

May 2005/21
Policy development
Progress report

This document explains the process for reviewing HEFCE's funding method for teaching, and establishes the aims of the new method.

This report is for information

Review of the funding method for teaching

**Aims of the new method and progress
of the review**

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To	Heads of HEFCE-funded higher education institutions Heads of HEFCE-funded further education colleges Heads of universities in Northern Ireland
Of interest to those responsible for	Finance, Planning, Strategy
Reference	2005/21
Publication date	May 2005
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Executive summary

Purpose

1. This document explains the process for reviewing HEFCE's funding method for teaching, and establishes the aims of the new method.

Key points

2. Just over 60 per cent of our funding (£3,826 million in 2004-05) is allocated to support teaching and learning, through a funding formula. It is this formula that we are reviewing. In addition some activities, for example related to particular needs or policy aims, are funded through special initiatives, where there are restrictions on how the money is spent. We are committed to reducing the number of these special initiatives.

3. We periodically review all our funding methods to ensure they remain fit for purpose. It is important that our method for allocating funds for teaching remains relevant and robust, and reflects the HE sector as it is today and as it is likely to develop. A review is particularly appropriate at this time, given the introduction of variable fees in 2006.

4. This document establishes the aims of the new funding method and reports on progress of the review. We intend to consult on the principles and shape of the new method in autumn 2005; and then on the detail of how it will operate, in spring 2006. The

earliest that we can implement any elements of a new method will be for the academic year 2007-08.

5. Underpinning all our deliberations, in terms of what the method should seek to achieve and how it will go about doing so, is the importance of considering the needs of students and the impact of any decisions on the student experience.

6. Our current strategic aims for learning and teaching and widening participation together define the purpose our teaching funding. They are:

- to ensure that all higher education students benefit from a high-quality learning experience fully meeting their needs and the needs of society
- to provide the opportunity of higher education to all those who could benefit from it.

7. The aims of the new method relate to those characteristics of learning and teaching in HE that can be susceptible to influenced by HEFCE funding. We believe that our formula funding method should help to:

- a. Ensure an appropriate capacity of learning and teaching in HE at a sector-wide level.
- b. Ensure and promote a high standard of teaching quality and academic standards.
- c. Enable learning and teaching in HE to respond to the diverse needs and demands of students, business and wider society.
- d. Enable the higher education sector to provide innovative learning and teaching opportunities
- e. Enable the sector to make higher education accessible to all those who could benefit from it.
- f. Enable the higher education sector to make the best use of public money to enhance the student learning experience.

8. We will need to address a number of issues in deciding how the method will operate. These include the relative priority of the aims; the suitability of the formula funding method for achieving them; and to what extent we can or should use the funding method to incentivise certain activities and behaviour by institutions.

Action required

9. No action is required in response to this document. We will continue discussions around these issues with sector representative bodies such as Universities UK, the Standing Conference of Principals and the Association of Colleges, as well as with the sounding board set up to advise HEFCE, and other relevant stakeholders. Further information can be obtained from Chris Taylor, e-mail c.taylor@hefce.ac.uk, tel 0117 931 7264.

The current funding method

10. In 2004-05, we distributed £6 billion in public funds. This money supports four main areas of activity in higher education.

- teaching and learning
- widening participation of under-represented groups
- research
- strengthening links with business and the wider community.

11. Most of the money is distributed as a block grant to higher education institutions (HEIs) or further education colleges (FECs) delivering higher education. Institutions can decide how to spend their block grants, to meet their own priorities. Some activities, for example related to particular needs or policy aims, are funded through special initiatives, where there are restrictions on how the money is spent.

12. We calculate the block grant through formula and non-formula funding methods, and apply different methods to calculate funds for teaching and for research. Just over 60 per cent of our grant is allocated through the main formula funding for teaching. It is this funding method that we are reviewing.

13. Special funding initiatives include the Fund for the Development of Teaching and Learning and the Centres of Excellence in Learning and Teaching. We are committed to reducing the number of these special initiatives, in order to reduce the burden that is associated with them. One aspect of the review is the potential to address specific policy aims through the formula funding method, and the consequences of this for the balance between formula and special funding.

14. In distributing funds, we aim to promote high quality cost-effective teaching, and in doing so to meet the needs of students, employers and the nation.

15. In 1995-96, we conducted a fundamental review of the teaching funding method that had been in place since we were established in 1992. The method that emerged from that review was based on two main principles: that we should fund similar activity at similar rates for all institutions, with variations for explicit and justifiable reasons; and that growth in student numbers should be allocated competitively. The revised method, which was first used to allocate funding for teaching in 1998-99, is still in operation, and is described in HEFCE 2004/23.

16. When the method was launched it had the following aims:

- a. To make the best possible use of public money provided for higher education so as to enhance the learning experience for students.

- b. To recognise and encourage diversity in the provision and delivery of higher education, and in the range of students.
- c. To respond to the interests of employers and the Government.
- d. To promote quality in teaching and learning.

17. We also set out the following features of the method, describing how it would operate:

- a. Openness. The funding method will be clear and public. The data on which allocations are based will be auditable and, wherever possible, public.
- b. Predictability. The method and its parameters will be predictable, so that an institution knows how decisions it might take, and changes in its circumstances, will affect its funding.
- c. Flexibility. The method will be flexible enough to respond to external policy changes, and particularly to developments in the Council's own policies.
- d. Fairness. Differences in funding between institutions will be for good and justifiable reasons.
- e. Efficiency. The funding method will impose as small a burden as possible on institutions, consistent with the principles outlined above.

18. We made some changes to the teaching funding method, which were introduced from 2004-05 (see HEFCE 2004/24). These resulted in some significant shifts in allocations, but they did not involve revisiting the aims, principles or features of the method.

Background to the review of the funding method

19. We periodically review all our funding methods to ensure they remain fit for purpose. There has been much change since 1995 when the last major review of the teaching funding method was carried out, such as in policies to support widening participation. It is important that our method for allocating funds for teaching is still relevant and robust, and that it reflects the HE sector as it is today and as it is likely to develop.

20. A review is particularly appropriate at this time given the introduction of capped variable fees in 2006. The current method is based in part on the principle of providing similar resources for similar activities. This principle is specifically challenged by the possibility of institutions charging anywhere between £0 and £3,000 for fees, instead of the standard regulated fees we have now.

21. We provide similar resources for similar activity by dividing the money available to fund teaching (our grant plus an assumed amount at a sector-wide level for tuition fees) by the total number of full-time equivalent students in the sector and applying weightings for differing subjects and premiums for specific factors. This approach gives a level of equity by ensuring that a similar level of resource is provided for each student, taking account of money from tuition fees, regardless of where they study.

22. Part-time and postgraduate students already have a de-regulated variable fee system. The arrangements we have made to fund them highlight the difficulty in maintaining the principle of providing students on similar courses with similar resources. We deal with these groups in the funding formula by assuming a sector-wide average fee. This is different to full-time undergraduate students, where we assume a fee based on the regulated fee levels. If institutions charge higher fees to part-time or postgraduate students than our assumed fee, then we do not reduce the grant we pay. Equally, we do not provide incentives for institutions not to charge student fees by increasing our funding where actual fee income is less than our assumption. Thus, for part-time and postgraduate students, we are not currently ensuring similar resources for similar activity. Given the extension of variable fees to full-time students, it would not seem possible to maintain this principle.

The review process

23. There are four key elements to our funding method that need to be addressed:

- **purpose** – what the funding is for
- **aims** – what the funding seeks to achieve in order to deliver the purpose
- **principles and features** – how the method will seek to achieve its aims
- **mechanisms** – exactly how we will allocate funds.

24. Our priority in setting the timetable for this review has been the need to provide some stability for the sector in the run-up to variable fees: there will be no substantial changes to the funding method in the first year of variable fees. When we revised the method in 2004-05, we also committed to make no further substantial changes for a further three years (HEFCE 2004/24).

25. The earliest that we can implement any elements of a new method is in the 2007-08 academic year. We intend to consult twice in developing the new method: once on the principles and shape, in autumn 2005; and subsequently on the final detail. Given the fundamental nature of this review, we may possibly require new or different data from HEIs, and this may have an effect on the timetable for implementation. We are fully committed to not burdening institutions unnecessarily, and both the design and implementation of the new method will reflect the need to manage change in order to minimise disruption to institutions.

26. Underpinning all our deliberations, both in terms of what the method should seek to achieve and how it will go about doing so, is the importance of considering students' needs and the impact of any decisions on the student experience.

27. We will need to pay particular attention to how we allocate growth through the new method. For 2006-07 and 2007-08, funding for growth will be made available in two main ways:

- a. For major strategic projects that have either already secured support from the Strategic Development Fund, or where a proposal to the fund is in advanced stages of preparation (strategic growth).
- b. For growth meeting national or regional needs, where proposals are brokered with HEFCE regional teams (managed growth).

28. We will need to consider these arrangements in the light of any new method.

Progress so far

29. In developing this document we have held discussions with representative bodies in the sector including the Association of Colleges (AoC), the Standing Conference of Principals (SCOP) and Universities UK (UUK). We have also consulted with the Department for Education and Skills (DfES), the Department for Employment and Learning Northern Ireland, and the Skills for Business Network. We expect these discussions to continue as the review progresses.

30. We have convened a sounding board to provide advice, as requested from time to time, to HEFCE, its strategic committees and Board to inform the review. The terms of reference and membership are at Annex A.

31. As an initial part of the review, consultants SQW Ltd were appointed in December 2004 to evaluate the current teaching funding method. In doing so they interviewed staff from 28 institutions, along with relevant stakeholders and representative bodies such as DfES, UUK, and the British Universities Finance Directors Group, and held a seminar in March 2005. SQW were, in particular, asked to:

- a. Evaluate the extent to which the current HEFCE teaching funding method has met HEFCE's stated intentions when developing it.
- b. Identify and evaluate the extent to which the current method has produced any unintended and/or undesirable effects on the sector.
- c. Comment on any other issues arising in relation to the operation of the method that may be relevant to the Council's future policy on the method.

32. The final evaluation report is on the web at www.hefce.ac.uk under R&D reports. Its summary conclusions were as follows:

- a. The current formula funding method is an attempt to resolve tensions, and sometimes conflicting objectives, in the system. HEFCE has a limited

statutory scope to act as a planning body, and the process for allocating formula teaching funds therefore allows institutions flexibility in how they spend the grant. This flexibility is restricted in practice, and there is also a tension between seeking to reflect government priorities and giving institutions scope for discretionary actions.

b. Many of the issues which HEIs identified during this study could only be resolved by a much more finely grained formula funding method, which SQW believe would increase the burden on both the sector and the funding council. In addition, more detail in the formula funding method implies less flexibility for institutions to manage their allocations.

c. The overall conclusion is that the current funding method has achieved a good balance of these various tensions and objectives, with two main qualifications. The first is the way in which the funding method has been implemented: specifically, changes in premiums and price groups have on occasion reduced predictability and created difficulties for some HEIs.

d. The second concerns detailed aspects, in particular the levels of the allocation for widening participation, the part-time premium and the treatment of students who do not complete their courses. These were widely thought to be inadequate and/or problematic.

33. The evaluation has helped us to understand the effects of the current method, and highlighted the areas where change may be needed.

34. Although our focus in this document is on what the funding method should seek to achieve, there are a number of areas emerging in parallel to the review that are relevant to how the method will operate. We are particularly interested in the potential benefits of using full economic costing of activities, and in how best to support the provision of flexible learning and teaching.

35. We have therefore commissioned work looking at these two areas. Specifically we are investigating the viability of using a more cost-based approach to our funding method, and the viability of using credits as a measure of the volume of student learning within the funding method. Both studies will examine the practical requirements and implications of any possible approaches. We expect the research to be complete by July, and subsequently to be published. This work will input primarily to the thinking around the first consultation. We will also look at what can be learned from other funding methods such as those used by Welsh and Scottish funding councils, and the Learning and Skills Council.

Aims of the funding method

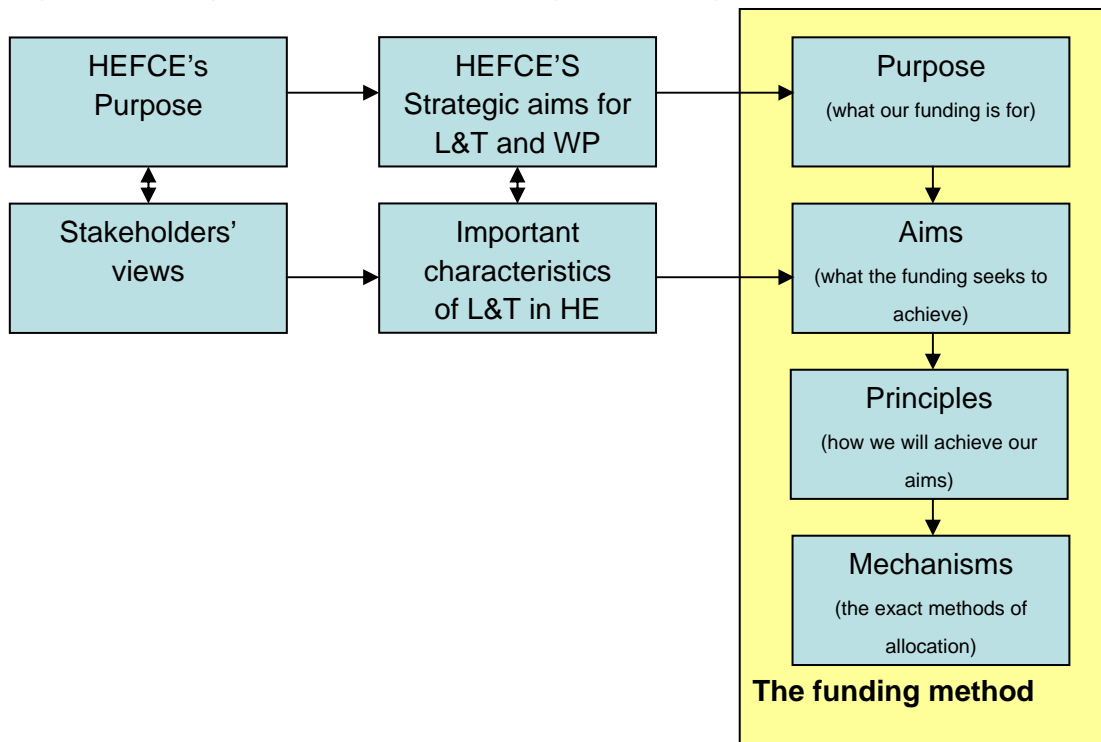
36. The purpose of the funding method for teaching is to allocate funds to support our strategic aims – as they currently stand, and as they develop for 2006-11 and beyond. Figure 1 maps the contributing factors to the aims of a new method.

37. The current strategic aims for learning and teaching and widening participation are:

- to ensure that all higher education students benefit from a high-quality learning experience fully meeting their needs and the needs of society
- to provide the opportunity of higher education to all those who could benefit from it.

38. In achieve these aims, the formula funding method must address a number of characteristics of learning and teaching in HE. It is not, however, the only means of achieving our strategic aims for learning and teaching and widening participation, and so does not necessarily address all aspects of HE that contribute to these aims.

Figure 1 Strategic relationships informing the funding method



39. In parallel with this review, we are developing HEFCE's strategic plan and strategic aims for 2006-11. Much of the discussion will be focused around the future role of the Council in the context of variable fees, the impact that this variability may have on the sector, and to what extent and how HEFCE should intervene to address areas of higher education that could be at risk.

40. However, it is also important for us to establish the views and wishes of those we fund and share public responsibility with, in order to build consensus on the purpose, aims and mechanisms of our funding. We have already begun to ascertain these views: the evaluation, sounding board and discussions with stakeholders are all providing us with useful inputs as the review progresses.

41. The following sections describe the characteristics of learning and teaching in HE that we think the formula funding method should aim to address be that explicitly or in ensuring that the method does not inhibit them. Many of the issues are established ones, so some of these aims are the same as those for the existing method.

Capacity

42. We are concerned with the ability of the sector over time to maintain its teaching capacity, and to maintain quality and standards. Given the introduction of variable fees and the associated market exposure this may be of increasing importance to institutions. There are some specific issues that we can influence that are central to maintaining an appropriate teaching capacity in HE at a sector-wide level. In particular, many stakeholders have said that they want HEFCE to maintain the current unit of resource and to fund institutions in a manner that can be predicted and that provides a level of year-on-year stability.

43. However, we do not see ensuring appropriate capacity as just about stability, predictability and maintaining the status quo. Rather we will need to have regard to the efficiency and dynamism of the sector as a whole, and to maintaining its diversity. We will be particularly concerned with the distinctiveness of institutions, and how we will support minority and strategic subjects and specialist institutions.

44. We will also need to consider the balance between providing predictability and stability, on the one hand, and enabling institutions to be flexible and responsive, on the other; and whether both can be supported concurrently through the funding method.

45. **We believe that our formula funding method should help to ensure an appropriate capacity of learning and teaching in HE at a sector-wide level.**

Quality

46. Major concerns for all stakeholders involved in providing higher education are to maintain high teaching quality (the learning process and student experience) and academic standards (the learning outcomes), and to protect quality and standards from any risk of decline. We also have a statutory responsibility to ensure that the quality of education is assessed in institutions that we fund or are considering funding.

47. This desire to maintain quality is particularly important in the context of greater exposure to market forces with the introduction of variable fees. While the precise

impact of market forces is yet to be seen, there are, alongside the expected improvements due to more funding, potential risks to quality and standards. We have been considering the idea of protecting a 'threshold' of quality and standards through a combination of funding (for example, by maintaining the unit of resource, and the principles through which funding would be allocated) and quality assurance arrangements.

48. How quality and standards will be affected by the possibility of a fully variable fee regime in future is an important consideration for the strategic direction of HEFCE. We have therefore been exploring links between funding and quality, both to protect threshold quality and standards, and the feasibility or desirability of any links beyond this.

49. These issues, when related to what extent we should intervene to maintain and promote quality through the funding method, are complex and potentially contentious. A central question for the future will be whether we can or should move beyond a concept of threshold quality and standards as a pre-requisite for funding, to a concept of quality as a determiner of funding. These are not necessarily issues that need to be resolved for this review, but may be revisited in the light of any further changes to fee arrangements.

50. We are also pursuing, through our viability study of a cost-based approach to funding, the concept of a 'range-finding exercise'. This would identify the overall cost of sustainable teaching across the higher education system, and in individual institutions, that at least maintains current teaching quality and academic standards.

51. **We believe that our formula funding method should help to ensure and promote a high standard of teaching quality and academic standards.**

Responsiveness and flexibility

52. There are many things to which teaching in HE may need to respond. They include student demand in a system where proportionally more funding will follow student choice; and more diverse student needs and preferences as participation continues to increase and widen.

53. Demands on teaching in HE to respond to employer needs have never been greater. With the focus on developing skills relevant to the workplace, and the growth of foundation degrees and lifelong learning, the blurring of the lines between work and learning will continue to provide teaching in HE with new challenges.

54. In determining the extent to which the formula funding method should support or encourage HEIs to respond to these challenges, we will need to consider what conditions enable institutions to respond to demands and whether they are conditions that we can influence through the method. Of particular relevance will be flexible provision as a key way of responding to demand for new and different types of provision,

from a wide range of students. We will need to consider the extent to which teaching funding can enable, support, or indeed hinder this.

55. We believe that our formula funding method should help to enable learning and teaching in HE to respond to the diverse needs and demands of students, business and wider society.

Innovation

56. Many people think that learning and teaching in HE must be innovative to respond to change. Some would argue that innovation is central to the definition of HE-level learning and teaching. Perhaps the most important driver of innovation is the desire to continually improve the student experience and to respond to student needs.

57. To support innovation, we will need to think about our funding as an investment in change and about the requirements for innovation that drives change. We have in the past, for example, provided development funding for new types of provision. This need to invest in requirements that drive change may be increasingly necessary as the introduction of variable fees and the associated uncertainty may drive institutions away from any potentially risky behaviour. We will also need to be aware of the role that market forces may have in driving innovation, as institutions may be compelled to innovate to maintain or improve their position within the market, and whether such forces can be relied on to provide the levels of innovation required.

58. Clearly much of the focus of our special initiatives is on enhancement and innovation. The issues we have raised around the balance between formula and special funding are therefore particularly relevant to this aim.

59. We believe that our formula funding method should help to enable the higher education sector to provide innovative learning and teaching.

Accessibility

60. We believe that participation in higher education equips people to operate productively within the global knowledge economy and to receive social benefits, including better health, lower crime and a more tolerant and inclusive society. We therefore expect the argument for widening participation in HE to continue to be made strongly by both institutions and policy makers over the coming years.

61. We currently allocate funding each year to recognise a proportion of the additional costs that institutions may face in recruiting and supporting students from disadvantaged and non-traditional backgrounds, and students who have disabilities. These funds are not a form of individual student support, they are allocated to institutions.

62. In deciding how and to what extent we should continue to support accessibility, we will need to consider whether these additional costs are adequately reflected in the

formula funding method. We will also need to consider whether the funding method can take into account the possible need to incentivise institutions to recruit more students from disadvantaged backgrounds, especially given rising attainment levels at Level 3 and expected demographic changes increasing the numbers of more 'traditional' students seeking places.

63. We believe that the formula funding method should help to enable the sector to make higher education accessible to all those who could benefit from it.

Use of public money

64. HEFCE grants for learning and teaching are public money. We must therefore ensure that they are used efficiently and effectively not just in terms of accountability but to help enhance the student learning experience. The pursuit of certain characteristics of teaching in HE must therefore be tempered with an awareness of the source of funding that supports them. A central element in supporting the efficient use of funds in the current method is the use of the block grant principle and the funding of outcomes.

65. We have already noted that we are concerned with maintaining a certain level of quality through our funding method, and that we are committed to making the best possible use of public money. The question is whether we can go beyond this with a formula funding method that explicitly considers costs, to enable institutions to make better use of resources.

66. This approach requires us to consider how to define the actual resources required by institutions for particular types of provision, in order to provide benchmarks against which comparisons can be made. A more cost-based approach could assist this, and we are investigating the feasibility of using cost data in the formula funding method. Of major concern will be the benefits of this approach in relation to the burden it could create for institutions. We will also need to consider whether we are concerned with value purely in terms of outcomes or whether we should think in terms of value-added.

67. We believe that our formula funding method should help to enable the higher education sector to make the best use of public money to enhance the student learning experience.

Issues

68. Although we have established the aims, there are many issues to consider in deciding how the method will operate. We cannot address them all here, but they include:

- a. The priority of the aims relative to each other.
- b. The suitability of the formula funding method for addressing them.
- c. The explicit incentivising of activity and changes in behaviour.

Priority

69. Figure 2 summarises the aims for our formula funding method. Some are more regulatory by nature, whereas others (shown shaded) are more enhancement-based.

Figure 2 Aims of the new funding method and their relationships

Quality Ensure and promote a high standard of teaching quality and academic standards	
Responsive and flexible Enable learning and teaching in HE to respond to the diverse needs and demands of students, business and wider society.	Innovative Enable the higher education sector to provide innovative learning and teaching.
Accessible Enable the sector to make higher education accessible to all those who could benefit from it.	Capacity Ensure an appropriate capacity of learning and teaching in HE at a sector-wide level.
Use of public money Enable the higher education sector to make best use of public money to enhance the student learning experience.	

70. The relationships between these aims are not simple. The pursuit of any one aim, and how it is pursued, may impact on the ability to pursue any of the others. We might, for example, wish to beware of seeking innovation with little or no regard to value for money. We will therefore need to consider carefully the relationships between the aims of the funding method and in particular their relative priority, so that the most important aims are not adversely affected by unintended consequences of pursuing other aims.

Formula funding method addressing policy aims

71. We stated earlier (paragraph 12) that our formula funding method is only one way that we allocate funds for teaching. We also highlighted the role of special initiatives in addressing specific policy objectives, many of which share the aims described above, and our commitment to reducing the number of initiatives. This commitment does not mean reducing the overall grant, but rather allocating these funds in an alternative and potentially less burdensome way.

72. We are thus concerned with the suitability of the formula funding method to address specific policy aims, and subsequently with the balance of teaching funding between formula and non-formula methods. We will therefore consider *to what extent* we should address particular policy aims through the formula funding method.

Incentivising

73. We will need to consider whether any of the aims should be explicitly incentivised in the formula funding method. This means going beyond supporting characteristics of learning and teaching by reflecting differential costs – as we do currently in the allocations for widening participation – to providing additional formula-based funding to incentivise particular activity and changes in behaviour. This may be the case in relation to accessibility and widening participation (see paragraph 62), and there may be other aims that we would want to explicitly incentivise.

Further information

74. We intend to continue discussions around these issues with sector representative bodies such as UUK, AoC and SCOP, as well as with the sounding board and other relevant stakeholders. Further information can be obtained from Chris Taylor, e-mail c.taylor@hefce.ac.uk, tel 0117 931 7264.

Annex A Sounding Board for review of the funding method for teaching

Terms of reference

1. The review of the Council's teaching funding method will be overseen by the HEFCE Board, with advice from its strategic committees for Quality Assessment and Learning and Teaching (QALT) and for Widening Participation. The review will be managed by the Council's Executive.

2. The role of the Sounding Board, representing institutions funded by the Council, will be to provide advice, as requested from time to time, to the Council, its Executive, strategic committees and Board, to inform the review. This will include:
 - a. Advice on issues and concerns of the HE sector relevant to the review.

 - b. Advice on the implications for the sector and for the course of the review of major outputs from the review, including the evaluation of the current method, major policy studies and emerging policies, and the principles and details of any new method.

 - c. Advice on any gaps in work undertaken to inform the review, such as in the commissioning of research and/or gathering of further evidence as required.

 - d. Advice regarding the impact of any proposed changes on the sector, including consideration of detailed modelling.

3. Members of the Sounding Board will be appointed for two years in the first instance.

Membership

Professor Peter Scott, Vice-Chancellor, University of Kingston (Chair)

Professor Colin Bundy, Director and Principal, School of Oriental and African Studies

Mr Rowland Foote, Principal and Chief Executive, Bournemouth and Poole College

Professor Graham Henderson, Vice-Chancellor, University of Teesside

Mr John Herman, Assistant Principal, Manchester College of Arts and Technology

Mr David Holmes, Registrar, University of Oxford

Mr Melvyn Keen, Assistant Vice-Chancellor and Director of Middlesex Business Services, Middlesex University

Professor Derek Longhurst, Director, Foundation Degree Forward

Dr Professor Philip Jones, Pro-Vice-Chancellor and Sub-Warden, University of Durham

Mr Russell Mosely, Director of the Centre for Lifelong Learning, University of Warwick

Professor Peter Rubin, Professor of Therapeutics, University of Nottingham

Ms Berenice Smith, Finance and Commercial Director, University of Leeds
Ms Barbara Stephens, kmc international and lay member of the HEFCE Widening
Participation Strategic Committee
Dr Ian Tunbridge, Director of Academic Partnerships, University of Plymouth
Mr Edmund Wigan, Principal, Leeds College of Art and Design
Professor Dianne Willcocks, Principal, York St John College