

HE Matters

Strategy for Universities

Summer 2018



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HE Matters – Strategy for Universities

Welcome to HE Matters

The term “strategy” can mean different things to different people, and this is as true in universities as it is in the corporate world. However you define strategy, its importance increases dramatically as a market goes through pressure or change, something that certainly applies to the Higher Education landscape at the moment.

In this Summer 2018 issue we look at some of these big strategic challenges that universities are grappling with, some of the ways in which these can be analysed, and the tools that universities can deploy in response. The articles include:

- **The power of choice** discusses the need to make clear strategic choices in respect of the future of each institution.
- **Apprenticeships – challenge or opportunity** looks at the role that the changing apprenticeship landscape is playing as both threat and opportunity for HE institutions.
- **Managing risk in Higher Education** analyses the risk registers of 37 universities.
- **Differentiation through employability** reviews different approaches to improving employability.
- **Investing for the future** outlines some of the issues in raising finance to develop the estate.

- **Aligning cost to strategy** describes our approach for helping universities to best allocate scarce resources to the delivery of strategic priorities.
- **Course correction** discusses some of the measures that universities can take in response to unexpected bad news.

We hope you find this collection useful in considering the opportunities and risks your institution faces. As always, we are interested in any feedback you have on this edition of HE Matters, or ideas for topics you would like to see covered in future editions. Details of how to get in touch with your local Higher Education contact are at the back of this edition.



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The power of choice

The key element of strategy development is in understanding the ecosystem in which an institution sits in order to identify the most critical issues for that institution, and then making choices.

Ian Koxvold discusses the need for clear strategic choices in respect to the future of each institution.



In my experience, when universities ask for help with their strategy, they tend to ask for support in delivering the strategy rather than in either formulating it or testing it. I've worked with a number of HEIs to support them in developing strategies to deliver the key aims of their institutions.

When developing their strategies, these kinds of institution tend to take a deliberative and challenging approach, asking strategic questions like "what's going to happen to demand for our key subject areas?", "what are our competitors doing?", "what level of international student recruitment is realistic and what do we need to achieve this?", "how do students decide to come here or go elsewhere?".

The key element to this sort of strategy development is in understanding the ecosystem in which an institution sits in order to identify the most critical issues for that institution, and then making choices.

It is not surprising that public institutions are less accustomed to asking these types of questions. Historically, there has been a surplus of student demand, and in recent years the £9k undergraduate tuition fee level (averaged up even further by international students) has allowed universities to recruit teaching staff that have been able to devote plenty of time to research.

Each university has its own challenges, and these are derived from a mix of national and local pressures. Universities can make extremely good tactical decisions – to add new courses, to invest in marketing capability, to offer some courses online, to develop new student accommodation.

These typically support the ability of the institution to recruit on a year-to-year basis without fundamentally changing the way in which students think about the brand.

Our experience is that there is a lot of power in these incremental developments, but there is a limit as to the total impact – and that some institutions have reached this point of declining returns. We follow a four-step process that helps us to identify real options for change:

1. **Forming a view of how the landscape is going to change, and how these factors will affect the particular institution.** This should reflect a view of what is happening to the market, and how this will affect you – for example a university with many EU undergraduates will be affected differently by Brexit than one with few. Equally, there will be local factors – if a similar university 30 miles away is significantly investing in its estate, for example.

2. **Synthesising a short description of what the strategic threats are, and what the differentiated positioning or assets in the business are.**

These should be short lists – if there are more than three-to-five priority items to worry about than it will be hard to focus effort and attention enough to make a difference to any of them. If you are describing a unique strength, you should be confident that at least most of your competitors couldn't realistically make the same claim.

3. **Developing a list of fundamental options that might address the threats or play to the institution's strengths.** These should be bold – as a rule of thumb, if it's not a bit frightening it's probably not strategic.



4. **Assessing the impact of each of these alternatives, underpinning the conclusions with research, in order to make a decision.** Of course any decision of strategic significance should be supported by robust research, not only to validate the potential opportunity/measure the risk, but also to identify Plans B/C/D in case of surprising policy change, or a nearby (whether geographically or in the league table) competitor embarking on a conflicting direction. Not to mention – you may decide that your institution’s current market risk profile is better than the execution risk of a fundamental change.

Each of these is important in order to make a strategic plan which is more than just “business as usual”. Real strategic planning is hard, and it is risky – but it may be vital for surviving the level of challenge that may be coming to some institutions over the next few years.

<i>Example key strategic challenges</i>	<i>Example unique strengths</i>	<i>Example key decision</i>
<ul style="list-style-type: none"> • The proliferation of new courses (both at our institution and others) is reducing the class size and increasing delivery cost. • Recruiting outside our traditional segments has led us to a student body that has different needs than we are used to supporting. • As a lower-ranked generalist university, our ability to attract students from outside our region is in decline. • Although we are very successful in research and postgraduate, a growing component of rankings and quality assessment is based on undergraduate outcomes/value-add. • Our reserves are depleting and at current rates our institution will not be viable in three years’ time. 	<ul style="list-style-type: none"> • Within our region, we are the first choice for [c.60%] of the [c.50k and growing] students predicted less than BBB. • Within our region, we have the best links with employers, and our students are their first choice for recruitment. • In each our top 3 subjects we are within the Top 5 institutions for national reputation. • We are the first choice for students coming out of the armed forces. • We have established a reputation and alumni body in [India] which sees us get an unusually strong and sustainable volume of international applications. 	<ul style="list-style-type: none"> • Over a decade we will reduce our provision outside of our core Humanities market, and build on our strength there to become the leading non-Oxbridge provider to national students. • We will embrace the apprenticeship market, elevate the delivery of training to parity with more academic provision, and ask all senior staff to become closely involved in this. • We will look to merge with our two local FE colleges, and take on responsibility for 16-60 education in our region. • Over five years we will invest [£50m] in our student services infrastructure in order to reduce non-teaching staff levels by [c.60%]. • We will stop offering any course that cannot break even on a fully-costed basis for three years in a row, expecting this to reduce revenue by [10%] and cost by [25%].

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Managing risk in Higher Education

Chris Monk analyses the results of our annual benchmarking study of the risk registers of a sample of 37 higher education institutions, highlighting the most significant risks facing the sector and outlining how institutions are responding.

Each year we analyse the risk registers of a sample of 37 higher education institutions, highlighting the most significant risks facing the sector and how institutions are responding.

Figure 1 shows how these institutions think about risk – which risks are serious but unlikely to come about (top-left), which risks are “routine” (likely but not serious, bottom-right) and which risks are genuinely worrying where the likelihood of them coming to pass is high and the potential consequences are severe (top-right).

All of these relate closely to the future financial sustainability of universities, which is a critical issue in straitened times and as many institutions’ reserves are in decline.

Universities play such a pivotal role in society it is in everybody’s interest we have a successful and vibrant higher education sector. With such an uncertain and risky environment it is more important than ever to have effective risk management embedded in to decision making processes. It is no longer good enough to just “tick the box”, institutions need to use risk management as a tool to focus resource and management time to achieve their strategic objectives.

Our benchmarking has revealed the top 3 risks facing the sector in 2018 as:

1. Pensions
2. Government Policy / Political Landscape
3. Student Recruitment

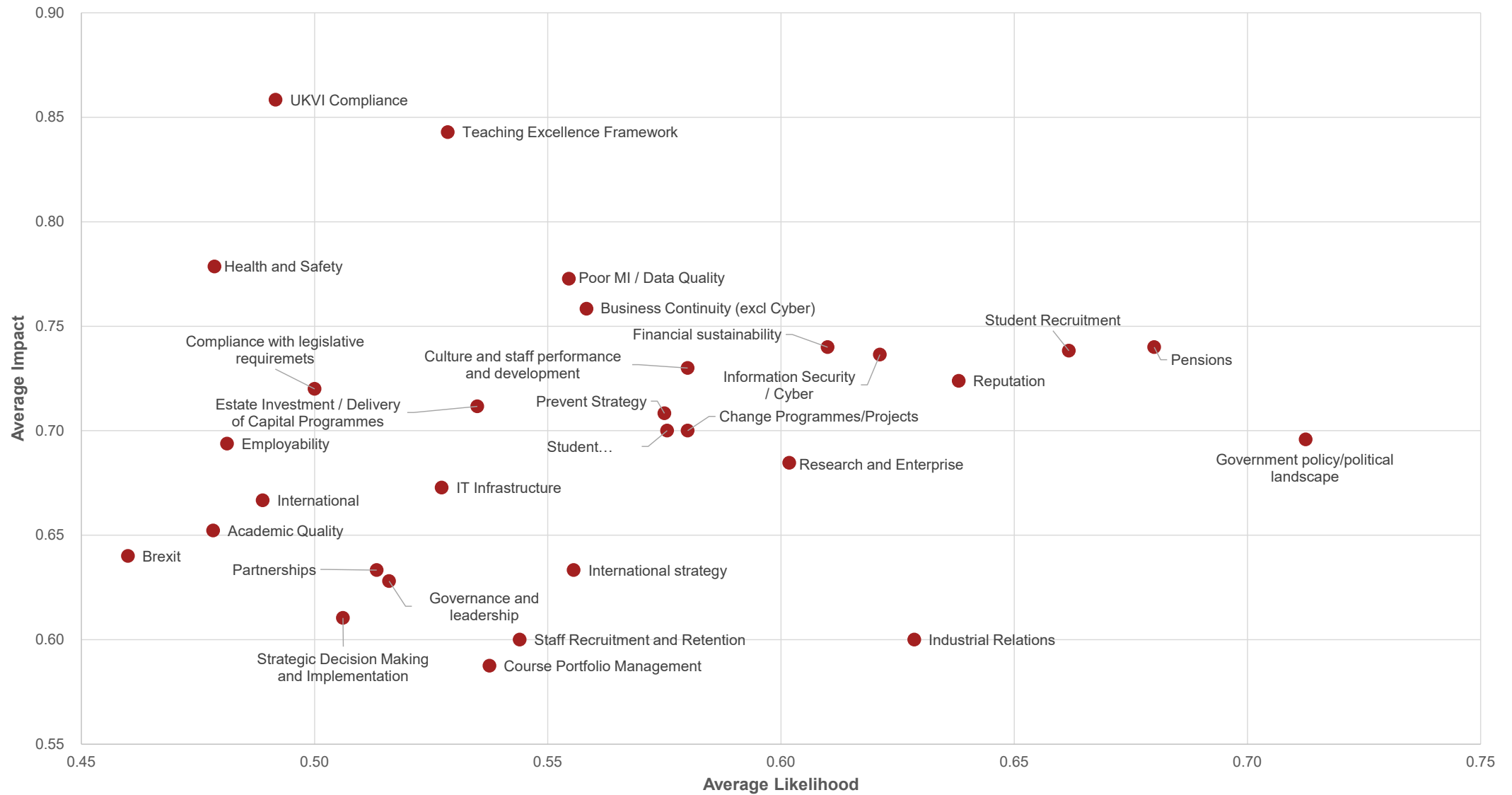
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HE Risk chart



Apprenticeships – challenge or opportunity

For years, the UK has been on “the verge” of the apprenticeship revolution, we have been told that the change is coming and that this time it will be different for the vocational poor relation of the education world. Could this time be different?

Peter Norriss explores how HEIs are responding to the changing landscape.



With higher costs for going to University, many young people are bringing a consumerist approach to education and making decisions based on an increasing number of factors. Apprenticeships have always been a lower cost form of education and this has been seen as synonymous with lower value in the eyes of the majority of society. Once the reserve of the “blue collar” or “less academic”, apprenticeships have never enjoyed parity of esteem with their more academic qualification counterparts.

Let’s be clear, true parity of esteem is still years away and may never be reached, but there is a paradigm shift coming and its happening now. With new qualifications in areas such as cyber security and advanced manufacturing and areas such as law opening their doors, apprenticeships are no longer the preserve of blue collar occupations.

With many large and prestigious organisations now offering high quality apprenticeship routes, young people now face a different set of options than ever before. It is now possible to start a well-paid career at a younger age and avoid a significant debt burden, whilst still opening doors to a high earning career. With a UK average salary of c. £20,000 for graduates, there is no longer a clear monetary return for all degrees and some young people are asking themselves if the debt to reward ratio really stacks up.

In a world of austerity, recession and a feeling of tightening wallets, education is the latest area to see people shopping around for a better deal. Price elasticity is coming to a market near you and it’s perhaps the apprentice route that is offering the best economic return for the savvy shopper.

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Differentiation through Employability

Young people are now, more than ever, looking at University as an investment, which they expect to get an economic return from and which is being scrutinised more than ever.

Peter Norriss sets out three strategic approaches to creating an employability premium for graduates.



There is a question burning in the HE sector right now and it is one which must finally be answered, with the advent of new competition and very different customer behaviour.

Young people are now, more than ever, looking at University as an investment, one which they expect to get an economic return from and one which is being scrutinised more than ever. It is clear that many young people are looking at employability and average wage as key factors in deciding where they want to go in order to study for their degree.

For Universities, there is a need for a clear strategy if they are going to show the return on a person's investment and this strategy has to focus on the employability premium which can be achieved. The question now is, what does an effective strategy look like? There are a number of strategic approaches which will lead to an employability premium for graduates, below we look at the three approaches we think are best suited.

A local focus

By focusing the degree offer on large employers in the locality, it is possible to significantly increase the chances of a young person getting a job in the local area. For large employers, they know that they can recruit in a national and international market and as such it can be hard to hold their attention over the years. A local university has the advantage in that they can work with the employers in their area to really tailor their courses to fit employer demand. There is a clear quid pro quo here in that if employers

want a tailored course which supplies day one ready candidates, they know they must employ people on a regular basis and in numbers significant enough to make the partnership work.

A national focus

A national focus can be hard, especially if it is based on simple sector analysis. By working with 3 or more major national employers, a university can build its offer to become a specialised employer of choice in a particular area. The small number of large employers act as an anchor to sector, providing cutting edge market intelligence and offering advice on course and curriculum refinement. By having a broader base of national employers, it is also possible to offer employment access to students all over the country, increasing prospects and flexibility. The risk of a strategy such as this is that by focusing on too few employers, it leaves a university a hostage to employer choice but by focusing on too many, there is a chance that curriculums are too generic and don't provide that employability premium being sought.

A sectoral focus

Sectoral focus is becoming harder as staying on top of trends, demographics and consumer taste is as much an art as it is science. In order to take a trend based focus, universities must start to think on a 5 – 10 year basis. What markets have an aging workforce? Will that workforce be replaced with people or technology? Can other international markets serve the demand and will immigration policy allow for this? These are all questions which are key to developing courses which will lead to strong employability prospects.

When developing a sectoral focus, the strategy has to be developed around areas of intense skills demand as any course developed in this way will always be more generic and won't benefit from the premium attached to more tailored courses.

There is no doubt that the question of employability is one which universities need to answer. By showing the value of their qualification to someone's employment prospects and demonstrating the return to their salary, universities can show the return on investment that people can expect. Whilst this economic basis may seem crude and even objectionable to some more traditional academics, it is a reality which more and more people are using as a keystone of their decision making process.

Getting the right strategy isn't just important to those taking the qualification, it could very well be key to the survival of the organisation and the long term future of the HE sector.

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Investing for the future

Whether an institution plans to grow, specialise or perhaps consolidate, its estates masterplan is often considered to be a key element in the delivery of the overarching strategy.

Karen Best and Daniel Earle analyse the current trends in borrowing in the sector.



When you delve into the detail of institutions' strategic plans you will be hard pressed to find one that does not refer to the need for long term investment in its estate. Whether an institution plans to grow, specialise or perhaps consolidate, its estates masterplan is often considered to be a key element in the delivery of the overarching strategy.

There are many examples in the sector where the total forecast spend on an institution's long term capital programme runs into the hundreds of millions. For many of these institutions there is a challenge around funding this investment solely from operating surpluses and reserves.

This, combined with the lack of long term capital funding available from the Government or the traditional bank lenders in the sector, has led universities to the capital markets on an unprecedented scale.

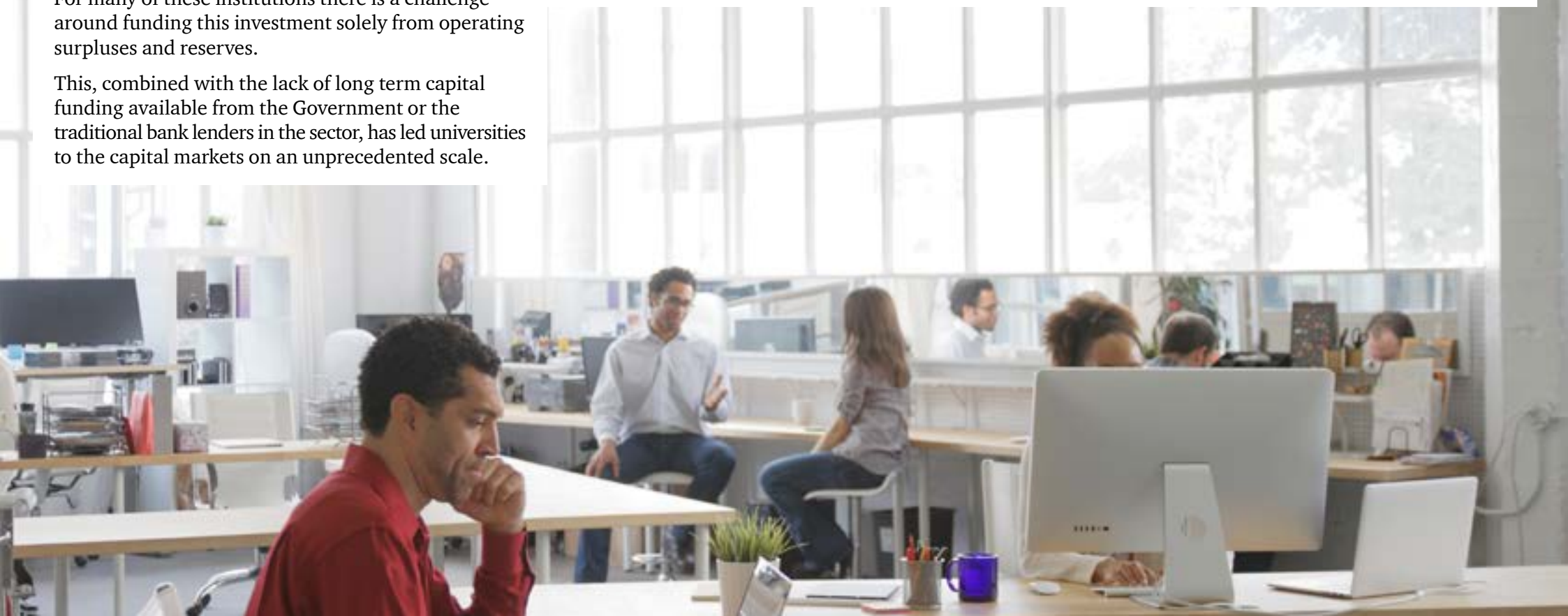
Access to both public markets and private placements offers debt at long tenors and a low cost of capital, driven in part by the historically low interest rate.

What has happened to borrowing in the sector?

Borrowing in the sector has been steadily increasing and according to HEFCE's latest 'Financial health of the higher education sector' report, at the end of July 2017, the sector reported borrowing of £9.9 billion, equivalent to 33.1 per cent of income.

This has increased from 30.7 per cent of income in July 2016, 28.1 per cent in July 2015 and 26.3 per cent in July 2014.

Since July 2017, Universities have continued to secure significant levels of funding. Take for example the University of Oxford, raising a public bond of £750 million in December 2017. Not only is this the largest bond raised by any UK University, but it also has a significantly longer maturity date at 100 years.



Then in March 2018, University of Portsmouth announced that it secured £100m of borrowing through a private placement with two North American institutional investors.

Will this trend in borrowing continue?

It is difficult to see any change to the imperative to raise capital and if anything it surely becomes stronger as universities continue to focus on the student experience in order to win market share in an increasingly competitive domestic and global marketplace. In this context, the quality of the campus, its buildings and the accommodation offering has become one very tangible area of differentiation that will continue to be invested in heavily. In fact, universities might perceive that there is a greater risk attached to 'doing nothing' or 'doing minimum' in relation to its estate given the likelihood it will quickly lose ground to peers.

How sustainable is this trend in borrowing?

Going forward we expect that there will continue to be a high level of scrutiny from investors and credit rating agencies over the operating and financial strength as well as student growth projections of each individual institution.

It is widely accepted that not every institution will be capable of growing student numbers and that will undoubtedly put pressure on lower ranked institutions.

Potential investors and lenders will also be interested in the wider political landscape, at least in the short to medium term of; the current review into student fee levels, assessing the impact on the sector of a change in the UK administration leading to student fees being abolished and of course the ongoing Brexit negotiations.

The recent decision by the OfS not to enforce the ANOC-based financial commitment threshold will offer flexibility and perhaps temptation to institutions that have sufficient financial strength and capacity to leverage further debt. However, there is still a need for permission by institutions considered to be 'at higher risk' or where the OfS wishes to engage with it on the basis of a focused dialogue'. In this case it is unlikely to make any difference to those less financially strong as they will already be under

intense scrutiny from potential investors and may in some cases struggle to raise debt even if permission from the OfS is forthcoming.

What it does suggest is that it is going to become increasingly harder for smaller, less financially strong institutions that do not have a niche or market leading offering to raise money, invest in its estate and therefore meet the growing expectations of its student base.

Whilst the capital market afford an excellent opportunity for the sector to fund growth and generate competitive advantage, time will tell as to whether individual institutions can remain financially viable in the long term. What is clear to see is that institutions must ensure that they fully assess the financial resources required and their ability to secure these finances in order to deliver a sustainable strategy for the organisation.

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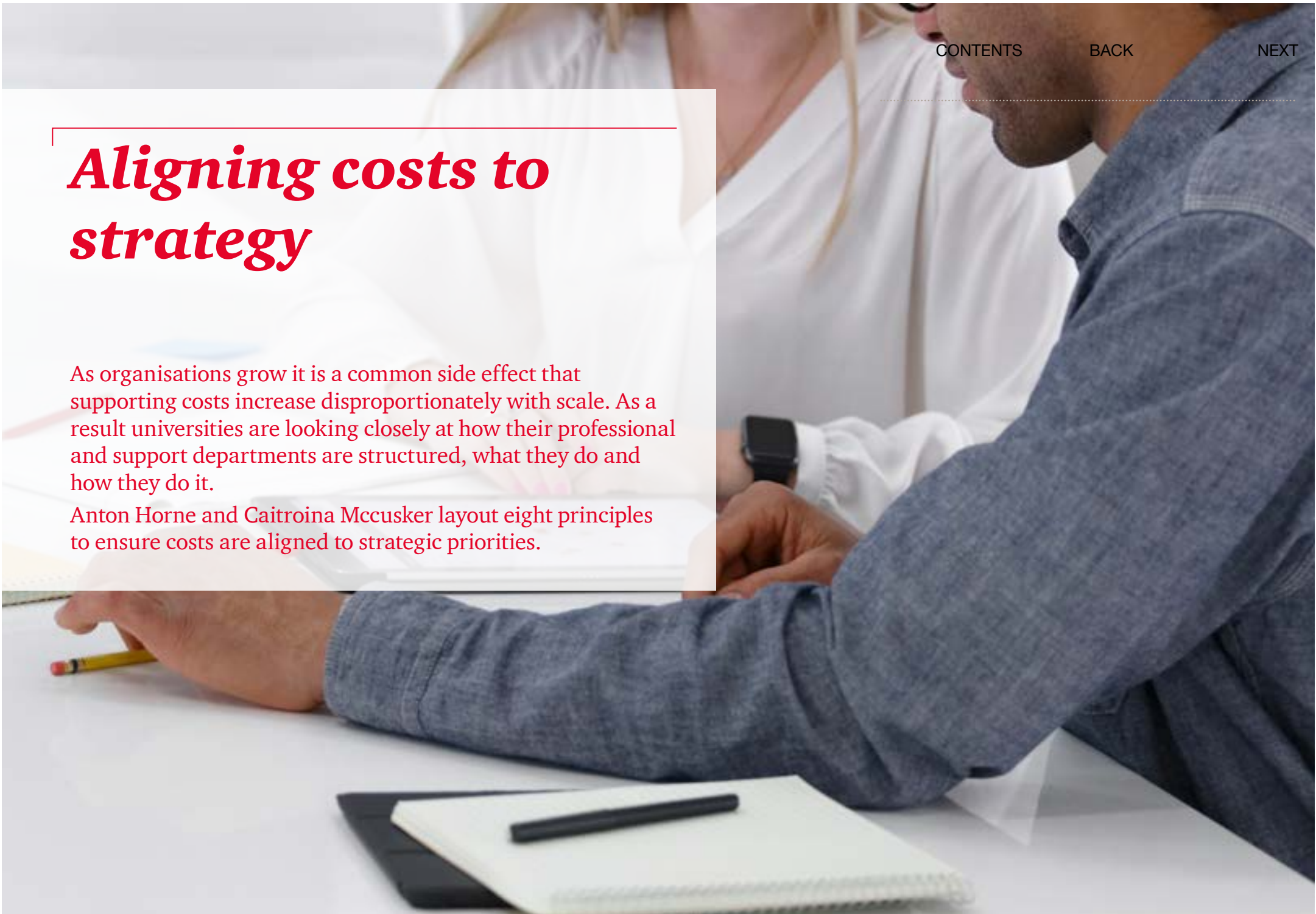
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Aligning costs to strategy

As organisations grow it is a common side effect that supporting costs increase disproportionately with scale. As a result universities are looking closely at how their professional and support departments are structured, what they do and how they do it.

Anton Horne and Caitroina Mccusker layout eight principles to ensure costs are aligned to strategic priorities.



By 2015/16 academic staff numbers (168,000) had been overtaken by professional and support staff across English institutions. As organisations grow it is a common side effect that supporting costs increase disproportionately with scale. As a result universities are looking closely at how their professional and support departments are structured, what they do and how they do it.

Universities need to have a solid understanding of how their support departments operate in order to avoid:

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

This knowledge 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 endure, is the need to create systems and behaviours that will ensure lasting cost reduction.

Universities should expect budget holders and senior support staff to evidence how their costs directly deliver agreed outputs that enable strategic outcomes. This allows HEIs to have confidence that strategic priorities will be delivered within budget and supports them to make informed decisions as to where best to invest cost to meet their needs.

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 department.
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 should be supported by a structured approach (consistent approach, governance and pace) that evidences what each function does (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.

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Course correction

With the UK HE sector facing a number of headwinds, Tim Armstrong considers how HEIs can prepare themselves to cope with the shifting landscape.



As this issue of HE Matters demonstrates the UK HE sector is facing a number of headwinds, many of which appear to be continuing to gather pace rather than subsiding as we move towards the end of the 2017-18 academic year.

Many institutions in the sector are well positioned to cope with the headwinds and will continue to thrive. Some organisations still have significant cash reserves to buffer them in the short-term, others have already successfully developed a differentiated experience that is driving demand, and some who are not delivering on demand forecasts have management teams in place who are taking early remedial action to set a course for calmer water.

However, experience tells us that the macro shifts we are seeing in HE will result in some levels of financial stress and distress in the coming years.

Ongoing financial challenges – an overview

HEFCE's report on the 'Financial health of the higher education sector' for 2016-17 reported that the overall sector surplus fell from over £1.5bn in 2015-16 to just over £1bn 2016-17, with 24 institutions reported deficits in the year as compared to 11 previously. HEFCE expect this trend to continue based upon their consolidation of the sector forecasts through to 2019-20.

The funding requirement of universities who are increasingly looking to differentiate their offerings and give a better student experience has driven an increased need for third party borrowing (to over £10bn in 2017, a 25% rise since 2014).

This trend is forecast to continue as the battle to attract a shrinking student population intensifies over the coming years.

This increased borrowing, or financial gearing, is adding an additional fixed cost to the HE sector I&E account each year, and leaves the sector more susceptible to unforeseen financial shocks. Borrowing as a percentage of income averaged 33.1% in 2016-17 across the whole sector, with the highest levels being seen in low-tariff institutions (40%) who, as a group, are likely to be more greatly exposed to downturns in demand.

In addition to a higher level of financial gearing, HE is also far more highly operationally geared than many other sectors i.e. there are generally a very high level of fixed costs in the business, particularly in the short term.

These means that those institutions that are not able to accurately predict demand and plan their cost base accordingly with some degree of foresight will be left to swallow large losses as they make decisions reactively to historic information.

What do lenders think of the sector?

Whilst there are alternative sources of loan finance, as evidenced by the recent bond raise by Oxford University, the vast majority of lending to HE continues to be provided by the UK high street banks. On the back of the increased leverage in the sector and HEFCE commentary on the financial sustainability, we are starting to see these lenders take a much closer look at HE to understand what is going on from a

macroeconomic perspective and to assess both their existing portfolios of lending and their appetite for continued funding.

We anticipate that this will manifest itself in two ways quite quickly over the coming 12-18 months:

1. Low tariff institutions without a niche offering will find it increasingly hard to raise new or increased borrowing or to refinance current facilities at favourable rates.
2. Banks will begin to take any opportunities afforded to them (e.g. need to amend terms, increase borrowing etc) to renegotiate terms and conditions and revisit pricing of lending to meet the perceived risk in the sector.

Additionally, whilst facing some different issues, the experiences these same UK clearing banks in the Further Education space and the challenges in restructuring these loans remain fresh in the memories of bankers. We expect this to have a consequential impact on pricing and depth of covenant suites in future agreements which we expect to be more akin to corporate arrangements.

What should management teams and governors do?

We anticipate that as the sector's financial position develops over time, there will be increased scrutiny on the actions taken by management and governors in respect of dealing with downturns of financial performance of institutions and decisions to take on additional borrowing.

The role of governors will become increasingly important in 'holding up the mirror' to management teams who are implementing cost reduction plans and borrowing more money/spending reserves to do so.

There are three immediate actions that management teams can take which will stand them in good stead when entering a period of financial uncertainty:

1. We see lots of management teams operating without the quality MI that is needed to make the right decisions at the right time. Therefore we would recommend some investment (often time, not money) in ensuring that the right information is being created and it is robust enough to support key management decisions.
2. Empower leaders in the business to take control of their own financial destiny by providing them with this MI and ensuring it is explained, understood and acted upon.
3. Encourage a culture of continued challenge around expenditure throughout the organisation. This might involve changing the way that budgets are constructed each year, changing approval levels for expenditure, reviewing procurement controls etc.

However, some institutions will still find themselves facing financial distress even having taken the above action and will receive increasing pressure from its stakeholders for a fully worked up and decisive plan to turnaround the institution or plan for a contingency. We work both with the education institutions to draft and agree these types of plans, and also with lenders to assess the robustness of these and consider alternative strategies and expect to see more of this in the coming months and years.

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Students voice

What would you want from the University of Tomorrow?

In the summer of 2017, we took the opportunity to ask our student interns the question “Reflecting on your experience of Higher Education and university, what would you want from the university of tomorrow?” and challenged them to work together to bring their ideas to life.

For more information go to:
www.pwc.co.uk/studentsvoice



Managing risk in Higher Education

Higher Education sector risk profile 2018.

Our annual benchmarking study analyses the risk registers of a sample of 37 higher education institutions, highlights the most significant risks facing the sector and outlines how institutions are responding.

For more information go to:
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Our annual index of economic wellbeing in UK cities and regions.

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A modern industrial strategy to underpin economic success

Four main themes should underpin the government's industrial strategy: developing skills and education; upgrading national infrastructure; supporting investment, innovation and business growth; and ensuring a more regionally balanced economy.

This paper sets out recommendations on a wide range of specific policies and themes in all of these areas, with supporting analysis.

For more information go to:
<https://www.pwc.co.uk/industries/government-public-sector/insights/modern-industrial-strategy-for-economic-success.html>



Align in Higher Education

Financial stability in uncertain times.

While HEIs have proven to be resilient, overcoming many challenges in the past, they now need to take preemptive action to reduce costs and better align them to strategic goals so as to develop a robust financial model for the future.

In this paper we discuss what HEIs need to be doing to ensure financial stability.

For more information go to:
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Global Mobility in Higher Education

What every HEI needs to know if they have employees who spend time working overseas.

A successful global mobility framework will support HEIs with managing any of their employees who spend time working overseas. It is designed to provide a standardised process for managing risk, which is crucial at a time when the global tax and regulatory environment is becoming more complex, which in turn increases the risk of reputational damage.

For more information go to:

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