

March 2010/10

**Policy development
Consultation**

Responses should be made online by
Monday 12 July 2010

This consultation is the first part of the long-term review of teaching funding. It proposes, and seeks comments on, a set of principles and features that we believe will be important to any future funding method for teaching.

Review of the teaching funding method

Consultation on key principles and features

Alternative formats

This publication can be downloaded from the HEFCE web-site (www.hefce.ac.uk) under Publications. For readers without access to the internet, we can also supply it on CD or in large print. For alternative format versions please call 0117 931 7431 or e-mail publications@hefce.ac.uk

© HEFCE 2010

The copyright for this publication is held by the Higher Education Funding Council for England (HEFCE). The material may be copied or reproduced provided that the source is acknowledged and the material, wholly or in part, is not used for commercial gain. Use of the material for commercial gain requires the prior written permission of HEFCE.



Review of the teaching funding method: consultation on key principles and features

To	Heads of HEFCE-funded higher education institutions Heads of HEFCE-funded further education colleges Other relevant stakeholders
Of interest to those responsible for	Finance, Governance
Reference	2010/10
Publication date	March 2010
Enquiries to	Alan Palmer tel 0117 931 7340 e-mail teaching-funding@hefce.ac.uk Samantha Dunbar tel 0117 931 7178 e-mail teaching-funding@hefce.ac.uk

Executive summary

Purpose

1. This consultation is the first part of the long-term review of teaching funding. It proposes a set of principles and features that we believe will be important to any future funding method for teaching. It seeks comments on each of the proposed principles and features.

Key points

2. We propose three key principles that we believe should govern the future funding method for teaching. These proposals have been drafted after taking into account the views of the sector during a series of round-table discussion events that were held between November 2009 and January 2010. The three principles are that our funding method should:

- give institutions the freedom to manage provision in a way that best responds to the needs of students, employers and society
- enable us to incentivise change that is in the public interest
- be compatible with various modes of study, including flexible provision.

3. We also propose three key features that we believe are necessary to ensure that a future funding method for teaching adheres to these principles. We believe the funding method should:

- be as simple and easy to understand as possible
- be responsive and dynamic

- achieve value for money and continue to reflect the impact of income from tuition fees and contributions from employers.

4. A full list of the consultation questions is at Annex A.

Action required

5. Responses should be made by **Monday 12 July 2010** using the online form available at www.hefce.ac.uk alongside this document under Publications.

Introduction

6. In autumn 2009, we began a review of our teaching funding method. This is considering how appropriate the current method is in light of changes to the higher education (HE) sector over recent years. We are aware that the sector may well face some significant challenges in the near future, and we want to be sure that our funding method is able to support the sector in meeting these. Our commitment at the start of the process was to consider all options – ranging from minimal change to the current method, to the adoption of an entirely new approach to funding teaching. We do not expect any fundamental changes to be implemented before 2012-13, although some changes may need to be introduced before then on a phased basis. Moreover, we cannot rule out the requirement to introduce interim measures in the light of future financial settlements.

7. Our intention is that any changes to the teaching funding method introduced as part of the review would themselves be evaluated no later than 2015 to enable improvements to be made, but otherwise we hope that changes would hold as far as possible for at least five years to ensure stability for planning purposes.

8. This consultation seeks views about the principles and features that should underpin a future method. We are not consulting on the operational details of how a future method would work, but will return to this in a second consultation in spring 2011. This two-stage approach will ensure that any changes to the method are built upon principles on which the sector has been consulted before that method is developed.

Why review the teaching funding method?

9. There are a number of reasons why we need to review the teaching funding method:

a. Education patterns have changed since the current method was introduced. Institutions are exploring new patterns of study and new modes of delivery that offer alternatives to the

traditional three-year undergraduate degree, delivered on campus. We wish to consider with the sector whether anything further is needed to support these and future patterns of study.

- b. The current method was designed when the financial and political environments were very different, and when the higher education sector was in a period of growth. Circumstances have changed: public funding for higher education is constrained, and student numbers are being controlled because of limits on student support funding. We need to ensure that our funding method is able to deal with these new challenges.
- c. We need to be able to respond to external factors, including emerging government priorities and the Independent Review of HE Funding and Student Finance. We acknowledge that conducting a review of our teaching funding method during a period of external changes poses challenges. However, we believe it is imperative that we begin a discussion with the sector now if we are to be able to respond rapidly and appropriately to these changes.
- d. Due to incremental additions over the years, our current funding method has become highly complicated. We do not believe that it is sustainable to continue making cumulative changes to the funding method in order to respond to the needs of the sector and the expectations of the Government. Instead, we wish to fundamentally review our teaching funding policy, to arrive at a system that is simpler, easier to understand and well suited to current circumstances.
- e. Working with the sector, we have collected new data. These include the Transparent Approach to Costing for Teaching data on subject-related costs, and the information that we have collected through our survey of unregulated fees. We wish to take these data into account in our funding method.

Our approach

10. In 2010-11, we will allocate around £4.7 billion to 255 institutions¹ to contribute to the costs of teaching approximately 1.1 million students. Given the scale of this endeavour, and the amount of people with a stake in our teaching funding method, we feel it is necessary to adopt an approach which is highly consultative throughout. As well as considering available research and evidence, we wish to draw on and learn from the thoughts of the sector and others throughout the process. To facilitate this, we have planned a two-stage approach. This consultation is the first of two written, sector consultations. It seeks views on the principles and features that should underpin a method for funding learning and teaching. The second consultation, planned for spring 2011, will seek views on the operational and technical elements of the method.

11. As part of this consultative approach, we have already hosted six round-table discussion events. Each one was chaired by a member of our Teaching Funding Advisory Group (which comprises members of the HEFCE Board's Teaching, Quality, and the Student Experience Strategic Advisory Committee). The delegates were chosen to ensure we elicited views from all parts of the higher education sector and beyond. Conversation was focused around key issues that we have become aware of in our various interactions with colleagues

from the sector. These included: the perceived complexity of our funding method; volume measures; the emerging government interest in contestable funding; and the relationship between HEFCE funding and tuition fees. Although we cannot claim to have reflected all of the wide (and sometimes conflicting) range of views expressed at these events, the contributions of delegates were important in shaping the principles and features discussed in paragraphs 31 to 56.

12. We suggested in paragraph 9 that external factors were a consideration in planning this review. Our proposals take into account some of the current political thinking about higher education, but are intended to be sufficiently high-level to be compatible with emerging and future priorities. We have developed these with awareness of the various points of interaction between our teaching funding and the Independent Review of HE Funding and Student Finance. We will reiterate some of the themes in this consultation in our response to its recently published 'Call for Proposals'².

About this consultation

13. The consultation begins with a statement of the purpose of HEFCE's funding for teaching and what it can be expected to achieve in a mixed funding environment. In paragraphs 21 to 30, we discuss how our funding can recognise and support the wider public benefits of higher education, ensure an

Provisional timetable

Winter 2009	Consultation and debate with sector representatives and other stakeholders, through a series of round-table discussions.
Spring 2010	A written consultation on the principles that should underpin our future method. Consultation events to discuss proposals.
Summer/autumn 2010	Analysis of consultation responses and development of proposals or options for the funding of learning and teaching.
Spring 2011	A written consultation on proposals or options for the method.
Autumn 2011	Announcement of decisions taken by the HEFCE Board about the future method.
March 2012	Provisional grant announcement for 2012-13 to institutions, using the new method.

¹ For more information see www.hefce.ac.uk under Finance & assurance/Grant announcement.

² Available at <http://hereview.independent.gov.uk/hereview/2010/03/reviews-call-for-proposals-launched>

appropriate level of investment in higher education and address policy objectives. We wish to seek your views on whether this conceptualisation is correct.

14. The next part of the consultation focuses on three principles that we believe should underpin our teaching funding method. We also discuss three features that will be important in the design of any future funding method to ensure that it adheres to those principles. These sections have been developed taking into account the round-table discussions referred to in paragraph 11. We discuss each principle in turn and seek your views on each one. We are not implying that they necessarily follow a hierarchical order. We wish to seek your views on these and any other wider issues, and so invite you to suggest additional and/or alternative principles and features.

15. There has been a great deal of discussion recently about how, in a time of constrained public funding, organisations charged by Government with the responsibility for allocating that funding might be able to secure changes that help to achieve policy priorities. We believe that this area of debate – which is closely related to the issue of contestable funding – is particularly significant to the HE sector, since it could lead to a different relationship between institutional investment and policy direction. In the final section of the consultation, we seek your views on this.

16. This consultation is not a discussion of the operational mechanics of calculating funding for learning and teaching. We believe that this long-term review of teaching funding should be built on a set of coherent principles from which the technical detail can then flow. We discuss some important features of the future funding method, but the more detailed assumptions and calculations behind the mechanics of the funding method (such as: the tolerance band; price group weightings and other weighting factors; targeted allocations; and funding to support widening participation, equivalent and lower qualifications, and strategically important and vulnerable subjects) are not directly part of this consultation. We expect to give the sector the

opportunity to discuss these aspects of the teaching funding method in the consultation planned for spring 2011.

17. Throughout this consultation, it is important to recognise the limits of what the teaching funding method can achieve. The method does not, for example, affect the total amount of public funding available to higher education – that is determined by Government. Also, while the teaching funding method plays an important part in supporting the sector's delivery of high-quality provision to students, it is not the only factor. Robust and comparable public information and a rigorous and transparent quality assurance system are equally important.

18. We plan to hold consultation events in June 2010 which will give us the opportunity to explain these proposals in more depth and to listen to sector opinion. Details of these events will be available on our web-site, www.hefce.ac.uk under Learning & teaching, in due course.

Further information

19. This consultation assumes some knowledge of our current teaching funding method. Further information is available in 'Funding higher education in England: How HEFCE allocates its funds' (HEFCE 2008/33)³. Information about recent changes to our teaching funding method and its features is also available at www.hefce.ac.uk under Learning & teaching/Funding.

20. If you have any queries on this consultation process please e-mail teaching-funding@hefce.ac.uk.

The purpose of HEFCE funding for teaching

21. Teaching in higher education is jointly funded from the public purse and from income from tuition fees (which itself receives a level of public subsidy). We are also working with higher education institutions (HEIs) to increase the level of funding from employers. Since the introduction of variable fees in 2006, the balance between public funding and income from tuition fees has shifted, and income from tuition fees, from home and EU-

³ All HEFCE publications are available at www.hefce.ac.uk under Publications.

domiciled students, presently amounts to around 18 per cent of the total funds available for higher education⁴. A change in the fee regulations, or a reduction in public funds, would lead to further shifts in the balance between income from tuition fees and public funding.

22. The majority of public funding for teaching is provided through HEFCE grant. It still represents a substantial proportion of overall funding for teaching and plays an indispensable role. We consider it is helpful to articulate the purpose of our funding. In paragraphs 23 to 30 we set out reasoning as to why public funding for teaching is indispensable, and remains so even in the context of discussions of increased income from tuition fees. This provides important background to the proposals that follow; we want to be sure that our teaching funding method enables our funding to deliver its purpose.

Supporting the wider public benefits of higher education

23. As was recognised by the Dearing Report in 1997, higher education teaching should be funded by the various parties that benefit from it. It would be hard to precisely quantify these benefits, and they will vary in each case. In general terms, one of the key beneficiaries is the student, who tends to earn higher wages on graduation, as well as non-financial benefits. Another beneficiary is the employer, who profits from the skills of graduates. But there are also benefits of higher education that accrue to society or the public in general.

24. Graduates bring levels of knowledge and skills that contribute to the economy. Many graduates go on to work in the public sector – for instance, as teachers and health professionals – contributing benefits to society as a whole. Harder still to measure, but equally important, is the impact of higher education upon the nature of society. For instance, research suggests that graduates are more likely to be involved in community and voluntary activities, and to have an egalitarian attitude towards gender and race⁵. Higher education

teaching also has a role in promoting cultural development, including arts, music and literature. We provide funding for teaching to recognise and support these wider public benefits, which cannot be linked to an individual student or employer.

Ensuring an appropriate level of investment in higher education

25. As one of the main beneficiaries of higher education teaching, students should therefore meet some of its costs. However, their willingness and ability to invest in higher education will be limited. Potential students may underestimate the financial benefits of an HE qualification. Even if students do fully appreciate these benefits, they will typically lack the financial power to reflect this in their investment; few banks, for instance, would be willing to lend a potential student the funds necessary to meet the full costs of a medical degree, despite the eventual financial returns to the student. A further complication is that the benefits of higher education to a student are not uniform, but depend upon a number of factors, making it difficult for the student to assess the eventual benefit of their experience of higher education.

26. These points suggest that contributions from students alone would always leave higher education significantly under-funded. To some extent, this could be addressed through providing better information to students (and banks) about the benefits of an HE qualification. However, some public funding is also needed. We work with the Government to implement a two-pronged approach to this. The present cap on fees for full-time undergraduate students ensures that the costs borne by the student are kept relatively low. Public funding is provided, primarily through HEFCE's teaching grant, when we calculate the costs of teaching to be greater than the amount that institutions can raise through tuition fees. Our funding is particularly important to support the teaching of high-cost subjects, because tuition fees meet a lower proportion of their costs.

⁴ Source: HESA finance record, Table 1 and 6a (2008-09 figures).

⁵ 'The wider benefits of higher education: Report by the Institute of Education, University of London, sponsored by the HEFCE and the Smith Institute' (HEFCE 01/46).

27. Employers, who also benefit from higher education, invest in it in various ways: for example through co-funding, funding workforce development, and through offering sandwich placements to students. But again, there is likely to remain a gap between their level of investment, and the benefits they gain from a supply of trained graduates, which implies the need for public funding. This is partly because employers cannot be certain of recouping their investment, because the portability of an HE qualification allows employees to move easily between employers. A related point is that public funding is required to support the general skills associated with an undergraduate degree – skills in areas such as reasoning and communication. These skills are necessary for a flexible and efficient labour market, but could be under-valued if HE teaching was overly reliant on funding from individual employers.

Addressing policy objectives

28. Public funding for teaching is also important to achieve specific policy objectives related to the public interest. These are typically agreed between HEFCE and the Government. Often these policy objectives aim to compensate for market failures. For instance, if the system is producing insufficient science graduates to meet the needs of employers and the economy, we may work with the Government to channel more funding towards science subjects with a view to increasing provision. Additional funding for teaching is not always necessary to address market failures. Some will correct themselves over time. Sometimes, though, an injection of funding (often together with demand-raising initiatives) is the most effective way of bringing about a policy objective, particularly when rapid change is required.

29. Some policy objectives will be motivated by considerations of equity, as well as economic reasoning. A policy commitment shared by HEFCE and the Government is to widen the participation of students currently under-represented in higher education. There are economic justifications for this: increased participation in HE is necessary to

meet rising skill needs and maintain global competitiveness. Moreover the policy objective is important because we believe that in any fair higher education system, everyone with the potential to benefit from HE should have the opportunity to do so, whatever their background or circumstances.

30. Another policy objective, which we support through funding, is to secure appropriate quality and standards in learning and teaching. Our ‘Policy for addressing unsatisfactory quality in institutions’ (HEFCE 2009/31) enables us to withdraw funding from unsatisfactory provision.

Consultation question 1

Do you broadly agree with our statement of the purpose of HEFCE’s funding for teaching?

Proposed principles of teaching funding

31. In paragraphs 21 to 30 we have explained the main reasons why HEFCE funding for teaching is important. Two reasons provide a rationale for providing a public contribution to the overall funds for teaching, but they do not determine how this funding should be used. A third suggests that some public funding will need to be more precisely targeted to achieve particular objectives. These approaches to allocating funding are reflected in the proposed principles and features described below, although we do not intend to imply that there is a one-to-one relation between purposes, principles and features. Rather, we believe that it will be the interaction between the principles and features that creates a funding method that best enables us to fulfil the purposes we describe in paragraphs 21 to 30.

Principle 1: Our funding method should give institutions the freedom to manage provision in a way that best responds to the needs of students, employers and society

32. Our funding for teaching forms part of the block grant to institutions⁶ which, within some broad parameters, can be used to support their own

⁶ The block grant comprises funding allocated for teaching, research and the Higher Education Innovation Fund.

priorities. This approach is successful because institutions are often best at engaging with students and responding to their needs. Through giving institutions the discretion to decide how to use a large proportion of their funding, we enable them to deliver HEFCE's strategic aims – such as providing a high-quality learning and teaching experience – far more effectively than we would through a more interventionist strategy. Through a strong understanding of the needs of students, institutions are able to develop graduates who meet employer expectations and contribute to society.

33. We believe that the block grant approach will remain part of any future funding method for teaching. We do not expect institutions to simply mirror HEFCE's teaching funding model in their internal resource allocations. Rather, each institution should allocate resources in a way that reflects its own costs and priorities, which will vary between institutions and may or may not be similar to our allocation model. In our teaching funding method, we cannot hope to reflect the exact costs incurred by particular subjects, or forms of teaching. Our aim is a method of calculating funding that reflects averages and that thereby provides a broadly appropriate level of grant for each institution.

34. Within a block grant, it is possible to influence institutions through targeted funding streams. We draw a distinction between **removing disincentives** and **providing incentives** through the funding model. In funding terms, we remove the disincentive for engaging in a certain form of behaviour by recognising its additional costs. We would incentivise a form of behaviour by offering funding that exceeds the additional costs. In theory, through removing disincentives we allow institutions to pursue their natural missions, whereas through adding incentives, institutions are encouraged to venture into new territory. (In practice, the distinction between the two approaches will blur, because in a tight financial climate any additional funding may be perceived as an incentive).

35. We propose that our core funding for teaching be allocated in a way that reflects some of the costs of teaching. By applying a cost-based approach to the funding from HEFCE, we would remove

disincentives for venturing into higher-cost areas, and would therefore help institutions to respond to the needs of students and employers. The costs that we may recognise in our future funding method include subject-based costs, the costs of particular modes of study (including flexible provision) and the costs of recruiting and teaching particular types of student. We could not hope to, and would not wish to, reflect all the differential costs of teaching in our funding method. There are some costs that it would not be appropriate for HEFCE to recognise, while others could be taken account of only through making the funding method unhelpfully complicated, or burdensome to operate. As discussed in paragraphs 54 to 56 below, our funding method will also recognise that institutions use funding from a number of sources, including tuition fees, to meet their costs.

36. We believe that a cost-based approach as described above minimises the effect that HEFCE's core funding will have on institutions' behaviour. This respects their freedom to manage their provision. We can do this because we know that institutions share our broad aims for higher education teaching and are committed to the delivery of public benefits. This is an important part of their status as charitable organisations. We will not usually use levers within core funding when we wish to promote particular policy objectives. The primary vehicle for promoting such objectives will be a separate funding margin, which sits outside the core. The role of this 'strategic margin' is described in more detail in paragraphs 37 to 41 below.

Consultation question 2

Do you broadly agree that our funding method should give institutions the freedom to manage provision in a way that best responds to the needs of students, employers and society?

Principle 2: Our funding method should enable us to incentivise change which is in the public interest

37. As noted above, we will sometimes need to use our funding method to bring about specific changes that are in the public interest. This may reflect

policy objectives determined by the Government or identified by HEFCE. Policy objectives that we have supported through our funding in recent years include: widening participation; employer engagement; strategically important and vulnerable subjects; and flexible learning. Often these are priorities that institutions are already committed to and have been successful in delivering – but sometimes additional funding is needed as a catalyst and support for change.

38. We wish to create more effective ways to bring about change. We propose to do this through a strategic margin that is specifically designated for this purpose. Funding through the strategic margin will be intended to incentivise or reward certain activities, for example through introducing a funding premium or through the award of student numbers. The strategic margin will sit outside of core funding, and as such we do not expect it to be about recognising recurrent costs of teaching – it may be more appropriate for such established costs to be funded through the core.

39. In our current method, we promote policy objectives through the targeted allocations. However, there would be a number of differences between the current operation of targeted allocations and the strategic margin. One difference is that the funding allocated through the margin will typically be short-term and highly fluid. In providing additional funding to support a particular activity, we would not typically see ourselves entering into a long-term funding commitment; funds will quickly be recycled as policy objectives are met and new ones take their place. The strategic margin will be our principal mechanism for promoting change through the funding method, and will operate in tandem with other approaches (for example performance indicators and conditions of grant).

40. Another difference is that we do not expect that all institutions will wish to engage with all aspects of the strategic margin. Depending on the policy priorities, some institutions will be better placed than others to respond effectively. Some will choose to focus on delivering one or two policy objectives that accord with their particular

specialisms. Others may prefer not to divert attention from their core missions, and so take strategic decisions not to support the delivery of particular policy priorities. Institutions would be able to create their own funding package, by selecting streams from the strategic margin to add to the core.

41. We would expect that a minority of our total recurrent teaching funding would be dedicated to promoting change. As described above, the majority of our teaching funding will be allocated via a core that does not in general aim to influence institutions' behaviour. It will be important to us as part of the second consultation to seek views on how much grant should be used to bring about change without substantially diminishing institutional autonomy.

Consultation question 3

Do you broadly agree that our funding method should enable us to incentivise change which is in the public interest?

Consultation question 4

Do you broadly agree that we should achieve this through a 'strategic margin'?

Principle 3: Our funding method will be compatible with various modes of study, including flexible provision

42. From the round-table discussions, it is clear that many in the sector believe that our current funding method is more compatible with the traditional model of the full-time undergraduate who completes a degree within three years. This is, to some extent, appropriate; measured in terms of full-time equivalence, 62 per cent of student activity relates to full-time students who are under 21 on entry, and aiming for a first degree⁷. It is clear that for the majority of students, studying for a degree within three years remains the most popular option, but this could change in future. Another issue raised in the round-table discussions was the distinction between part-time and full-time study, which some

⁷ HEFCE analysis of the HESA Student Record 2008-09.

delegates felt to be obsolete. Although we acknowledge this issue, the extent to which the distinction between part-time and full-time study remains depends on other factors, one being the outcomes of the Independent Review of HE Funding and Student Finance.

43. We are aware that for many students full-time study is not necessarily the best option. Some students want to study part-time, or to take a break from study midway through a course. Some wish to study in the workplace, or through distance learning. Other options include accelerated two-year honours degrees and intensive part-time degrees that can be completed in four years. We have supported institutions that wish to develop such innovative approaches through our flexible learning pathfinders.

44. It is important to us that the provision offered by institutions is driven by the needs of the student, rather than by our funding method. Through this review, we will work to ensure that our funding method is compatible with varied modes of study, including flexible learning. As a step towards this, we will consider different approaches to measuring volume, including credit-based funding. A credit-based approach would make it simpler to take into account the costs of teaching students who change their study intentions during the year. It might also offer new options for funding intensive provision, such as two-year honours degrees. Depending on the views we receive on this principle, we would come back to the operational issues in the consultation planned for spring 2011.

45. We wish to support flexible provision primarily because we believe that it meets the needs of students. However, we are also aware that many of the benefits for the student associated with higher education come from completing their course and achieving a qualification. We believe that institutions have a responsibility to support this, particularly given the substantial contribution that students make in the form of tuition fees. A priority will be to ensure that our funding method strikes an appropriate balance between enabling flexibility of provision and encouraging retention of students.

Consultation question 5

Do you broadly agree that our funding method should be compatible with various modes of study, including flexible provision?

Features of a future funding method

46. We propose that any future funding method that we introduce will adhere to the principles outlined in paragraphs 31 to 45. We also believe that this future funding method will need to display the following key features if it is to support those principles.

Feature 1: The funding method will be as simple and easy to understand as possible

47. The current funding method has become very complicated. This is because of the numerous additions that have been made to the method since it was introduced in 1998-99. Some of these additions have addressed government policy priorities. Others, such as the flexible study method, have been introduced partly in response to concerns raised by the sector. Each of these additions has been individually necessary – but the cumulative effect is a funding method that is complex to operate.

48. Because of this complexity, institutions sometimes find it hard to anticipate how they will be affected by changes in funding – something which is particularly important in the present financial climate. In addition, some institutions report a disproportionate increase in the administrative effort involved in returning accurate student number data. A further problem is that the complexity of the method can make it difficult for us to explain (for instance, to the Government) the role played by each of the funding streams that we provide. It is important that we can explain, to those with an interest in how higher education teaching is funded, the purpose of this funding and why we believe that it will achieve particular objectives.

49. Our teaching funding method is designed to allocate a substantial amount of funding to a highly diverse sector. As such, it will always involve some

complexity. But we wish to ensure that this complexity is kept at a reasonable level. To achieve this, we propose to recognise differential costs only when they are relevant and likely to make a significant difference to funding at the institutional level. We also believe that we should recognise the limits to what the funding method can achieve in terms of influencing institutions' activities (and by implication, changing students' and employers' behaviour) and achieving policy objectives. Some changes may be achieved through regulation or through providing better information; others may be left to the workings of the market. When we do wish to bring about change through funding, we will aim first to do this through the strategic margin, as described elsewhere, thus preserving the simplicity of the core.

50. A simple funding method cannot reflect all the different costs at each institution. We appreciate that some institutions have different approaches to teaching, or to outreach, or to maintaining their teaching facilities. But we would not aim to reflect these in the method because this would make our method unworkably complex and probably inequitable. Our intention is to create a funding method that produces an overall level of teaching grant that is fair and broadly appropriate for each institution – not to reflect the costs associated with each activity at an institutional level.

Consultation question 6

Do you broadly agree that our funding method should be as simple and easy to understand as possible?

Feature 2: The funding method will be responsive and dynamic

51. Providing funding to institutions through a block grant allows individual institutions to respond to changes in demand from students and employers, for instance by changing the programmes that they offer, or providing new modes of study, and delivers a degree of predictability. But sometimes demand shifts between institutions too – over time, some institutions become more popular, while others may struggle to recruit. We might term this 'market

dynamism', because it arises spontaneously from the functioning of the market (including the activities and choices of institutions, students and employers) rather than being created by HEFCE or government policy objectives.

52. One of our approaches to recognising these shifts has been to award additional student numbers to successful institutions. However, in a period of restrained funding and efficiency savings, we need to consider new ways of redistributing funding to respond to successful institutional recruitment patterns. In addition, the market may not fully be able to adjust to a time of declining resource, tighter student numbers and changing priorities. We therefore may need to use the funding method to promote dynamism.

53. The tolerance band is an important part of the current funding method. It allows some dynamism in student numbers, because institutions can change their behaviour as long as they remain within their contract range. However, this is not reflected by changes in funding unless an institution's recruitment places it out of its contract range. This is something that many delegates at the round-table events found controversial, and wished to debate further. As we consider the details of the method from 2012-13, a key area for debate will be the advantages and disadvantages of the tolerance band. We will also consider other ways in which we might facilitate the flow of funding for student numbers between institutions.

54. In the current financial climate, we cannot guarantee complete stability. Neither do we think that this would be desirable. We also appreciate, however, that the needs of the student are not best served through a volatile funding regime. Few institutions would be able to focus on delivering high-quality learning and teaching while responding to large, unpredictable changes in HEFCE grant. We wish to ensure that institutions can manage change successfully, including being able to anticipate the effect that their behaviour has upon funding.

Consultation question 7

Do you broadly agree that our funding method should be responsive and dynamic?

Feature 3: The funding method will achieve value for money and continue to reflect the impact of income from tuition fees and contributions from employers

55. Higher education teaching in England is mainly funded through tuition fees and public funding (with contributions from employers increasingly playing a role). As already noted in paragraph 21, tuition fees from home and EU-domiciled students amount to around 18 per cent of the total income for higher education. By comparison, our teaching grant amounts to around 30 per cent of the total⁸. Neither public funding, through HEFCE grant, nor student fees alone would be sufficient to support a strong sector – both are required to make up the complete package of funding for teaching.

56. Because of the different costs of teaching different subjects, the impact of tuition fees has always varied. Higher-cost subjects, such as the sciences, stood to benefit less from the introduction of variable fees in 2005-06. This is because the maximum fee, originally set at £3,000, makes a greater relative contribution towards the costs of teaching lower-cost subjects. Following the outcomes of the Independent Review of HE Funding and Student Finance, it may be the case that we come to see greater variability in fees, both at the institutional and the subject level. If this happens, we will need to consider the overall impact on funding for subjects and institutions.

57. In order to use our grant as effectively and efficiently as possible, we believe that we must take account of income from other sources, particularly tuition fees, when we distribute our teaching grant. This is necessary to sustain a full range of provision, and remove potential distortions to the market. It is also an important part of how we achieve value for money: it reduces the risk of over-funding provision that is well placed to benefit from income from

other sources. We already take into account income from fees through sector-wide fee assumptions. A minimal step would be to ensure that these are updated (something that has not been done following the introduction of variable fees). We may also need to consider whether a more finely grained approach to income from fees is necessary in the future, although these discussions will depend upon the outcomes of the Independent Review of HE Funding and Student Finance.

Consultation question 8

Do you broadly agree that, to achieve value for money, our funding method should continue to reflect the impact of income from tuition fees and contributions from employers?

Consultation question 9

Do you consider that any other principles or features should be fundamental to our teaching funding method?

Mechanisms for securing dynamism and change

58. As discussed in this document, we will sometimes need to use our funding for teaching to bring about change. This change may be related to very general policy objectives, such as improving retention, or it might be aimed at something more specific, such as increasing recruitment to a particular subject area. In paragraphs 37 to 41, we propose that the strategic margin will be the primary vehicle for achieving change.

59. Prior to our second consultation, we wish to ask the sector, in very general terms, about the mechanisms that they believe will be most effective in bringing about change. We would be particularly interested in hearing of any unintended consequences that might be associated with the options we have identified. This information will help us plan the next stage of consultation, and will be particularly useful in our conversations with the Government.

⁸ Based on 2008-09 financial statements from higher education institutions as part of their annual accountability submissions.

60. We have identified the following possible mechanisms for promoting dynamism and change:

- a. Allocating student numbers. We could support a particular policy priority through allocating student numbers to institutions that can demonstrate their ability to engage with this policy. Given that growth in higher education is currently very restricted, these would largely be numbers recycled from elsewhere in the system. These numbers would be closely monitored, and may be recycled as policy objectives are met and new ones take their place.
- b. Rewarding action that best achieves our policy priorities through additional funding. For instance, we might encourage continued sustainability in a particular subject area through providing an additional percentage of funding for each student already studying that subject. We might also choose to reward quality provision. When providing such rewards, we would expect any additional funding to be provided on a time-limited basis, and to be withdrawn once the policy objective has been achieved. We see this as a way of recognising change that has already occurred: a retrospective measure.
- c. Incentivising change through additional funding. We might make a policy objective known, and define what an institution would need to do in order to receive funds from the strategic margin. For instance, we might encourage institutions to increase the level of employer engagement in order to access additional funding. As with option b above, we would expect such funding to be provided on a time-limited basis. The difference between this option and option b is that it rewards institutions that change their behaviour, rather than institutions that are already delivering in a particular policy area. We see this as a way of recognising the potential of change yet to occur: a prospective measure.
- d. Discouraging action that is not compatible with policy objectives, or is of a lower priority, by reducing funding. If we wish to support a particular policy priority, we could reduce or

remove funding for behaviour that does not address this priority. For instance, if we wished to encourage a shift away from three-year degrees towards more flexible types of provision, we could reduce the funding associated with three-year degrees. This approach could be used in combination with any of options a, b and c above: we might, for instance, recycle funding withdrawn through this route as new student numbers, or through a policy premium.

Consultation question 10

What are the advantages/disadvantages associated with each of the options in paragraph 60? Are there other effective alternatives?

Annex A

Consultation questions

Responses should be made online by **Monday 12 July 2010** using the electronic response form, which can be accessed on the HEFCE web-site alongside this document at www.hefce.ac.uk under Publications.

Consultation question 1

Do you broadly agree with our statement of the purpose of HEFCE's funding for teaching?

Yes/No/Don't know

Add any further comments below

Consultation question 2

Do you broadly agree that our funding method should give institutions the freedom to manage provision in a way that best responds to the needs of students, employers and society?

Yes/No/Don't know

Add any further comments below

Consultation question 3

Do you broadly agree that our funding method should enable us to incentivise change which is in the public interest?

Yes/No/Don't know

Add any further comments below

Consultation question 4

Do you broadly agree that we should achieve this through a 'strategic margin'?

Yes/No/Don't know

Add any further comments below

Consultation question 5

Do you broadly agree that our funding method should be compatible with various modes of study, including flexible provision?

Yes/No/Don't know

Add any further comments below

Consultation question 6

Do you broadly agree that our funding method should be as simple and easy to understand as possible?

Yes/No/Don't know

Add any further comments below

Consultation question 7

Do you broadly agree that our funding method should be responsive and dynamic?

Yes/No/Don't know

Give reasons for your answer.

Consultation question 8

Do you broadly agree that, to achieve value for money, our funding method should continue to reflect the impact of income from tuition fees and contributions from employers?

Yes/No/Don't know

Add any further comments below

Consultation question 9

Do you consider that any other principles or features should be fundamental to our teaching funding method?

Consultation question 10

What are the advantages/disadvantages associated with each of the options in paragraph 60? Are there other effective alternatives?

**Higher Education Funding Council for England
Northavon House
Coldharbour Lane
BRISTOL
BS16 1QD**

**tel 0117 931 7317
fax 0117 931 7203
www.hefce.ac.uk**