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Financial sustainability of universities: the OECD/IMHE study and current UK experience

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The OECD/IMHE project
    methodology
    UK/England position
    findings

UK policy initiatives on sustainability

Case study – HE infrastructure in UK

The OECD/IMHE project

Drew on eight national studies

Australia, England, Germany, Ireland, Japan, Netherlands, Sweden, USA.

Two big challenges:

How can governments achieve their education and social/economic goals through higher education institutions? (*not considered here*)

How can institutions protect their long-term academic and financial viability?

The project was about how to achieve both objectives in a sustainable way: not one at the expense of the other.

Report published by OECD 2004

Diverse systems: common problems

The national reports show:

Diversity of HE systems:

- 40 to 4000 institutions
- National, federal, unitary, binary systems
- State-owned to private universities.

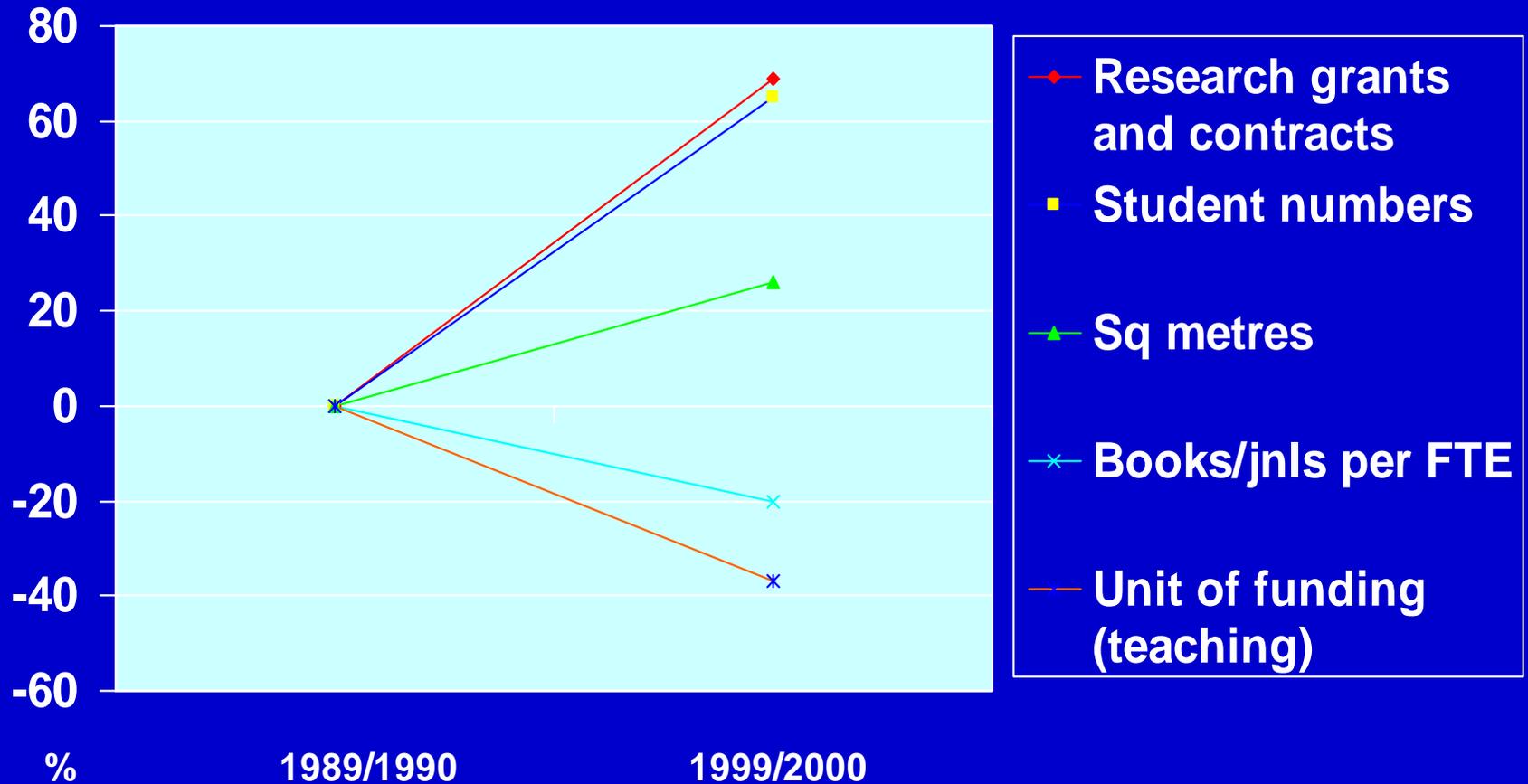But, common pressures in most countries:

- Broader roles expected of HEIs
- State funding declining as a % of HEIs income
- Core funding being replaced by contract or incentive funding
- Market pressures becoming more acute
- Activity growing faster than capital investment
- Accountability to a wider range of stakeholders

potential threats to sustainability.

The position in the UK - 2004

- Research costs exceed income – and incentives to over-trade (RAE rewards quality and volume)

- Teaching broadly funded at cost – but some T costs significantly more than funding (widening participation, strategic subjects etc)

- Institutions in deficit if include full economic costs

- Capital investment backlogs: buildings, equipment. Investment also needed in people and modern working methods

- Much infrastructure is inflexible, and poorly utilised

- Leadership and management an issue – especially in traditional research universities – could additional funding be used sustainably?

- Few HEIs have real finance or capital asset strategies

- Too many institutions (160)?

HEIs did an excellent job, but were a long way from full strategic management for sustainability.

Relative growth in HE activity and funding (UK)

Legend:
- Research grants and contracts
- Student numbers
- Sq metres
- Books/jnls per FTE
- Unit of funding (teaching)

X-axis: 1989/1990, 1999/2000

Y-axis (%): 80, 60, 40, 20, 0, -20, -40, -60

Changing state and higher education relationship

"It was once the role of Governments to provide for the purposes of universities; it is now the role of universities to provide for the purposes of Governments"

Fundamental shift in the relationship between the state and higher education

Sir Howard Newby, (Chief Executive of HEFCE)
Jan 2004

Changing university culture?

Pre-business

- Supply-led
- Reactive, resist change
- Depends on state
- Cash-funded on needs basis
- Administered
- Risk averse

"Business" model

- Market-driven
- Pro-active, strategic
- Autonomous
- Portfolio financing and Investing for the future
- Managed
- Manages a range of risks

What does sustainability mean?

"Working today in a way which does not make it more difficult to do so tomorrow"

For an HEI in the UK, this means:

1. Surpluses: attracting income for its teaching and research and other activity which is sufficient to cover the costs of these activities and to permit the institution to invest for the future (e.g. in physical infrastructure, staff, innovation which enables it to compete at a world level, if this is its mission).

2. Strategies: having the strategies and management capability to manage these long-term investments, and to ensure that the institution generates an adequate financial return.

This is not surviving.

It is about academic vitality and innovativeness as much as buildings and equipment.

It needs some basic management tools (e.g. proper costing systems) and some freedoms (to make surpluses, to borrow, invest, take risks).

Is this achievable in a university?

A business does this, but it is not typical of a public body – or of a "democratic group of scholars".

Is it compatible with an academic culture and a public service ethos?

- Does it threaten academic freedom?
- Will it damage the public service role of institutions?
- Will government be willing to pay full economic cost?
- Will academic staff accept corporate management (and large surpluses)?
- Will unfair competition penalise those HEIs which forego current consumption to invest in infrastructure (perverse incentive)?

Achieving sustainability is a significant long-term culture change for many HEIs. It will need consistent support by government and careful strategic management.

Recent UK policy initiatives

1. **TRAC – standard costing system for all HEIs**

   Introduced as an accountability mechanism, but it shows full economic cost of activity (FEC) and so permits analysis of surplus/deficit, realistic pricing, and portfolio management.

2. **Improved public funding of research**

   From 2005, public funding of research is based on FEC, so a net increase in income for HEIs.

3. **Increased student tuition fees from 2006**

   Extra income for teaching for HEIs, but also a more marketised system.

4. **Capital grants for remedial infrastructure investment (SRIF and L&T capital)**

   Formulaic, and flexible (not project-based) so funds are predictable and HEIs can plan over several years

5. **Monitoring of institutional sustainability**

   Every HEI provides a sustainability framework statement and funding councils derive "trigger metrics" to give early warnings

Will this be enough?

All the above can help institutions to become more sustainable

This is now clear government policy (set out, e.g. in the 10-year Framework for Science and Innovation and required by funding councils)

But there are also factors acting against sustainability:

- Poor financial position of universities and colleges (in England in 2003/04 surplus was £200m on income of £14bn – and this is a deficit on a TRAC full economic cost basis)

- There are still perverse incentives to grow uneconomic activity (RAE is strongest of these)

- There is a culture of lack of priority for long-term problems, and hope that government will fund "if it gets bad enough"

Example: physical infrastructure

J M Consulting study 2001: UK higher education had £34bn of Buildings plus equipment with an investment backlog to bring to suitable condition of £8bn (30% of asset value).

- No HEI could deal with this without ability to make large surpluses
- Backlogs were damaging research productivity, student experience, ability to recruit world-class staff, and efficiency and reputation of UK HEIs
- Strategic asset management was not a recognised priority in universities

Government's first reaction was FEC-based funding of research (tackling the recurrent funding issues) and new capital grants for infrastructure (SRIF, L&T capital:- approx £1bn per year since 2004)

Follow-on study 2006:

- Is there still a problem? (Have we not sorted it?)
- How much more government funding is required?

What has happened since 2001?

Findings from investigation at 12 HEIs:

- A lot of money has been invested – but not all wisely (for sustainability)
- Activity and infrastructure have grown
- The worst backlogs which were preventing appropriate quality T or R have been addressed
- 5 years of ageing buildings and cost inflation
- Improvements in utilisation and efficiency
- Some HEIs now planning much more strategically

The answer is partly money, but also culture change. Universities have a huge asset base. This needs 10-year plans, clear corporate decisions, and secure Finance. Increasingly, the finance will not come from government.
HEIs with big problems may have to rationalise or take hard decisions.

So, the position has improved significantly (but there is still some way to go).

Indicators of sustainability - estates

These are suggestions:- not official UK policy

1. <u>CE/CP ratios</u> (ratio of assets/turnover: - varies by a factor of 3:1 across UK HEIs)

2. <u>Annual spend on infrastructure as % of asset value</u> (is the HEI investing enough for sustainable infrastructure?)

   (this should be measured against a target defined by the governing body – but will normally be in the range 3-6%)

2. <u>Cash generated by operations/(required annual investment)</u>   is the HEI generating enough cash to finance the necessary investment?

3. <u>Condition and fitness of estate</u>:- comes from standard UK statistics (Estates Management System), but should be referenced to the mission and market position of the HEI.

But sustainable estate is a tool to deliver academic benefits: not an end in itself.

Threats to sustainability

1. High CE/CP ratios "too much asset base in relation to income"
2. Management focused on growth, neglect existing infrastructure
3. Low surpluses or low cash generated from operations
4. Debt (past borrowing still being serviced)
5. Excessive backlogs (many old buildings and need to rationalise)
6. Over-ambition – cannot finance own strategy, but unwilling to change it
7. Lack of management control (e.g. very devolved, temporary managers)
8. Dependency culture "up to government to fund us"
9. Inadequate life-cycle costing

And, of course external factors: pay costs, building costs, energy costs all rise faster than funding, competition, government policy etc

A sustainable model - example

This is a traditional research university

1. Knows where it wants to be in world league tables
2. Wants every main discipline to have world-class facilities
3. Has one of the best returns on assets in the UK sector
4. Has a 10-year investment and financing plan
5. All investment decisions are corporate
6. As each building is renewed/upgraded, it is made adaptive (future proof) and academics who work in it are expected to increase their earnings
7. Makes surpluses and invests at 6% of asset value each year
8. Depends on government funding T and R at FEC
9. Will be able to finance its own development
10. But recognises this is a high-cost high-risk strategy and there are many factors which could threaten sustainability

Some new (Teaching) universities are also sustainable.

The balance of public funding

Evolution of financing for investment in infrastructure for teaching and research

Total investment requirement

Recurrent funding at fEC

Public capital grants e.g. SRIF, L&T capital

X

Other sources of capital funding