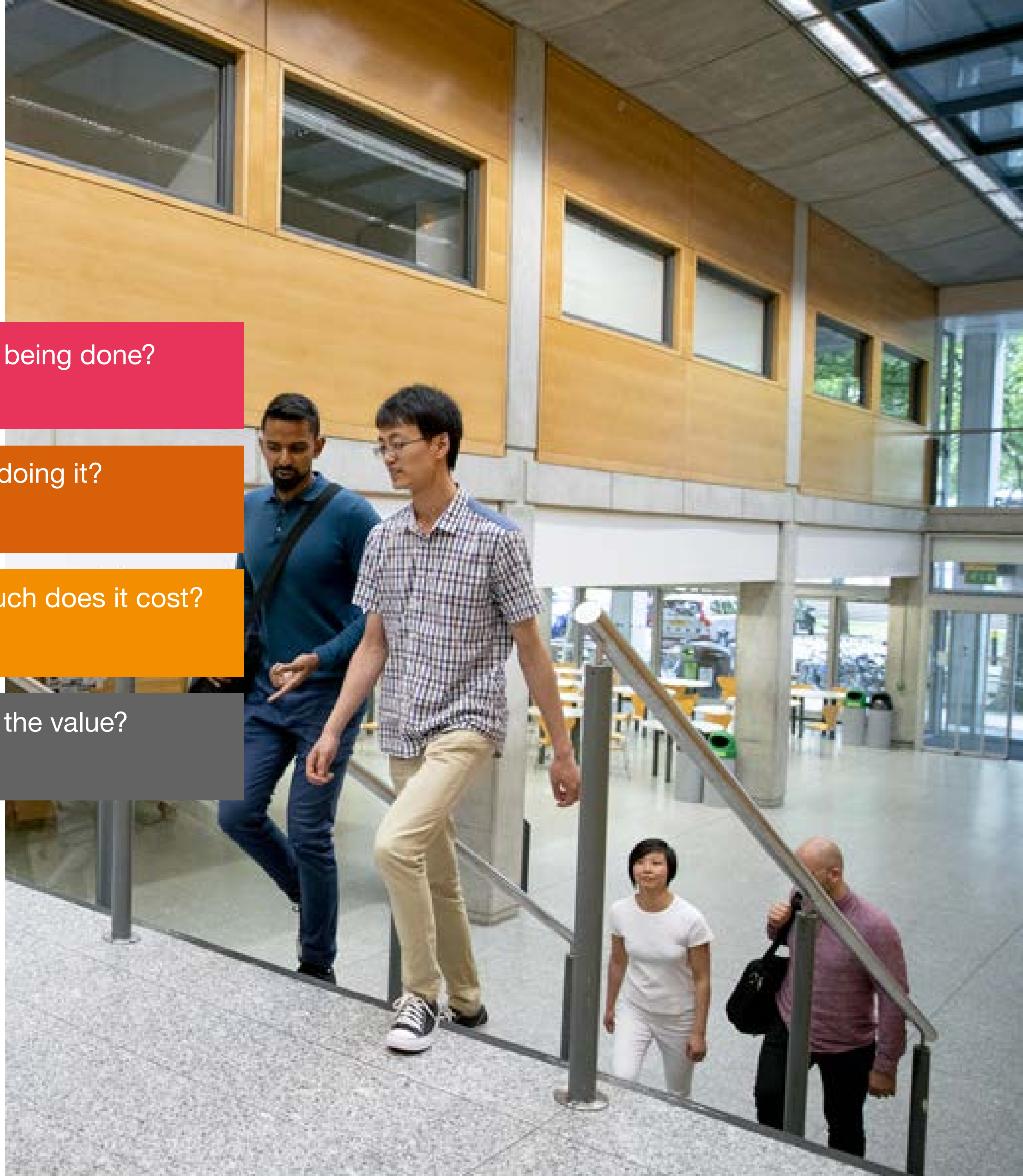
Universities really should expect budget holders to be able to evidence how their costs directly deliver agreed outputs that enable strategic outcomes. If HEIs do not have this evidence, how can they have confidence that strategic priorities will be delivered within budget, and how can they make informed decisions as to where best to invest cost to meet their needs?

What is being done?

Who is doing it?

How much does it cost?

What is the value?



16 – www.hefce.ac.uk/analysis/staff/
17 – www.hesa.ac.uk/data-and-analysis/staff/working-in-he

# The need to align cost to priorities

Many universities do not actually have a transparent organisation-wide view of their costs and whether they are truly aligned to strategic goals. A key reason for this situation is that many HEIs choose to allocate budgets by faculty or department. Senior managers are left to manage costs as they see fit in line with departmental plans.

It is extremely rare for universities to actively challenge the value of the activities being delivered, as most have never been formally detailed, quantified or costed. Even when efficiency interventions take place it is usually the norm for areas to return their savings with the organisation unaware as to whether the right activities have been impacted. Often the only requirement is to remain in budget and/or deliver an arbitrary savings target.

We believe institutions can no longer afford to operate in this way. Instead, a change in emphasis is required to enable more effective control and alignment of costs to strategic priorities.

We have developed eight principles to enable this alignment to take place.

1. **Prioritise services** – evaluate the relative importance of individual services rather than entire departments.
2. **Question past patterns of spending decisions** – encourage more creative conversations about service delivery.
3. **Do important things well** – identify services that offer the highest value and continue to provide funding for them, while reducing service levels, divesting, or potentially eliminating lower value services.
4. **Spend within the university's means** – start with the revenue available, rather than last year's expenditures, as the basis for decision making.
5. **Know the true cost of doing business** – focus on full costs ensures funding decisions are based on the true cost of providing a service.
6. **Provide transparency of organisation priorities** – when budget decisions are based on a well-defined set of priorities, the university's aims are not left open to interpretation.
7. **Provide transparency of service impact** – focus on the results the service produces for achieving organisation priorities.
8. **Demand accountability for results** – demand accountability for the service's budget allocation as well as for staying within spending limits.

These principles are supported by a structured approach (consistent approach, governance and pace) that evidences what individual universities do (i.e., services delivered in terms of inputs, outputs and outcomes) and what they cost. This provides the evidence base for informed cost decision making, supported by strategic prioritisation to derive a balanced budget. In simple terms – align costs to strategy.

This is the level of detail we believe individual HEIs will need to understand to have confidence in their financial security for the future.

Outcome: an organisation-wide view of costs, and real choices to enable the building of a balanced budget aligned to agreed priorities.

Cost reduction methods are targeted and focussed

All service delivery options need to be robustly challenged

Repeatable, enabling ongoing search for efficiencies and savings

# Conclusion

Since 2012-13 most HEIs have continued to grow in response to changing political and economic conditions. Alongside growth came increased levels of cost which have been amassing almost unchecked.

While many HEIs have in the past undertaken cost reduction programmes, culturally they have been more disposed to investment, which explains why sustainable efficiencies often did not materialise.

The increasingly competitive and challenging Higher Education market has now forced some universities to consider drastic measures in an attempt to secure continued financial security. The concern is that these interventions will not guarantee long-term survival as the fundamental issues that caused the cost crisis in the first place often remain.

Furthermore, the value for money agenda is only gathering pace. With a legal obligation placed on the OfS to promote value for money, they have been clear about making this a priority.

Now is the time to seize control of your costs, understand what choices you have and make informed decisions to demonstrate value and move you closer to achieving your strategic goals.

# About us

Working together with our clients across the Education sector as well as in; Local Government, Health, Transport, Home Affairs, Housing, Social Care, Defence and International Development; we look for practical, workable solutions that make a difference in solving the pressing challenges that are being faced every day.

As well as bringing our insight and expertise to this sector, we contribute our thinking and experience to the public policy debate through our Public Sector Research Centre. To join this free online community, go to www.pwc.com/psrc and register today for our research and analysis.

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