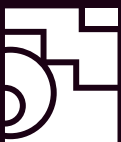




Adapting business models in a changing environment



Universities UK



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This report has been prepared by EKOS on behalf of Universities UK.

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Preface

This report presents an analysis of the diversity of income streams in UK higher education institutions (HEIs) at a time when the sector is facing considerable uncertainty. The research was conducted over a six-week period from March to April 2010 and, as such, it predated the establishment of the new Coalition Government in the UK. In the period since, both the Government's Emergency Budget of June 2010 and subsequent announcements have introduced a series of measures with important implications for higher education (HE) in the UK.

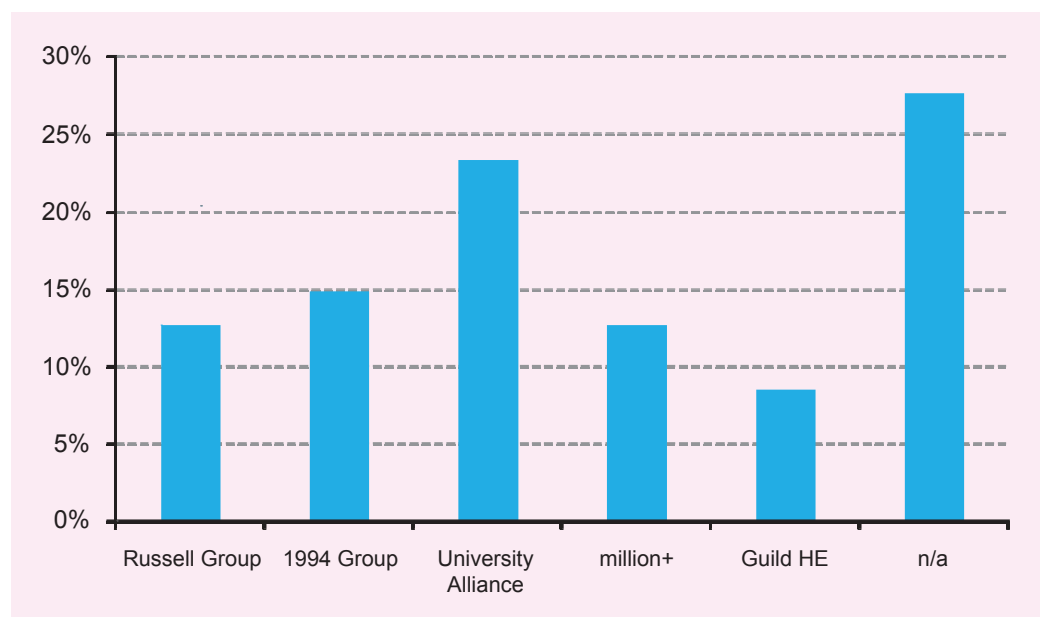
With Lord Browne's *Independent review of higher education funding and student finance* due to report in the autumn, it is inevitable that there will be substantial changes across the HE sector. This report is intended to highlight some of the issues to be considered as the sector plans for the future. It is, however, important that it is read with its timing in mind. It is possible that the recent announcements by the new Government would elicit different responses if the research were to be repeated now.

This notwithstanding, the report offers both an analysis of trends in HE income over time as well as a snapshot of the views of the sector at a time of great challenge and uncertainty.

1. Introduction

- 1.1 HE is rightly regarded as an essential component of national economic competitiveness and as a crucial part of the social fabric of the nation. The UK's universities offer teaching and research excellence across a wide range of academic and vocational disciplines, and contribute in excess of £59 billion each year to the UK economy.¹
- 1.2 HE is now coming under growing financial pressure. Despite a decade of increasing public funding, the economic recession and its impact on public finances are starting to adversely affect the HE sector. In response, Universities UK launched a two-stage research exercise to examine the role and impact of HE in a recession.
- 1.3 The first phase of this research is now complete, and provided an assessment of the ways in which UK universities can and do contribute to economic recovery. The second phase is focused on the impact of the recession on universities themselves.
- 1.4 This report is concerned with institutional diversity of income, and draws data and information from three main sources:
- review and analysis of data on institutional funding²
 - one-to-one interviews with university vice-chancellors
 - an online survey of university finance directors
- 1.5 In total, 27 vice-chancellors contributed to the study, and 25 institutions provided a response to the online survey of finance directors (the full list of responding institutions can be found in Appendix A). In total, 48 different institutions contributed to the research. The sample of respondent institutions included a reasonable spread across mission groups, as shown in Figure 1.1.

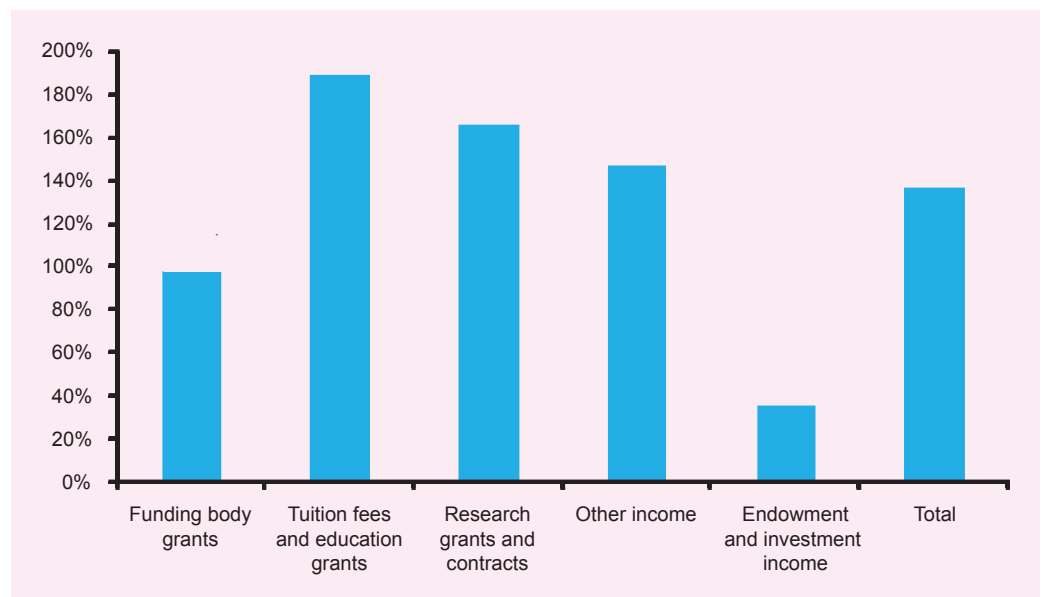
Figure 1.1: Respondent institutions by mission group (%)



2. Context

2.1 After a period of underinvestment, HE funding in the UK has been increasing for over a decade. Since 1995/96, grants from funding bodies have risen by 90 per cent in absolute terms, with tuition fees growing by almost 150 per cent. Research funding has also seen strong and steady growth, and universities have been successful in securing more income from other sources such as international student recruitment, and endowments and investments.

Figure 2.1: UK universities percentage change in income 1995/96–2008/09 (nominal values)



Source: Higher Education Statistics Agency (HESA) Resources for Higher Education Institutions

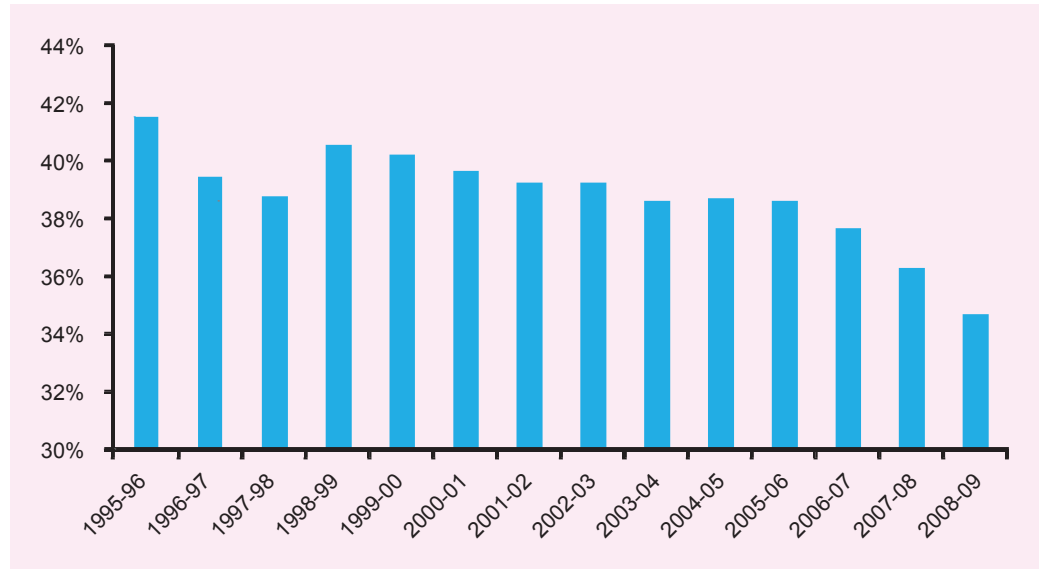
2.2 Increasing income must also be seen in the context of the very rapid expansion in student numbers. In 1999, there were 334,594 accepted applicants to UK universities. Ten years later in 2009 there were 481,854 – an increase of 44 per cent. Total student numbers have also increased from 906,480 in 1999/2000 to 1,108,685 in 2007/08, an increase of 22 per cent.³

2.3 There has also been an increasing emphasis on the wider role that universities play in economic and social development, placing escalating demands on institutions to demonstrate their contribution in areas such as widening access, producing and exploiting commercially relevant research, and encouraging public engagement.

2.4 This expansion has combined with growing staff employment costs (for instance, pay and pensions) and increased borrowing across the sector to limit the extent to which universities have been able to accumulate surpluses. It is also worth noting that even with increased grant income, funding per student is still lower than its 1989 level.

2.5 Between 1995/96 and 2008/09 (the period for which data were available), universities have consistently sought to diversify their income streams and reduce their reliance on grant income. Funding body grants now account for 35 per cent of all income to the sector, compared to 41 per cent in 1995/96 (Figure 2.2).

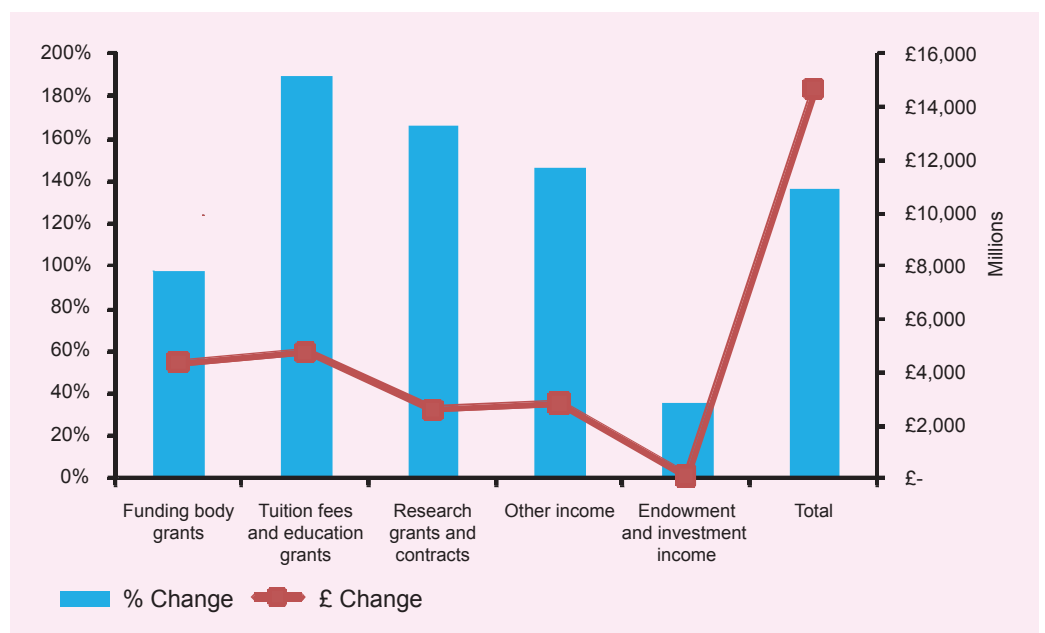
Figure 2.2: Funding body grants as a proportion of total sector income 1995/96–2008/09 (nominal values)



Source: HESA Resources for Higher Education Institutions data

2.6 All sources of income have increased substantially over the period (Figure 2.3). Tuition fees and education grants showed the strongest rise, both proportionately and in absolute terms, and while funding body grants showed the second lowest proportional increase this was the second strongest area of growth in real terms, behind tuition fees. Income from endowments and investments, while frequently identified as opportunities for income diversification, have actually been worth far less in cash terms to most universities.

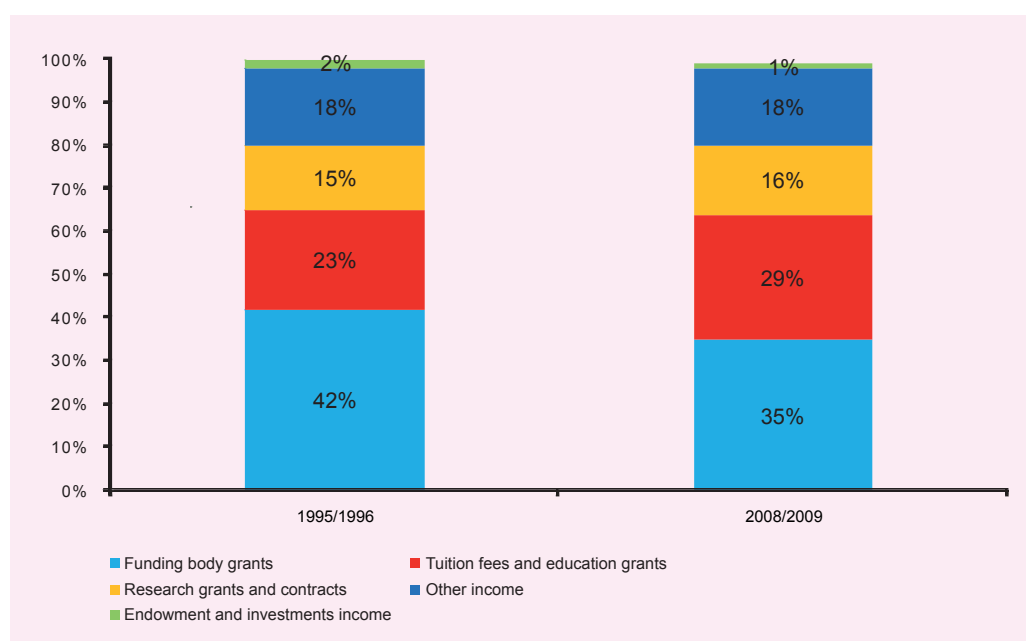
Figure 2.3: Actual and percentage change in different income streams 1995/96–2008/09



Source: HESA Resources for Higher Education Institutions data

2.7 The main shift in the balance of institutional income over the period has been an increase in the share accounted for by tuition fees (from 23 per cent to 29 per cent). Changes in the other categories have been marginal with the exception of the increase in research grants and income in Scotland (from 15 per cent to 22 per cent of total sector income) and in Northern Ireland (from 10 per cent to 16 per cent) (Figure 2.4).

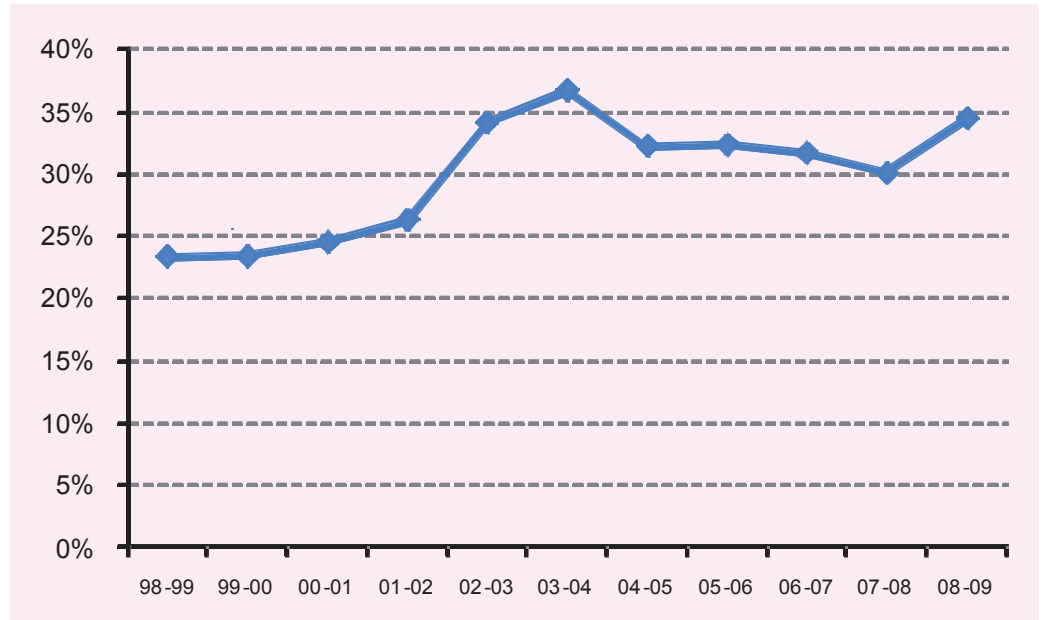
Figure 2.4: Balance of institutional income 1995/96 and 2008/09



Source: HESA Resources for Higher Education Institutions data

2.8 The increase in (teaching) grants and tuition fees has been driven by increasing student numbers but there is limited potential for further growth in this area in England, at least for full-time UK and EU students, and any further expansion is likely to be on an unfunded basis. However, most universities have sought to increase their income from overseas students, and the evidence suggests that this has been successful. The proportion of the sector's tuition fee income accounted for by non-EU students has risen from 23 per cent in 1998/99 to 34 per cent in 2008/09, a total actual increase of £1.87 billion (Figure 2.5).

Figure 2.5: Proportion of tuition fee income from non-EU students 1998/99–2008/09



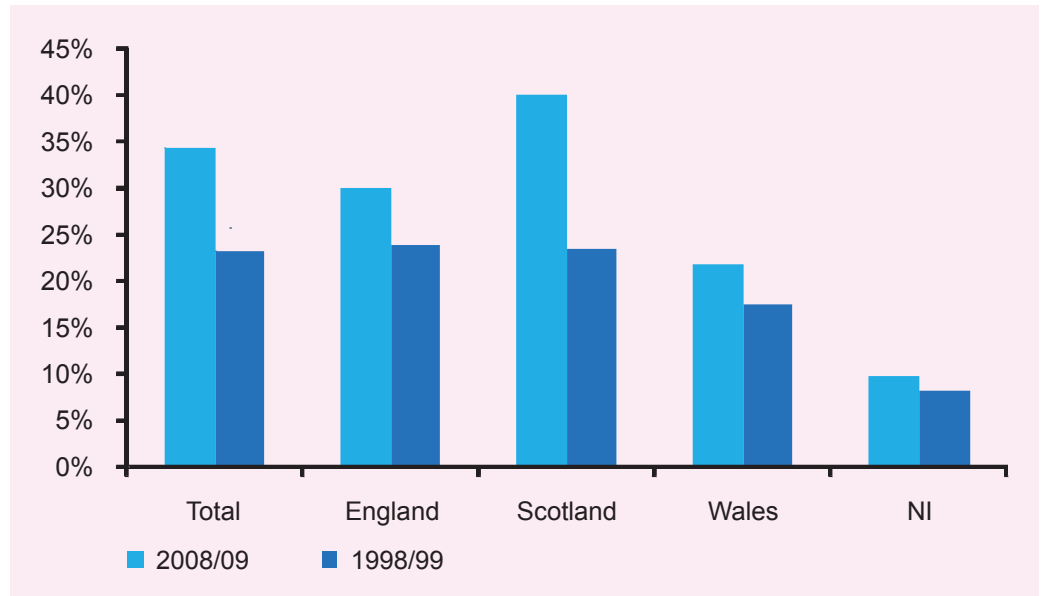
Source: HESA Resources for Higher Education Institutions data

▼
Students at Goldsmiths,
University of London.

2.9 This increase has been particularly marked in Scotland, where income from international (non-EU) students now accounts for 40 per cent of tuition fee income (2008/09 data).



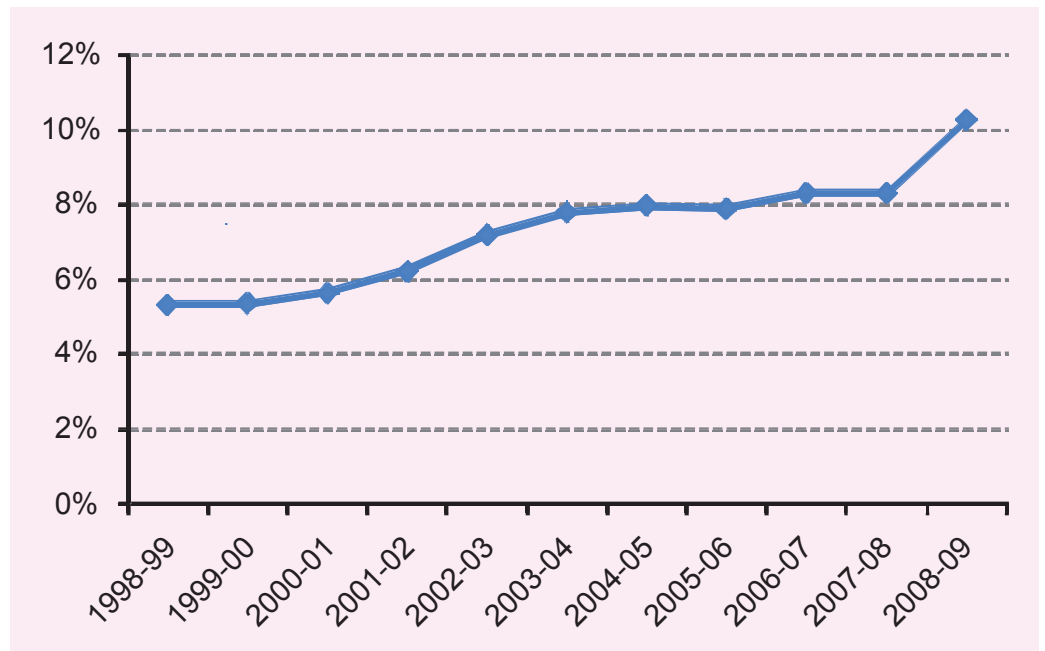
Figure 2.6: Proportion of tuition fee income from non-EU students by nation 1998/99 and 2008/09



Source: HESA Resources for Higher Education Institutions data

2.10 Income from international recruitment has also increased as a proportion of total sector income (Figure 2.7). In 1998/99, fees from overseas students accounted for five per cent. By 2008/09 this had doubled to 10 per cent.

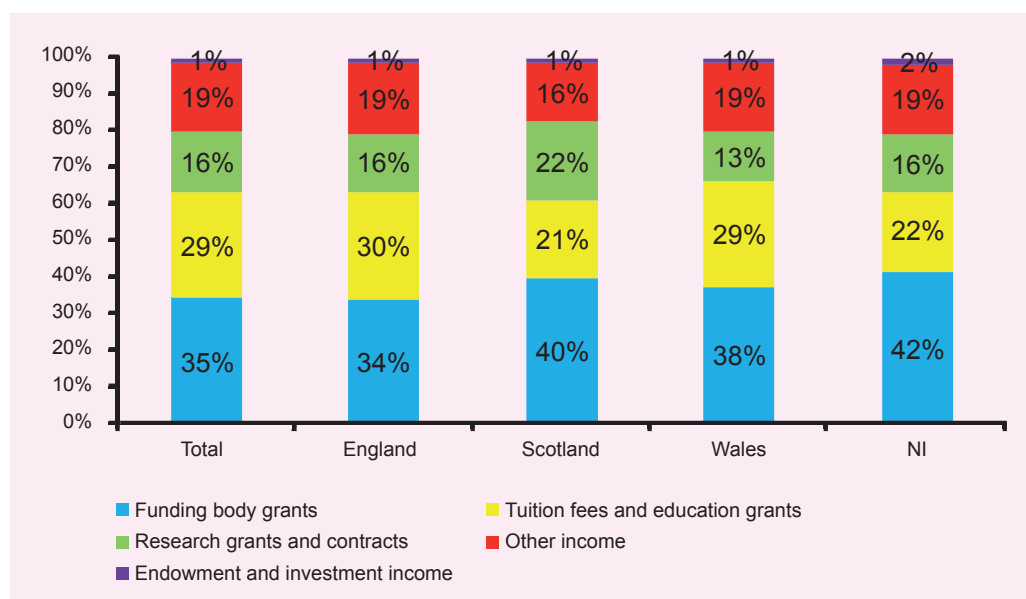
Figure 2.7: Proportion of total income accounted for by non-EU student fees 1998/99 to 2008/09



Source: HESA Resources for Higher Education Institutions data

- 2.11 Recent data from the higher education – business and community interaction (HE-BCI) survey shows an overall increase of 5.5 per cent in universities' income from knowledge exchange activities between 2007/08 and 2008/09 (this includes a range of activities such as collaborative and contract research, commercialisation through licensing, intellectual property exploitation and spin outs, delivery of professional training, consultancy and services as well as activities intended to have social benefits).⁴ That this has occurred during a period of deep recession suggests universities have been responding well to challenges and opportunities.
- 2.12 The HE-BCI data shows collaborative research income from commercial partners has fallen slightly, as expected in a recession, with stronger growth from non-commercial sources, a pattern that may reverse as the private sector recovers and public spending cuts start to bite. In contract research, while non-commercial sources still accounted for the lion's share of income, commercial spending did increase, a very positive endorsement of the value placed on academic research expertise, even in difficult economic conditions. Continuing professional development (CPD) income also increased by four per cent to £558 million in 2008/09, although this growth was from non-commercial sources.
- 2.13 Income from commercialisation activities has increased, although it is important to note that this accounts for only a very small proportion of total income. For example, income from intellectual property exploitation was £56 million in 2008/09 against total knowledge exchange income of £2,996 million, and the costs of intellectual property protection also rose.
- 2.14 Even with the success of efforts to diversify income streams, the majority of institutions' income still comes from two sources: funding body grants and tuition fees (all tuition fees). Together, they accounted for 64 per cent of sector income in 2008/09. It is also worth noting that reliance on funding body grants is greater in Northern Ireland and Scotland than elsewhere.

Figure 2.8: Proportion of income from different sources 2008/09



Source: HESA Resources for Higher Education Institutions

Institutional differences

- 2.15 Broad generalisations are difficult in a sector as diverse as HE in the UK. In particular, different institutions will be more or less able to develop specific income streams depending on their institutional focus and the markets they serve.
- 2.16 As a broad pattern, income growth has been strongest among the research-intensive universities. Recent analysis of universities' financial statements by Grant Thornton showed that Russell Group institutions had grown their share of total sector earnings from endowments, subsidiary companies, catering and residential operations from 46 per cent to 58 per cent, and had also gained in international recruitment.⁵ The same group has also been a major beneficiary of the growth in research funding.
- 2.17 When analysed by mission group, the HESA data on income streams shows that the Russell Group institutions not only account for the largest share of sector income, but also have the lowest dependence on funding body grants (29 per cent in 2007/08). These universities also earn a larger share of their income from research activities (26 per cent of total income) although this has reduced slightly as a result of the strong growth in tuition fee income. Similarly, the 1994 Group also has a lower degree of reliance on funding body grants (31 per cent in 2007/08).

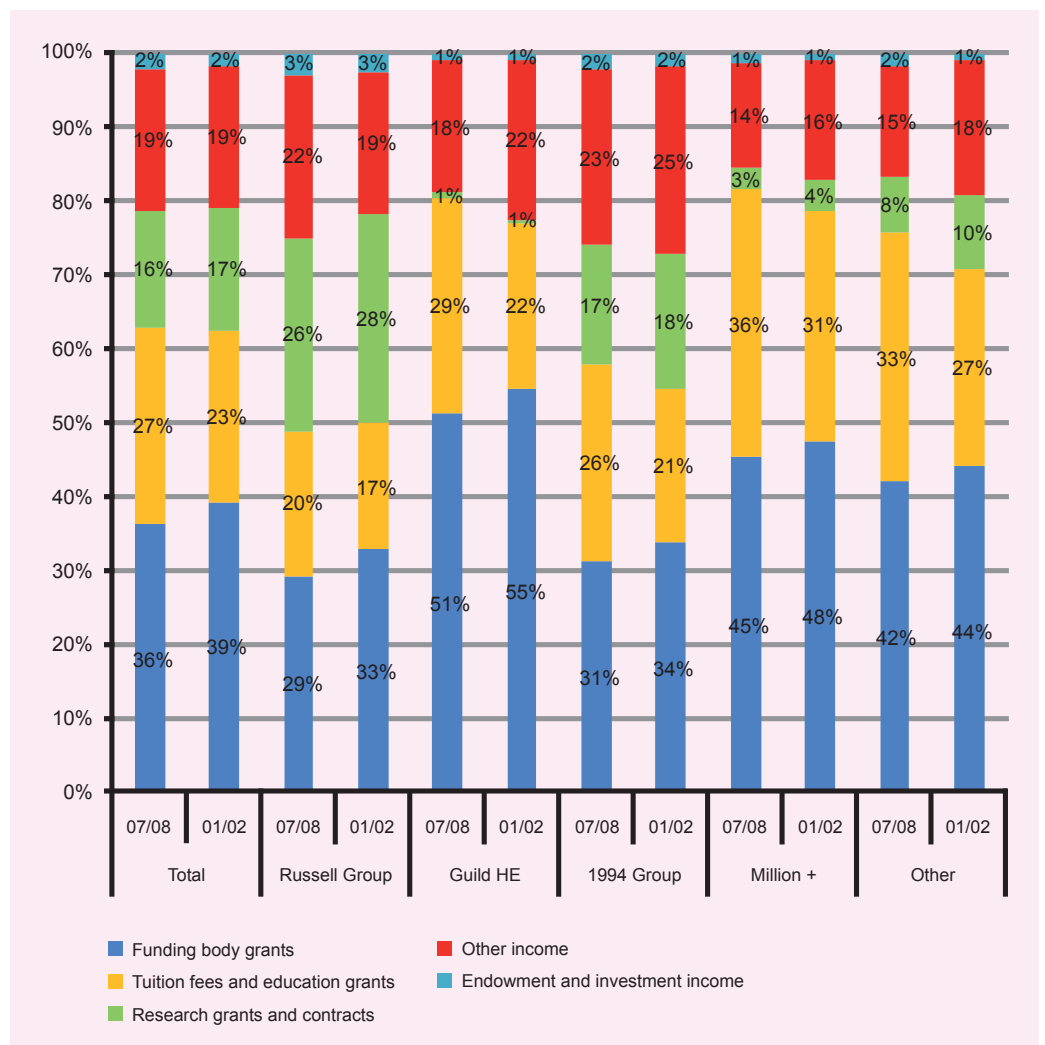
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John McIntyre Conference Centre, University of Edinburgh, courtesy of Edinburgh First, University of Edinburgh.



2.18 In contrast, Guild HE members, typically small specialist institutions, have a much higher reliance on funding body grants (51 per cent of total income in 2007/08) with only a very small proportion of income (one per cent) coming from research activities. Million+ members, all post-1992 institutions, also have a greater reliance on funding body income (45 per cent) and earn only three per cent of their total income from research activities.

2.19 It is worth noting that income from endowments and investments accounts for a very small proportion of income across all mission groups, even the Russell Group where, although the highest proportion of all groups, this accounts for only three per cent of total income (Figure 2.9).

Figure 2.9: Proportion of income by mission group 2001/02 and 2007/08



Source: HESA Resources for Higher Education Institutions data

Current financial health of the sector

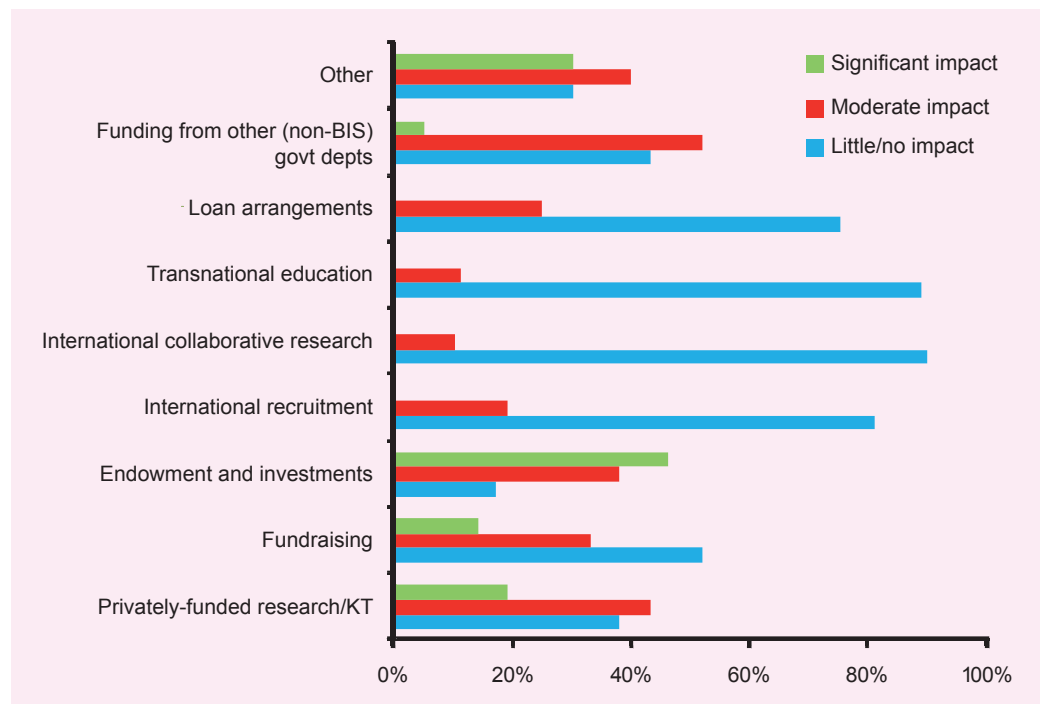
- 2.20 As the new Coalition Government seeks to reduce the deficit, public spending will come under immense pressure over the next few years, with cuts to the HE budget already announced and further significant cuts expected to follow.⁶ With the level of planned additional university places in England being reduced by 10,000, the crucial question is how well prepared universities are to weather this storm.
- 2.21 The Grant Thornton analysis of institutions' financial statements paints a mixed picture of the financial health of UK universities. The research found that despite growing income, the average level of surplus in the sector was 1.4 per cent of annual income, and that total borrowing had increased by 29 per cent.
- 2.22 Although the sector has been diversifying its income, the headline figures mask significant variation across institutions. The level of reliance on funding council grants, for example, ranges from eight per cent of income to 72 per cent, and strong growth in research grants and contracts not paid for by the research councils is largely dominated by Russell Group institutions. Similarly, the level of borrowing varies considerably, with some institutions now very highly geared, while rising employment costs are an area of real concern.
- 2.23 All this suggests that the ability of the HE sector to manage the difficult financial conditions ahead is highly variable. Given the high proportion of institutional costs accounted for by staff, it seems inevitable that staff reductions will feature, and indeed selective redundancy programmes have already begun in some institutions. More worryingly, especially for those institutions with a high degree of reliance on funding council grants, it may be increasingly difficult to continue to operate as independent institutions, and there may be growing pressure for mergers as a response to financial instability.
- 2.24 Much will depend on the extent to which institutions are thinking strategically about long-term sustainability, and acting accordingly. The Grant Thornton study found that although many institutions have been taking steps to manage the financial situation, these were not always as consistent or effective as they might be.⁵
- 2.25 These issues were also highlighted in the recent *Wakeham review on the impact of full economic costing on the HE sector*. In particular, the review found variability in the use of appropriate financial measures to assess sustainability, and recommended all HEIs take a more proactive role in monitoring institution-wide strategies for financial sustainability.⁷
- 2.26 In the following section the ways in which universities have been responding is examined in more detail based on the findings of the consultations with vice-chancellors and the survey of university finance directors.

3. Response from the sector

Impact of the recession to date

- 3.1 Despite the recently announced funding cuts in England, most universities in this survey reported that the full impact of the recession was yet to be felt across the sector. On the positive side, the recession was considered to have been a contributing factor in the sharp rise in student applications, although universities are not able to take full advantage of this increase due to the caps on home student numbers in England. Many also identified other positive impacts, including the weakness of sterling making UK universities more attractive to overseas students, and the low costs of borrowing.
- 3.2 However, most institutions reported pressure on various sources of income, including private sector research and consultancy, philanthropic giving, endowments and investments, and executive education (Figure 3.1). Some also reported a fall in part-time recruitment, attributed both to the reduced ability of businesses to fund employee training, and difficulties for students in paying fees (which are not deferred in the same way as full-time undergraduate fees).
- 3.3 In the survey of finance directors, endowments and investments, fundraising and privately-funded research activities were identified as the areas in which most significant impacts had been felt. International activities were reported to be holding up better, and while government funding has not been a major issue, this is expected to deteriorate.

Figure 3.1: Extent of negative impact on different income sources as a result of recession

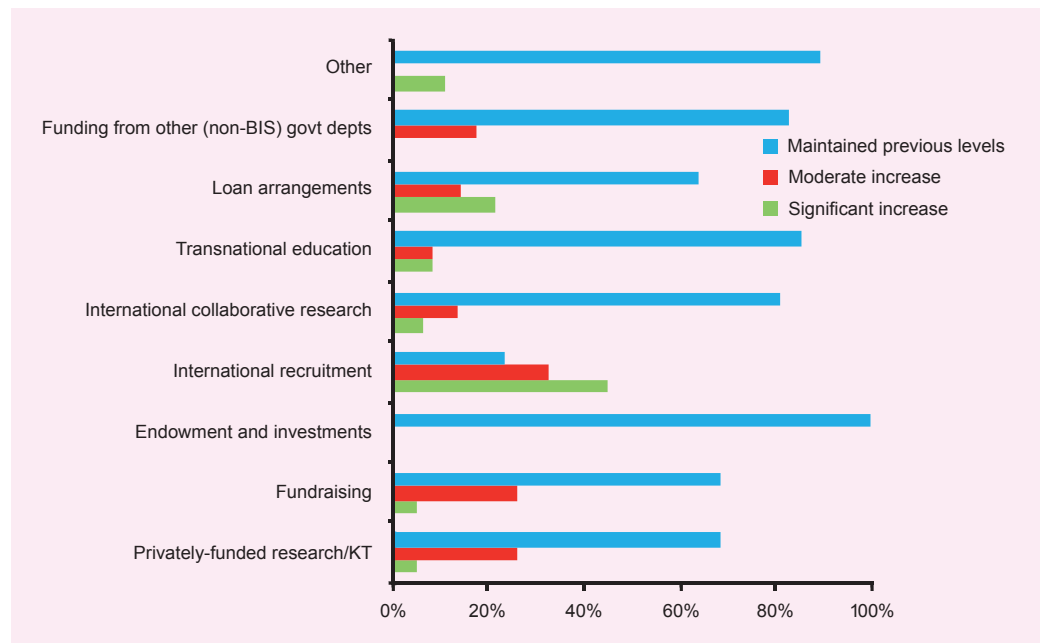


Source: Finance directors' survey, EKOS, April 2010

3.4 Under 'other' (in Figure 3.1), UK and EU student numbers, recurrent Learning and Skills Council (LSC) and Higher Education Funding Council for England (HEFCE) grants and employer engagement fees were all identified as having being significantly negatively affected by the recession.

3.5 When asked about the areas in which institutions had been able to increase or at least maintain their income levels, international recruitment was the most buoyant. Interestingly, while endowments and investments were identified as an area of negative impact in Figure 3.1, the view in Figure 3.2 suggests levels of income have been maintained in this area. This apparent anomaly is due to a response bias in which fewer respondents actually provided a view on the latter question.

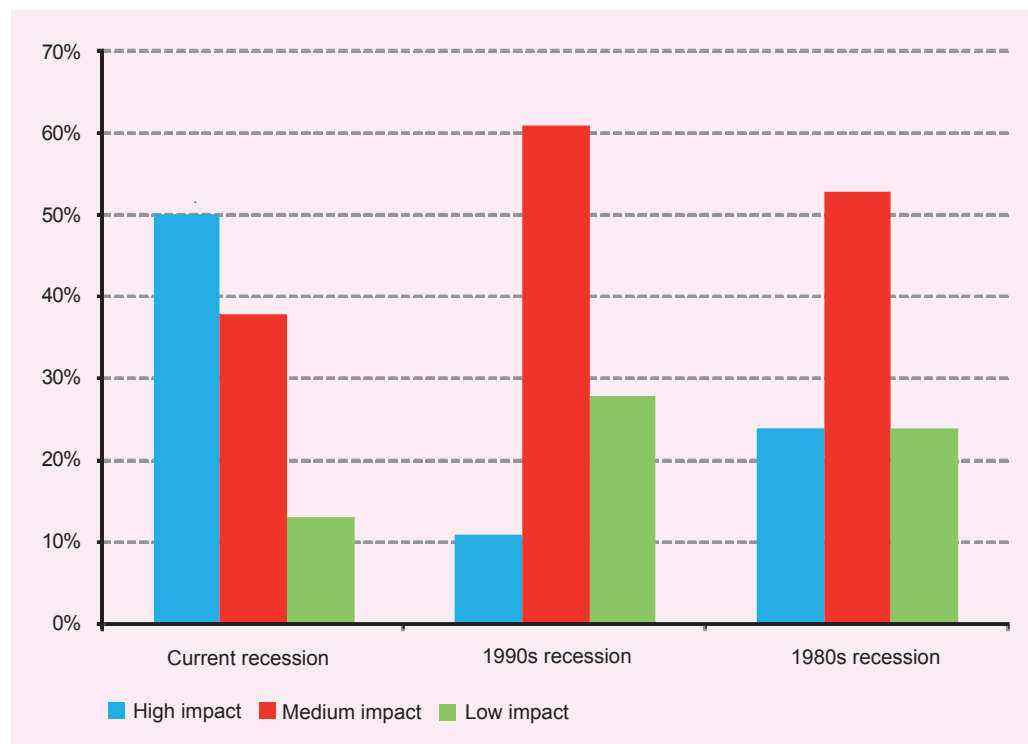
Figure 3.2: Income sources maintained or positively increased in the recession



Source: Finance directors' survey, EKOS, April 2010

3.6 The overall picture is one of the impacts of the private sector recession. Those institutions with greater exposure to private sector income streams – research, commercial income (such as conferencing and catering) and executive education – generally reported more substantial impacts to date. A number reported large reductions in investment income, including some write-offs as a result of the collapse of financial institutions.

-
- 3.7 These early shifts aside, the main issue raised by the institutions was that of uncertainty. All recognised that the public sector funding environment will become more challenging as steps are taken to reduce the public deficit. However, the scale and nature of funding cuts that will affect HE are still uncertain, and this uncertainty was widely reported to be making forward planning very difficult.
-
- 3.8 Although recent announcements have provided some indication of the likely scale of funding cuts, at least in England, uncertainty about the medium-term future persists. This is compounded by the fact that HE funding in Scotland, Wales and Northern Ireland are all working on slightly different cycles. The outcome of the Independent Review of Higher Education Funding and Student Finance (Browne review), will also be crucial. Although most institutions felt it likely that tuition fees would increase, the scale of any increase and its wider implications for the sector are areas of further uncertainty. In Scotland, where the fees regime is different, there was evidence of real concern about ongoing political resistance to variable fees.
-
- 3.9 Public funding uncertainty affects not just teaching and research grants, but also other sources such as NHS funding and teacher training support, important sources of income for many institutions. A few also highlighted the impacts on regional development agencies, resulting in reduced capital funding for some, and pressure on money for projects in areas such as knowledge transfer and research commercialisation.
-
- 3.10 Both the uncertainty and the extent of the recession's impact on public finances were seen as differentiating the current recession from those of the 1980s and 1990s. In the 1980s, HE suffered punitive funding cuts, resulting in redundancies and closed departments. However, the impact of the 1990s recession was at least partly mitigated by rising student demand (although the reduced unit of resource stored up future pressure). The concern now is that with limited potential to take advantage of rising domestic demand, and the cumulative effects of successive efficiency drives over the past 15 years, there is less room for manoeuvre.
-
- 3.11 The results of the survey of finance directors suggest the impact of the current recession is generally considered to be greater than that of previous recessions, a striking finding in light of the considerable impacts of the funding cuts in the 1980s (Figure 3.3). It should be noted, however, that as few of these staff were in similar posts during the previous recessions, this feedback may be based more on perception than experience.

Figure 3.3: Impact of the current and previous recessions

Source: Finance directors' survey, EKOS, April 2010

3.12 The general mood is one of real concern about future public funding. As noted earlier, the current financial health of the sector is mixed. Most vice-chancellors were reasonably confident that their institutions were entering the recession in good shape, but were less sure that this was the case for others. A number of critical factors were identified as important in positioning institutions to manage the difficult financial climate ahead. These are:

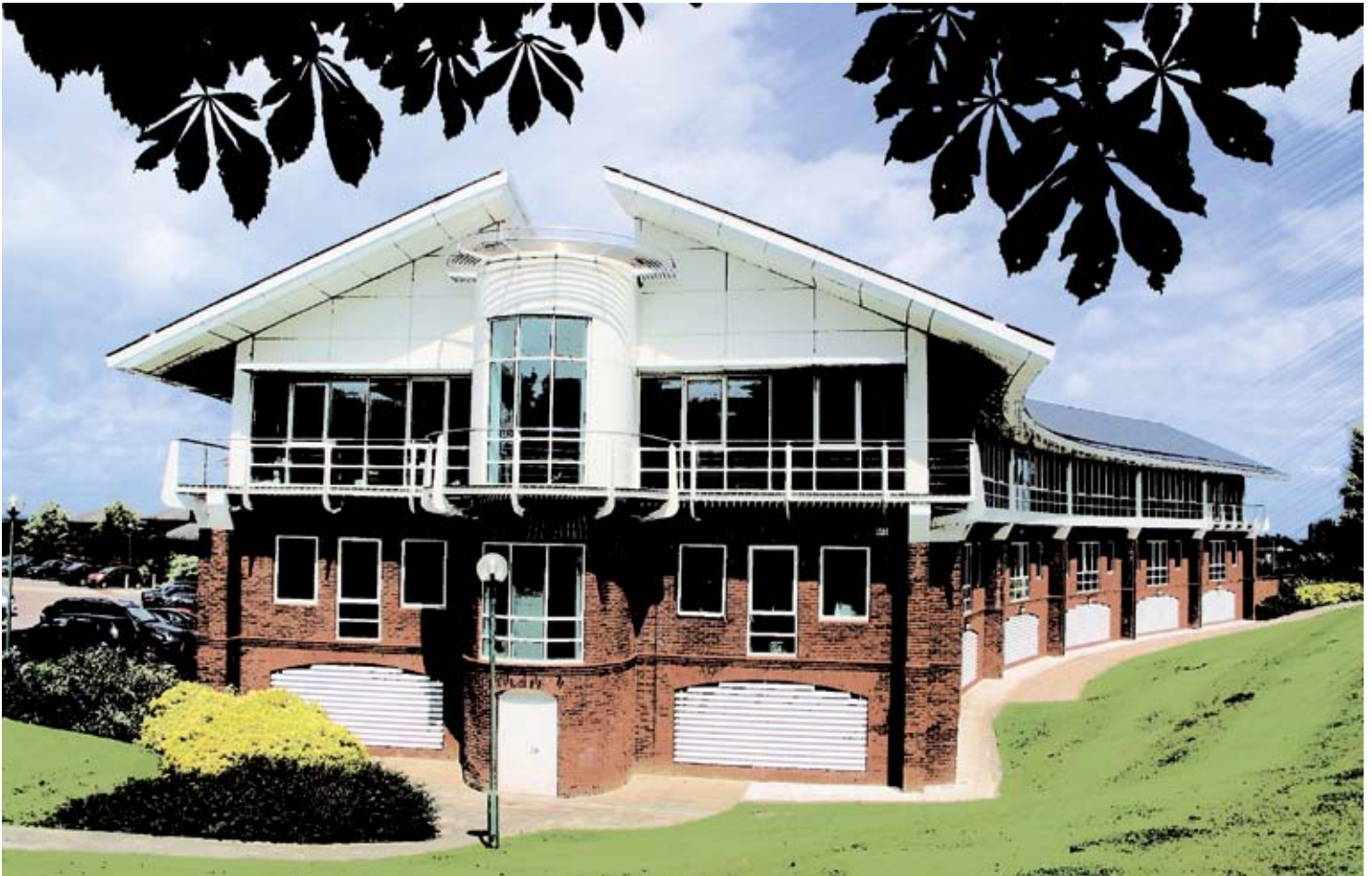
- good level of reserves
- low borrowing (and/or low gearing)
- lower than average ratio of staff costs to turnover
- high quality estate with low capital expenditure requirement
- diversified income base
- strong brand and presence in overseas markets
- focus on areas offering growth potential (or where cuts are likely to be less severe), for example, science, technology, engineering and mathematics (STEM) subjects

3.13 Above all, institutions highlighted the need for strong financial management, with clear strategic planning and robust risk assessment. Many highlighted that some universities had made substantial investments in research, and had subsequently failed to reap the rewards following the recent research assessment exercise (RAE).

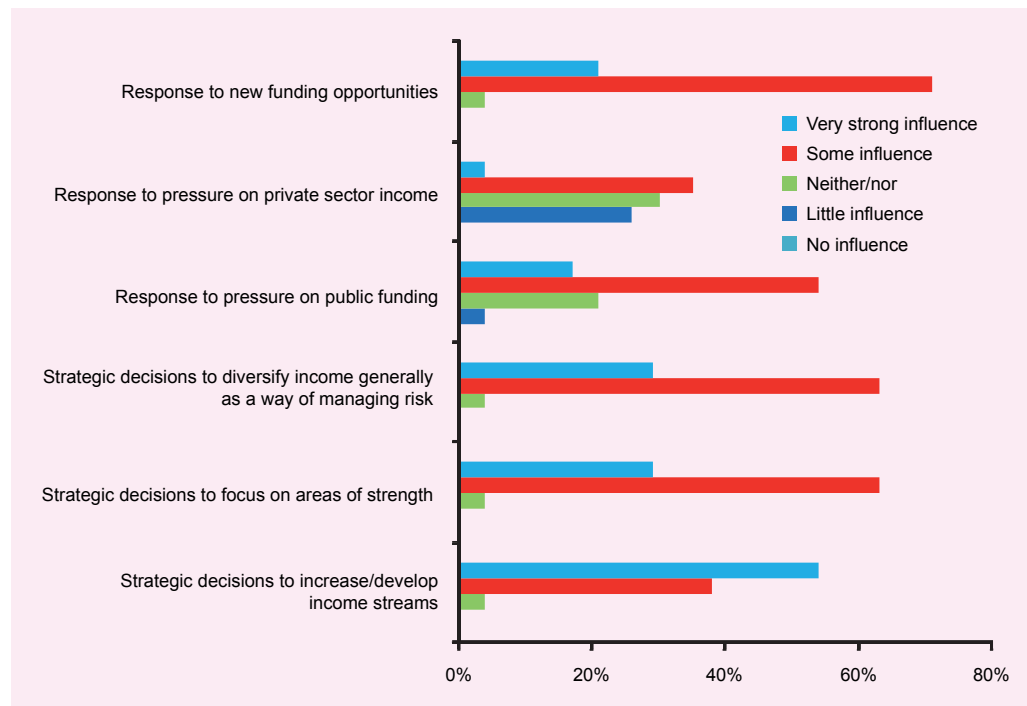
Institutional strategies

- 3.14 Most of the universities in this study have already been responding to the changing financial circumstances. The most frequently reported strategies were focused around tighter financial management and cost reductions, achieved in a number of ways.
- 3.15 Savings on staff costs are the most obvious, and a number of universities have already frozen recruitment and implemented programmes of voluntary redundancies, although some still hope to avoid such measures, and none relish the prospect of compulsory redundancy or pay cuts. Other institutions have simply tightened their belts by strengthening central control of finances and forcing faculties and departments to manage with less. The extent to which these strategies have been successful is difficult to assess objectively, but those that reported action in these areas were confident that this had positioned them better to cope with future cuts.
- 3.16 A few other institutions reported seeking greater efficiencies through more effective use of their estates. For example, one institution is in the process of consolidating multiple campuses to reduce inefficiencies. While this will incur substantial up-front capital costs, it will generate longer-term savings. Another identified the purchase of a research park some years ago as a key aspect of a long-term diversification strategy, initiated partly in response to the cuts of the 1980s. This has since generated ongoing income and has allowed the institution to build up a substantial endowment.

▼
University of Surrey
research park.



-
- 3.17 Other examples include better use of new technologies to achieve efficiencies in teaching, more collaboration with further education colleges, and outsourcing non-core activities to reduce costs (eg cleaning services).
-
- 3.18 However, it is clear that cutbacks have, for many, meant reducing or ceasing some activity. Among the institutions that responded to the finance directors' survey, the following were identified as areas in which activities had been scaled down or ceased completely:
- additional and replacement recruitment
 - capital projects
 - marketing and fundraising activity
 - specific courses and, in one case, faculties
 - employer engagement and knowledge exchange activity
-
- 3.19 This is consistent with the feedback from vice-chancellors and confirms the existing pressure on staff numbers and capital projects, with many of the latter stalling as a result of concern about borrowing, withdrawal or reductions in partner funding.
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- 3.20 While there was evidence of impacts on course provision, this was generally focused on universities withdrawing from unprofitable courses as a way of managing risk. There was a feeling that there will be more of this in the future, with possible implications for diversity of provision.
-
- 3.21 The reduction in employer engagement and knowledge exchange should be a source of particular concern, for two reasons. First, the latest HE-BCI data demonstrate not only the importance of knowledge exchange income to the HE sector, but also its resilience in the face of the recession (at least so far). Secondly, reduction in employer engagement and knowledge exchange activities risks limiting the contribution of universities to the UK's economic recovery.
-
- 3.22 These have largely been planned actions initiated in response to the early signs of recession and predictions of future funding cuts. However, in a few cases, institutions reported that internal cuts in provision had not been planned and were a reactive response to falling income and circumstances beyond their control.
-
- 3.23 Beyond efficiency saving measures, all respondents reported deliberate strategic moves to diversify income streams. When asked about the degree of influence of various factors on diversification strategies, the findings of the finance directors' survey provided clear evidence of the degree of strategic intent underlying these activities (Figure 3.4).

Figure 3.4: Influences on diversification strategies

Source: Finance directors' survey, EKOS, April 2010

3.24 There is a remarkably consistent pattern to income diversification, regardless of institutional type or scale. As discussed below, these factors are more likely to impact on the ability of institutions to take advantage of different opportunities. The main areas in which universities have sought to develop and increase their income are:

- research (through public and private income)
- international student recruitment
- postgraduate recruitment
- endowments, investments and fundraising

3.25 While some have also targeted raising income through engagement in wider strategic initiatives, for example, with partners such as regional development agencies, for most this has been cost neutral, and these funding streams are also coming under pressure.

3.26 The feedback suggests diversification strategies have been in place for some time, a finding confirmed by the earlier review of income data. However, it is clear that some areas, and some institutions, have been more successful than others. In particular, most reported good progress in international recruitment, although some from a low base and others with considerable scope for further improvement. Those with already high proportions of international (non-EU) students highlighted the positive benefits of the weak pound, but also the negative impacts of immigration controls which make it harder for some students to get visas, and the loss of international scholarships.

-
- 3.27 In particular, it was reported that changes in the immigration system over the last few years have increased significantly the complexity of the visa process for employees and students alike, with a consequent increase in the administrative burden on universities (the largest volume user of the immigration system).
-
- 3.28 Many also reported that they had significantly increased their research income, largely through successful performance in the RAE and, to a lesser extent, increased private sector engagement. For the majority, fundraising has been marginal, even for the older universities, and this was not generally considered to be an area that would offer much future potential to offset large reductions in public funding. Similarly, endowments and investments were not widely cited as major opportunities, although one university reported significant income from their investment in a research park.
-
- 3.29 Diversification of income was considered to be an important part of an institutional strategy for ensuring sustainability through the recession and beyond. Most felt that a diversified income base and reduced reliance on funding council grants would play an important role in helping institutions to weather the financial storm. However, this was not a universally-held view. Those institutions with less diversified income streams expressed clear concern about the future and a greater focus on cost-cutting strategies.
-
- 3.30 Opportunities for diversification are also not evenly distributed across the sector.
- It was widely expected that there would be greater concentration of research funding in the future, with fewer universities benefitting (although it is worth noting that the research pooling work in Scotland has meant a less marked shift towards research concentration).
 - Some institutions have larger estates to exploit (or have invested in commercial property such as science parks), while others have existing problems with the quality of their estates. Reductions in capital funding (again widely expected) will have differential impacts across the sector.
 - Engagement in international student recruitment is widespread but variable in extent, and its growth potential also varies considerably. For smaller institutions, there are real risks in increasing the level of dependence on international income as unforeseen changes in overseas markets, for example, in political circumstances or exchange rate fluctuations, could have a destabilising impact.
 - Newer universities with less established alumni bases saw less potential for substantial fundraising income. Even among the older universities, the proportional share of income from these sources is small, and further efforts in this area were not considered to offer potential for anything other than marginal gain.
 - Smaller institutions with fewer economies of scale and less financial flexibility are feeling particularly vulnerable, particularly if they have a less diversified financial base.

-
- 3.31 In addition, some universities have already felt the impact of the recession more than others, due mainly to their exposure to private sector income. This group will be less exposed to public funding cuts and generally expected to see some recovery in private income before any substantial turnaround in public funding.
-
- 3.32 Perhaps one of the most important findings is that the ability of universities to continue to diversify their income will also be affected by cuts in public funding. While those with already diverse income streams may be better placed to benefit from private sector recovery, the extent to which universities can now diversify will undoubtedly be constrained by cuts in public funding.
-
- 3.33 HE in the UK has a strong international brand, which enables many universities to compete successfully in the global marketplace. However, reductions in teaching grants may reduce course provision and diversity, impacting on student experience and potentially making the UK universities less competitive in overseas markets. Cuts in capital expenditure risk building up an estate backlog again and could impact on the quality of student experience, again threatening competitiveness in international markets. This was a concern for many of our respondents.
-
- 3.34 Similarly, a fall in research council income will constrain research activity with knock-on effects on the ability of universities to attract private sector sponsors and, again, to compete internationally. Ongoing pressure on private sector income and employer engagement will also constrain the availability of student placements, again impacting on the student experience and potentially damaging international competitiveness.
-
- 3.35 More generally, the uncertainty of the current financial climate, and understandable concerns about the future, make it less rather than more likely that universities will invest in higher risk, but potentially higher return activities. International campuses, expansion of the physical estate and even fundraising activities are vulnerable even though these are areas in which universities could raise income from sources other than the public sector. Without a stable financial platform, it will be increasingly difficult for universities to make the kinds of investments that will support further diversification.

4. The future

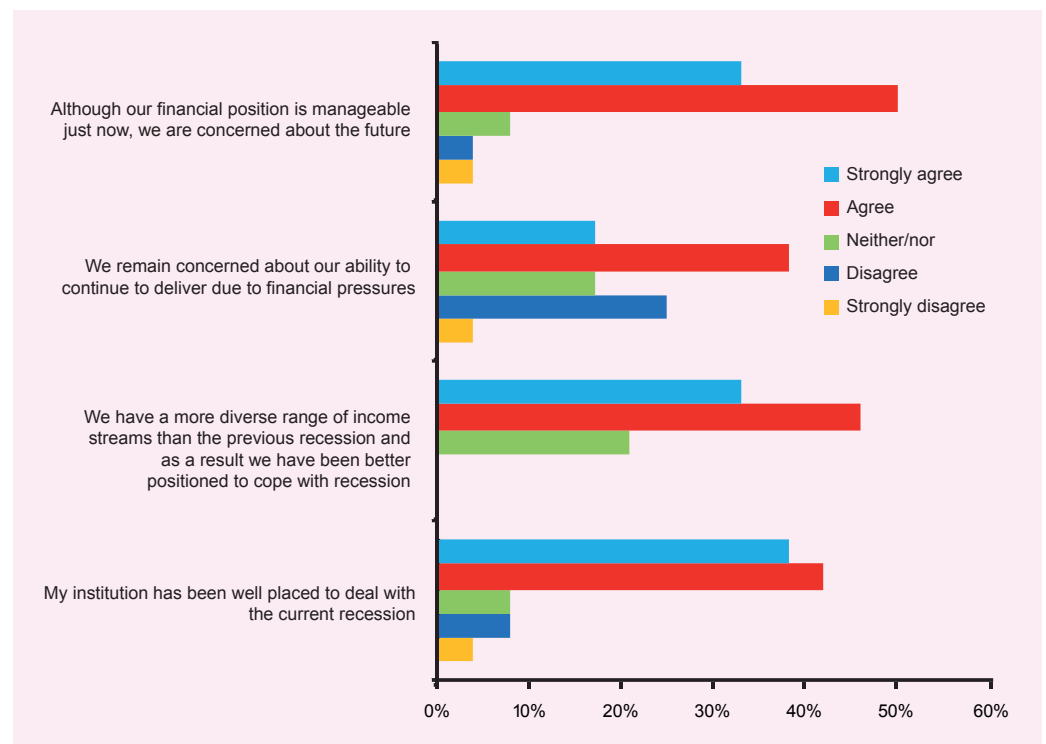
4.1 Looking to the future, all institutions reported two main drivers of future strategy:

- ongoing attempts to diversify income, but with an increasing focus on areas with lower risk and higher potential
- cost reduction

4.2 Only 29 per cent of the finance directors in the survey felt that the balance of funding in their institution was sustainable over the next five to ten years, with 42 per cent reporting that it was not, and the remaining 29 per cent unsure.

4.3 Although 80 per cent agreed or strongly agreed that their institution has been well placed to deal with the recession, 83 per cent also agreed or strongly agreed with the statement 'although our financial position is manageable just now, we are concerned about the future'. More than half were concerned about their ability to deliver in the future (Figure 4.1).

Figure 4.1: Agreements with statements about institutional capacity (% responses)

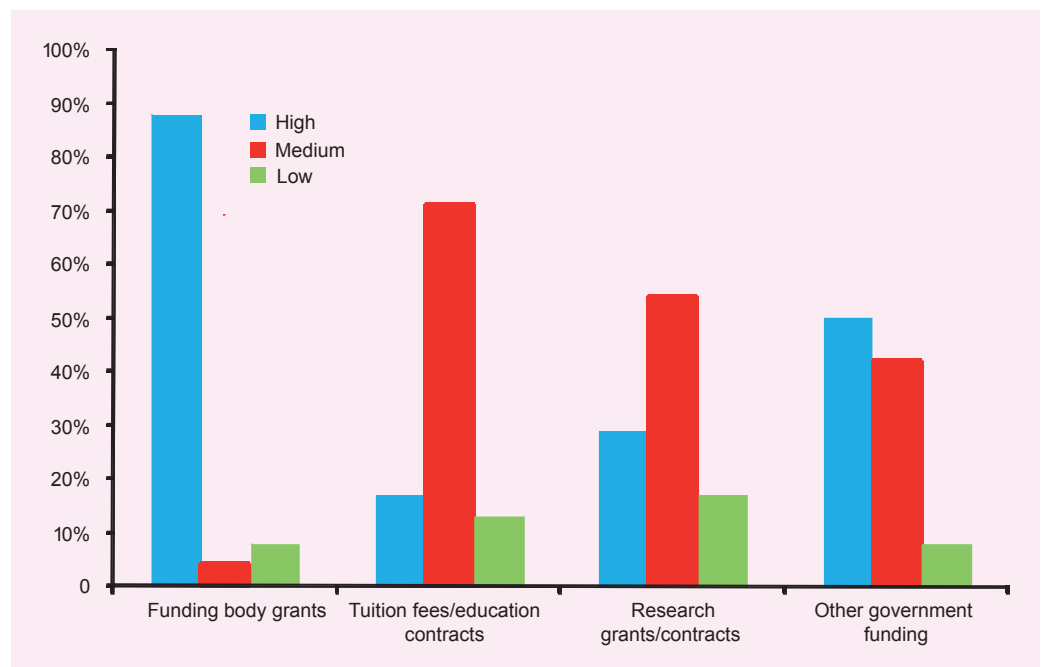


Source: Finance directors' survey, EKOS, April 2010

4.4 While opportunities for diversification do exist, the extent to which institutions are able to develop or increase income from different sources will depend on their portfolio of activities, their scale and their current market position. In more general terms, the survey findings suggest different levels of risk associated with different income streams as a result of the economic conditions.

4.5 Unsurprisingly, almost 90 per cent of finance directors identified funding body grants as high risk, and more than half also categorised funding from other (non-Department for Business, Innovation and Skills (BIS)) government departments as high risk (Figure 4.2). Perhaps more tellingly, while few felt that tuition fees was a high-risk income stream, 70 per cent classed it as medium risk (this will include public sources such as the NHS and the Training and Development Agency for Schools as well as mainstream fees). This highlights the uncertainty around the Browne Review and the ability of universities to take full advantage of rising demand.

Figure 4.2: Level of perceived risk associated with public income streams (% responses)



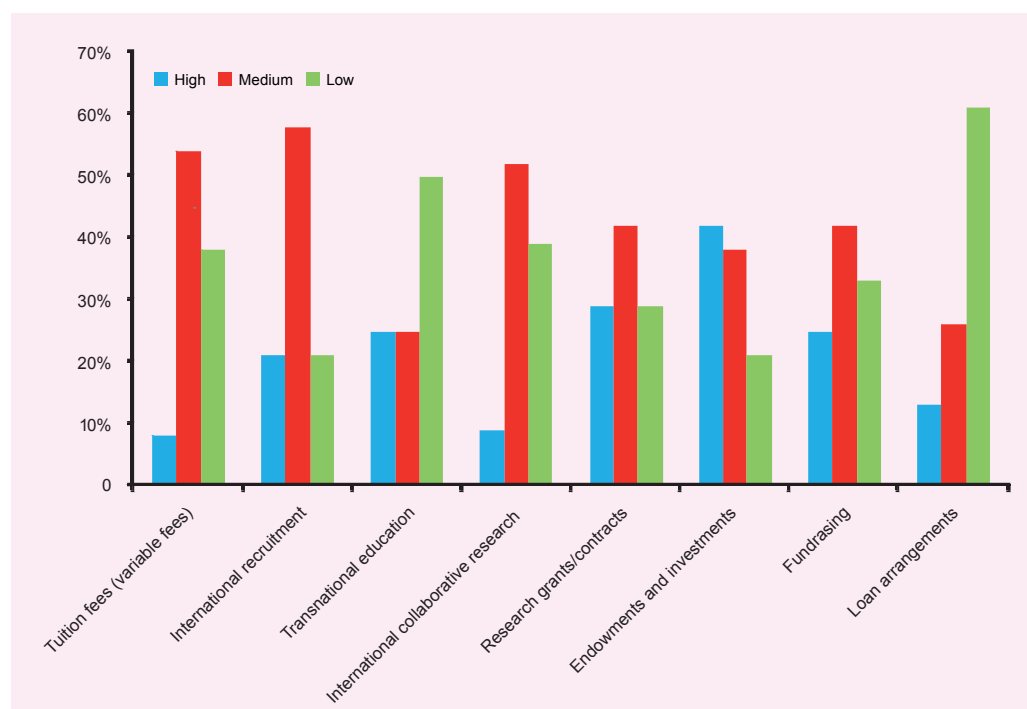
Source: Finance directors' survey, EKOS, April 2010

4.6 The situation for private income streams is considerably more mixed (Figure 4.3). The income streams most often identified as high risk were endowments, investments and private research income, although less than 50 per cent of the respondents took this view. Lower risk was attached to loan arrangements, perhaps reflecting current low levels of interest, although these will rise in the future, creating pressure on those institutions with high levels of borrowing.

4.7 Lower risk was also attached to transnational education, international collaborative research and unregulated tuition fees. Despite the very strong focus on international recruitment in institutional strategies, this was generally perceived as a medium risk (as was unregulated fee income), perhaps reflecting concerns about the complexity of the immigration system.

4.8 Of course, the level of risk attached to each of these income streams by any institution will be highly dependent on institutional characteristics and current and historic performance. It is therefore difficult to extract consistent messages.

Figure 4.3: Level of perceived risk associated with private income streams (% responses)



Source: Finance directors' survey, EKOS, April 2010

- 4.9 The feedback from both vice-chancellors and finance directors also identified a range of institutional priorities for income diversification and cost reduction, as well as views about the future implications of the recession for HE in the UK.
- 4.10 While all identified ongoing diversification of income as a key strategic goal, many, particularly smaller and newer universities, felt that this would be important but marginal in terms of compensating for the funding cuts that are expected.
- 4.11 Among those that saw greater potential in diversification of income, the primary areas of future opportunity were in international recruitment, greater international collaboration on both teaching and research, commercialisation of intellectual property (eg through licensing and spin-outs) and in-work learning and CPD activities co-funded with employers. For the research intensive universities, the prospect of greater research concentration was also felt to offer opportunities although uncertainty over future pressure on research funding meant that few were predicting income growth in this area. Although a few institutions were planning to continue or even increase efforts on fundraising, few were confident that this would make up for public funding losses.
- 4.12 The strong focus on non-regulated tuition fees is worth specific mention. Most institutions reported targeting growth in international student income and there was clear demand for action on visa restrictions to facilitate this. Some will also target postgraduate and/or part-time students. However, in relation to the latter in particular, the lack of a mechanism to defer fees was considered a barrier to growth in this area. More widely, the focus away from full-time home and EU students has implications for the UK and for widening participation goals, as discussed below.

-
- 4.13 Slow recovery in the private sector was widely felt to be an ongoing constraint on growth in research income, work placements and CPD activities, as well as private sector donations and endowments. However, increasing industry income was generally considered important, if, again, marginal for many institutions.
-
- 4.14 It is clear that the outcomes of the Browne Review will be crucial. As noted earlier, most institutions expected and supported an increase in fee caps, and caps on student numbers. This was considered by many as essential to the long-term sustainability of the sector although issues were raised about the implications of this for the HE landscape, particularly concerning greater differentiation within the sector and potential privatisation, issues discussed in more detail below.
-
- 4.15 Beyond diversification, all institutions emphasised a need for cost reduction through staff redundancies (voluntary or otherwise), multi-campus rationalisation, outsourcing loss-making activities (cleaning and security were mentioned) and more vigorous exploration of opportunities for shared services across institutions.
-
- 4.16 In a more constrained financial environment, more and more universities will be taking a harder line on activities that are not income generating, and the transparent approach to costing (TRAC) work was highlighted as a critical tool in cost control.
-

Implications

- 4.17 Stringent funding cuts, pressure on other sources of income (particularly private sector) and wide variations in the current financial stability of institutions has potentially significant implications for the future of the HE sector in the UK.
-
- 4.18 In particular, many respondents felt that, depending on political priorities, some institutions could fail, and there will be growing pressure for mergers. There was widespread scepticism about mergers as a solution to financial difficulty as the common view is that the evidence shows they rarely delivered the expected efficiencies. None of the institutions in this survey expressed any interest in this as a response to financial pressures.
-
- 4.19 It was also expected that there would be more collaboration and shared service models as a way of reducing costs, but currently this is constrained by VAT rules. As it stands, two or more universities establishing a new shared services operation would be required to set up a new organisation. That organisation would then be obliged to charge VAT back to the universities it serves, thereby adding costs and reducing the scale of the savings that could be achieved. This is currently a barrier to the development of these models and was an area identified for government attention.
-
- 4.20 More widely, there was a general feeling that the sector would become more differentiated with greater concentration of research funding resulting in a smaller group of competitive research intensive universities and others with missions more strongly focused on student experience. It was also reported by many that more HE would be delivered through further education colleges in the future.

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- 4.21 As the feedback suggests, small specialist institutions will undoubtedly find the tight financial environment more difficult than their larger counterparts, lacking as they do the economies of scale and flexibility of larger multi-disciplinary universities. Some of the respondents highlighted this as a real threat to the diversity considered to be one of the strengths of the UK HE system.
-
- 4.22 Others also voiced concern about the likely increase in tuition fee levels and what this might mean for accountability and institutional autonomy. Although this could provide some welcome income, some felt it would come with additional regulatory requirements as well as growing student demands. At a time of recession, it was argued, universities need more not less freedom over how they manage their activities.
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- 4.23 There was also a view that private sector providers are likely to increase their reach into the sector, cherry-picking the more lucrative areas of provision, and even a suggestion that some institutions may opt out of the public funding system altogether. Regardless, increased competition is widely expected, particularly in international recruitment.
-
- 4.24 As highlighted earlier, a growing emphasis on non-EU students was also identified as a risk to current government priorities of widening access to HE, and there was real concern that ongoing pressure would constrain the ability of universities to maximise their contribution to longer-term economic recovery and growth.
-
- 4.25 These issues and concerns start to raise more fundamental questions about the role of HE in the UK. For some years, the UK Government has pursued a policy focused on the twin pillars of excellence in teaching and research, and widening access to HE. However, it is abundantly clear that expansion is not possible without funding, and if funding is to reduce then the implications are obvious.
-
- 4.26 It is equally clear that universities have a crucial role to play, both in supporting economic recovery, and building the long-term competitiveness of the UK economy. They are key providers of the higher-level skills that will drive growth, and remain a critical source of new ideas and innovation. It is therefore important that the Government gives full consideration to ways in which universities can be supported such that they continue to deliver the high quality of HE for which the UK is internationally renowned. Some initial thoughts on possible policy measures are provided in the final section.

5. Conclusions and key lessons

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- 5.1 HE is facing an uncertain and challenging financial future. Public funding is reducing and there is pressure on a number of other income sources as a result of the economic recession.
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- 5.2 Many, but not all, universities have been quick to respond, reducing costs and continuing the trend towards greater diversification of income to reduce reliance on public sector finance. While this has been broadly successful for some time at the sector level, the situation varies for individual institutions and many remain highly dependent on public funding grants, leaving them exposed to future cuts.
-
- 5.3 The pressure on private sector income as a result of the recession, combined with uncertainty over future public funding, has already led many institutions to scale back on more speculative activities, potentially making the sector more risk-averse. Indeed, reduced public funding will, in fact, make it more not less difficult for universities to continue to diversify their income streams.
-
- 5.4 While continued diversification of income is crucially important, there is also no single model that will deliver success for the whole sector. As a result, policy and practice at sector and institutional levels must recognise the diversity of HEIs.
-
- 5.5 With these broad caveats in mind, the research has identified a number of areas in which there are opportunities for institutions to continue to diversify their income:
- international student recruitment, although this will require a clear proposition and strong brand presence in overseas markets
 - international collaboration on teaching and research activities
 - industry income through co-funded CPD and placement activities
 - fundraising, although recognising that this will be marginal for most universities
-
- 5.6 Although a number of universities also identified the commercialisation of intellectual property as an area for further growth, this is not likely to be an area with substantial income potential, as evidenced by the returns from the latest HE-BCI survey (see Chapter 2).
-
- 5.7 In addition, while these are areas of opportunity, without a stable financial platform, it will be increasingly difficult for universities to make the necessary investments. This is particularly true since efforts will be rightly focused on delivering against core missions in teaching and research, and on maintaining the quality of the student experience to remain competitive. Successive cuts in public funding for teaching and research could, therefore, have serious knock-on impacts on the ability of universities to develop other income streams, whether through international recruitment, contract and collaborative research, or commercial investments.
-
- 5.8 In particular, HE in the UK must maintain its global competitiveness. Income from international recruitment (and other international activities) is crucial, but depends on the ability of universities in the UK to provide excellent teaching and research, and a highly competitive student experience. There are real risks in funding cuts that may threaten this position.

- 5.9 There are also issues with the current uncertainty around immigration controls in the UK. The Coalition Government has signalled its intention to review the points-based system for immigration, starting first with economic migrants. It is likely that the system for other migrants will also be reviewed. As the Government has stated its intention to reduce net migration, it is now likely that limits may be set on immigration routes, constraining the scope for international recruitment of staff and students by universities.
- 5.10 Taking all of these issues into account, it is clear that income diversification alone will not be sufficient to sustain HE as it is today. This must be matched with a concerted effort to reduce costs across the sector. Key priorities in this respect include:
- developing a clearer understanding of the true costs of different activities (making use of the TRAC method)
 - cutting duplication and outsourcing loss-making activities, where possible (rationalisation may be important for multi-campus universities, although there are obvious costs in this)
 - greater collaboration and work towards shared service models (although VAT rules may require attention to facilitate this, as outlined in paragraph 4.19)
 - controlling staff costs
 - maintaining robust financial management and risk assessment processes, aligned to clear strategic planning

▼
Coventry University
technocentre.



5.11 Universities must now focus on those areas in which they can be truly competitive, reducing the level of risk associated with more speculative ventures. Indeed, although high-risk initiatives (eg science parks) can generate high returns, the challenging financial climate may mean a reduced appetite for these kind of projects. For some, this may also mean reducing expenditure on research while others may prioritise postgraduate education and international recruitment. Regardless, for every institution, this is about honest and rigorous appraisal of their mission, and of their relative competitive position within the markets in which they operate.

The role of policy

5.12 Government policy can certainly support HE and facilitate income diversification in a number of ways. Most obviously, increasing the caps on fees, and home and EU student numbers, would create some breathing space, and the outcome of the Browne Review will provide clearer guidance on this in due course. Other areas in which policy might contribute include:

- review of the VAT rules as they would relate to shared services for universities
- immigration policy, which has been increasing costs and constraining international recruitment for some institutions, and greater flexibility around student visas would ease pressures here in terms of the current system and also any future changes
- review of funding provision for part-time and postgraduate students to explore models to defer fee payment⁸

5.13 More generally, there was a clear call for swift resolution of the fees issue and a more sustainable HE policy in the UK that allows longer-term planning and provides greater certainty for institutions. The development of such a policy will need to take full account of the implications of current and planned funding cuts, the diversity of the sector, and the role of HE in society and in supporting economic recovery and growth.

5.14 This last point is crucial. Universities, rather than being part of the problem, are actually part of the solution to economic recession. HE policy should ensure sufficient priority for the areas in which universities can make a substantial contribution to economic recovery and long-term future growth. This includes the funding of research with the potential to create economic and social benefit and teaching provision that will help meet the Leitch Review's recommendations on higher level skills⁹.

Appendix A

List of contributing institutions

Arts University College Bournemouth	University of Essex
City University	University of Exeter
Canterbury Christ Church University	University of Glamorgan
Cranfield University	University of Glasgow
Glyndwr University	University of Gloucestershire
Goldsmiths, University of London	University of Hertfordshire
Institute of Education	University of Huddersfield
Keele University	University of Hull
King’s College London	University of Kent
Liverpool John Moores University	University of Leeds
London Business School	University of Leicester
Loughborough University	University of Newcastle
Manchester Metropolitan University	University of Plymouth
Northumbria University	University of Portsmouth
Nottingham Trent University	University of Sheffield
Queen Margaret University	University of Southampton
Royal College of Art	University of Sunderland
Royal Northern College of Music	University of Surrey
Royal Veterinary College	University of Wales, Newport
Southampton Solent University	University of Wolverhampton
Thames Valley University	University of Bristol
University College Birmingham	
University of Aberdeen	
University of Bath	
University of Bradford	
University of Cumbria	
University of Derby	

Endnotes

- ¹ University of Strathclyde (2006) *The Economic impact of UK higher education institutions* London: Universities UK
- ² Data drawn from the Higher Education Statistics Agency (HESA) *Resources for higher education institutions surveys*
- ³ Full time first degrees 1999/2000 and 2007/08, HESA Table 2a
- ⁴ HEFCE (2010) *Higher education – business and community interaction survey 2008-9* Bristol: HEFCE
- ⁵ Grant Thornton (2010) *Analysis of higher education institutions' financial statements* Times Higher Education Supplement, April 2010
- ⁶ The Higher Education Funding Council for England (HEFCE) grant for 2010/11 is £379 million less than planned, and a cut of £600 million in the HE science and research budget by 2012/13 was announced in the December 2009 pre-budget report. Since then, non-protected departmental budgets have been told to expect cuts in the order of 25 per cent which amounts to a reduction of £3.6 billion for the Department for Business, Innovation and Skills for science and research spending
- ⁷ Universities UK and Research Councils UK (2010) *Financial sustainability and efficiency in full economic costing of research in UK higher education institutions* Universities UK and Research Councils UK
- ⁸ Universities UK has called for any subsequent funding for part-time students to be additional to full-time undergraduate support
- ⁹ Leitch review of skills, Final report (2006) *Prosperity for all in the global economy – world class skills* London: TSO (Stationery Office)



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