



Department
for Business
Innovation & Skills

BIS RESEARCH PAPER NUMBER 296

Understanding the Further Education
Market in England

JULY 2016

RESEARCH

The views expressed in this report are the authors' and do not necessarily reflect those of the Department for Business, Innovation and Skills.

Department for Business, Innovation and Skills

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Research paper number 296

July 2016

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Executive Summary

Further Education (FE) in England refers to any study taken after the age of 16 that is not part of higher education (that is, not taken as part of an undergraduate or post-graduate degree)¹. It is delivered by a range of public, private and voluntary sector providers and, in general, equips a learner for further learning, including Higher Education, or for employment. It also plays an important role in reaching out to disadvantaged groups to encourage their participation in learning when they otherwise might not.

To inform decisions about how best to fund and regulate the FE market so that it can deliver effectively for learners and employers² and contribute to a skilled and productive workforce, this report has four key objectives. They are to:

1. **Describe the FE market³ and its sub “markets”**: the economic structure, policy landscape and key players in the market;
2. **Investigate the extent to which we observe features in the FE market and its sub “markets” that are common to well-functioning markets** and to identify where such features would not be appropriate given the wider objectives of FE;
3. **Identify the barriers that prevent the FE “markets” from functioning effectively**; and therefore,
4. Stimulate discussion of **priorities for policy intervention** to improve effectiveness.

In this report, we focus on the publicly funded components of the FE market and not the wide range of education and training that is privately funded by employers for their staff. We also exclude other study that FE providers may offer within the school and Higher Education systems e.g. vocational provision for 14-16 year olds.

Our approach

To carry out the analysis we have drawn on three substantive forms of evidence. Firstly, we have reviewed published literature including academic publications, research reports, statistical publications, guidance documents, government policy documents, provider annual reports, financial statements and legislation. Secondly, we have carried out detailed quantitative analysis using the Individualised Learner Record (ILR) for 2013/14; the National Course Directory; and the Provider Information Management System (PIMS). Thirdly, we have developed a deep understanding of FE through a series of around sixty semi-structured interviews with stakeholders across the market⁴.

¹ This is the definition used by government. See <https://www.gov.uk/further-education-courses/overview>

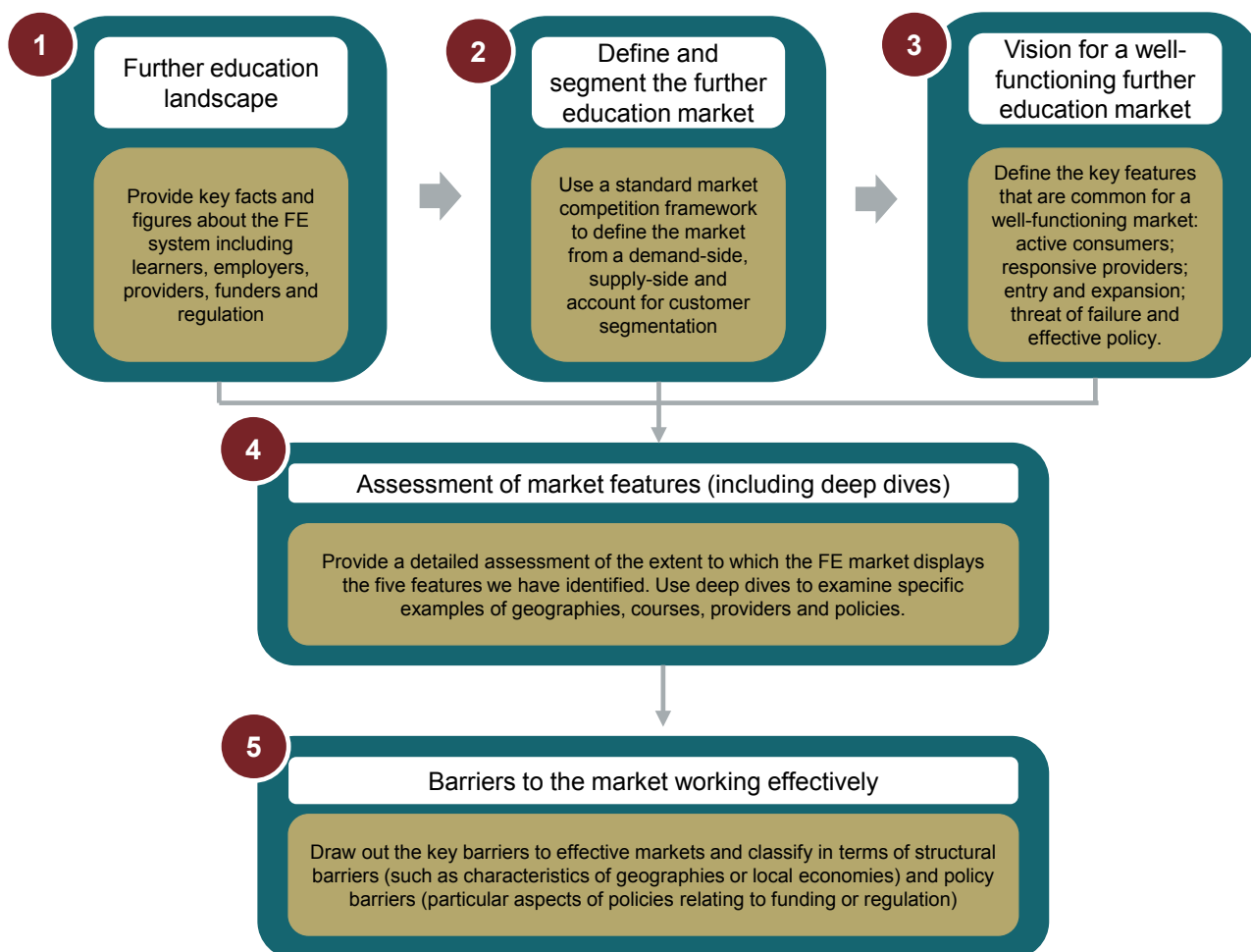
² Although the term “employers” is used throughout this report, this also includes self-employed individuals as they make decisions about their own training.

³ For the purposes of this study we are focusing on publicly funded and regulated FE (including direct funding and via loans) in England only. We are not including the wider work that some FE providers undertake, such as provision for those still in school (14-16), provision of programmes of prescribed higher education or overseas skills activities.

⁴ See Annex 1 for a full list.

Using this evidence, we have focused on understanding five areas of analysis as shown in Figure 1.

Figure 1. The five steps in our approach to this study



Our analysis is presented for each of these five areas in turn.

The FE landscape

The FE market is highly complex. It engages with millions of learners (around 4 million publicly funded learners in 2013/14) from a wide range of backgrounds and reaches out to many more not yet participating in FE. Most FE learners are over 19 years of age (75%) with just 25% under 19. Learners participate in learning with one of around 1,150 publicly funded⁵ FE providers across the country.

⁵ Here we refer to those holding direct contracts with the Skills Funding Agency or Education Funding Agency.

The total public budget for FE in 2013/14 was over £10 billion. The Skills Funding Agency (SFA) provides £3.8 billion of funding for further education divided into the Adult Skills Budget worth £2.1 billion⁶ and the Apprenticeship budget worth £1.4 billion in 2013/14⁷. The remainder of the SFA budget includes student/ learner support. The Education Funding Agency (EFA)⁸ funding was £6.2 billion. A further £159 million was provided by the European Social Fund (ESF).

Learners

In 2013/14 there were around **4 million learners** from a wide range of backgrounds in the further education market. The provider-base is **diverse** but learners were participating at General FE and Tertiary Colleges, private, independent and voluntary providers (publicly funded), School Sixth Forms, employers, Sixth Form Colleges, special colleges (including Agriculture and Horticulture Colleges; Art, Design and Performing Arts Colleges; and, Specialist Designated Colleges) and other publicly funded providers (such as Local Authorities and Higher Education institutions).

Alongside participating at one of the FE learning institutions above, workplace-based learning is also a notable feature of the market. Of all learners, some 851,500 are currently participating in an apprenticeship with the majority of apprentices being adults aged 19 years or above.

Learner's decision-making about what to study and where to study is complex. A wide range of factors influence decisions including informal advice from families, guardians or peers; the reputation of the provider and the type of **setting** (whether to learn in a multi-disciplinary setting, with a small independent provider or in a community-based setting).

Learners' choices about FE, at present, tend to be **very localised**. Most learners (70%) travel less than 10km from their home to the site of their provider, with 50% travelling less than 6km. Distances travelled vary by subject area and course. Time and cost of travel are key constraints. The distance travelled by learners appears to be generally lower for basic subject areas like Preparation for Life than for more specialised areas like Health and Social Care and Engineering and Manufacturing. Learners tend to travel shorter distances to their provider around big cities - such as London, Manchester and Birmingham – and longer distances in more rural areas like Norfolk and Cornwall.

FE Provision

Education and training within the publicly funded FE market is, at present, largely structured around **qualifications** – there are over 15,000 qualifications on the Ofqual Register of Regulated Qualifications, both academic and vocational, a wide range of levels and a broad range of sector specialisms. Qualifications are offered in a variety of settings and learning modes. **“Core”** areas of provision offered by most providers are preparation

⁶ This includes Adult Community Learning and funding for the Offending Learning and Skills Service (OLASS)

⁷ Alongside funding for apprenticeships for learners aged 19+, the SFA allocates 16-18 apprenticeship funding on behalf of the Department for Education.

⁸ This includes funding for schools and FE providers and student support funding.

for life and work courses⁹ (98% of providers); business, administration and law courses (87%); and health, public services and social care courses (72%). Less commonly offered subjects are social sciences, history, philosophy and theology and agriculture, horticulture and animal care. The largest expansions in provision since 2011/12 have been in retail and commercial enterprise programmes; education courses; and business, administration and law courses. The majority of learners (over 40%) are studying for a **level 2** qualification.

There are 1,150 FE providers in direct receipt of public funding, ranging from charitable organisations and non-profits to private companies and FE Colleges. The total number of providers offering publicly funded FE provision is likely to be much higher as **subcontracting** is a significant feature of the market, accounting for £780 million of contract commitments in 2014. Subcontracts are typically long standing (more than 5 years), focused on 16-18 apprenticeship and 19+ apprenticeship provision and particularly present in the construction, and health and care sectors. Lead providers typically retain between 5% and 30% of subcontractors' funding as management fees.

There has been **minimal entry** into the government funded FE sector over the last 3 years (except for entry of School 6th forms¹⁰ of which we understand approximately 260 have entered over the four years from 2011/12 to 2014/15) but there has been **extensive merger and consolidation** activity and also a notable number of **exits** of private providers. Providers have, however, been **flexing their offers** considerably over this period with more than 50% expanding into new subject areas and 35% withdrawing from subject areas.

The FE workforce

It is estimated that there are over 326,00¹¹ staff working across the FE sector¹² with approximately 250,000 staff in colleges¹³, 51,000 staff in Work-based learning training¹⁴ providers and 25,000 staff working in Local Authority providers of Adult and Community Learning. The majority of the workforce is aged 35 years or over and part-time working is extremely common. There is also some dependence on volunteer teachers within the sector.

FE providers report recruitment difficulties most frequently in functional skills, mathematics/numeracy and English/literacy. However, there is also a concern within the sector that high quality teaching and training relies on a clear line of sight to work¹⁵. This means that teachers and learners need to be continually exposed to new forms of knowledge and practice to perform at their best. It is reported that identifying either skilled

⁹ Including basic English and Maths.

¹⁰ Including new free schools, University Technical Colleges and studio schools.

¹¹ This figure excludes staff working in School Sixth Forms.

¹² Workforce data across the Further Education sector – 2013-14, Education Training Foundation

¹³ Including General FE Colleges, Sixth Form Colleges, Agricultural and Horticultural Colleges, Arts Colleges and Specialist Designated Colleges.

¹⁴ Including independent training providers, third sector/charity training providers, Group Training Organisations and employers providing training.

¹⁵ "It's about work... Excellent adult vocational teaching and learning", Commission on Adult Vocational Teaching and Learning, 2013

professionals or teachers able to offer training of this nature in some localities and occupations can be a particular recruitment difficulty.

FE Funding and regulation

As noted above, the total public budget for the FE market in 2013/14 was over £10 billion. The SFA provides £3.8 billion of funding for further education divided into the Adult Skills Budget worth £2.1 billion¹⁶ and the Apprenticeship budget worth £1.4 billion in 2013/14¹⁷. The remainder of the budget includes student/ learner support. Some £6.2 billion is provided by the EFA¹⁸. A further £159 million was provided by the European Social Fund (ESF). Around 60% of total funding goes to Further Education Colleges and Tertiary Colleges.

The EFA funds FE for young people aged between 16 and 19. Providers receive a funding allocation, based on the number of students, reflecting the number of students enrolled last year and an adjusted national funding rate per student.

Adult funding is administered by the SFA. The adult funding model applies to all learners aged 19+ and is currently based on qualifications with each qualification assigned a funding rate according to the size of the provision (credits or guided learning hours) and a programme cost weighting. For apprentices aged 19 and older, the SFA covers up to 50% of the funding rate, with the employer expected to make a contribution. Also, with effect from 1 August 2013, learners aged 24 and older wanting to study qualifications at Levels 3 and 4 are no longer funded by SFA. Those learners on eligible courses at these levels can apply for a **24+ advanced learning loan** to pay for their studies.

FE providers in receipt of government funding are subject to a range of **regulations**. They must be on the SFA's Register of Training Organisations and subject to appropriate due diligence. They are subject to regular quality inspections by **Ofsted** and financial health checks and if they fail to pass either of these, or fail to meet minimum standards, further action is triggered. For example, private providers could be issued with a notice to terminate their contracts with the SFA, or the FE Commissioner may become involved for Colleges or other particular providers under the remit of the Commissioner.

Defining the FE 'market'

The FE market is complex and seeks to meet the needs of a wide range of groups within the context of regulation to ensure quality, and substantial public funding to ensure wide accessibility to learning.

Although we refer to FE as a 'market' throughout the rest of this report, the level of government funding and the role of government and public agencies in the way FE is delivered mean it is not a typical 'market'. In a typical market, 'consumers' and 'providers'

¹⁶ This includes Adult Community Learning and funding for the Offending Learning and Skills Service (OLASS)

¹⁷ Alongside funding for apprenticeships for learners aged 19+, the SFA allocates 16-18 apprenticeship funding on behalf of the Department for Education

¹⁸ Covering funding for schools and FE providers.

interact with the resulting outcome presumed to be the best for society. This is not the case in FE for several reasons:

- Learning delivers wider benefits to society that go well beyond the benefits to those participating, and their subsequent employers.
- Learners do not ‘consume’ learning in a conventional way but rather participate in learning to enhance their skills and capabilities – some choose to do so, yet for others, participation is a government requirement (for example, JobCentre Plus referrals). Many learners do not pay to learn (government pays for them) yet some do pay towards their learning.
- Employers do not consume learning either – they reap the rewards from having a more highly skilled workforce, and reflect the value of those skills in salaries. Both learners and employers can however be seen to benefit from learning and one or both may contribute to the cost of its provision.
- Many providers do not compete on the price of their services as is common in many markets, but rather on the quality and relevance of their provision. However, as this report will later show, some may not ‘compete’ with others at all; and in some parts of the market learners do not choose providers but providers (e.g. selective 6th forms) choose learners.

Despite not being a typical ‘market’, this study investigates the effectiveness of the FE market through an economic lens. Although this is not straightforward, there are elements of the FE market that do demonstrate features typical to any market and for these, our economic framework is appropriate. We therefore apply our framework where it is appropriate to do so, and have adapted it where it is not to recognise the uniqueness and the various market failures and non-market objectives of the FE market.

We have identified 7 market groupings within the FE market using a commonly applied market definition framework that considers the substitutes available to consumers, the ease with which suppliers can switch between different products and geographies as well as the different choice conditions faced by some customer groups. The market groupings (divided into local, regional and national markets) are:

Local markets

1. **Local “core” mixed environment training**¹⁹, covering levels 0 to 3 and leisure courses. Within this market there are distinct customer segments for 16-18 year olds (who have a wider range of choice of providers than 19+ year olds) as well as for those learners routed via JobCentre Plus who may have little choice of provider.
2. **Local, “basic” community-based training**, covering levels 0 and 1 as well as adult community learning courses that do not lead to a qualification.

¹⁹ A provider offering courses across a range of sectors and subjects, for example a FE College.

Regional markets

- 3. Capital intensive training, offered from a FE provider's site** (rather than in the workplace), covering all qualification levels.
- 4. Regional "advanced" sector-focused training**, covering level 4+ but only on courses that are not capital intensive²⁰.

National markets

- 5. Sector focused training in the workplace**, covering all levels, with a distinct customer segment for large employers
- 6. Specialist (often residential) provision**
- 7. Prison-based learning**

These definitions were reached following detailed consideration of the learners' decision whether to participate in FE and if so, how, as well as the providers' decision about what to provide. The division of the FE market into these groups is reflective of the different structural characteristics and policy framework at play in these different parts of the FE system.

A vision for a well-functioning FE market

Ultimately, the question that government would like to be able to answer is whether the FE market is delivering the most appropriate outcomes for learners, employers and the economy more generally – could the private and social returns be higher? This is clearly an extremely challenging question as there is no obvious counterfactual to which the FE market today can be readily compared – no one knows what outcomes would look like under a different market system.

The FE market is subject to government intervention in a range of forms, many of which have been implemented to overcome market failures that would mean the FE market, left to its own devices, would not be expected to fully deliver the outcomes desired by society. Despite the recognition that government intervention is needed, there is also a view that the market mechanism plays a key role within FE.

The starting point for this work was therefore to determine whether the sub-markets within the FE sector were working as effectively as they could. Implicitly this is a two stage question where stage 1 asks whether and where markets have the potential to be effective in FE and stage 2, where they could be effective, are they working as well as they could?

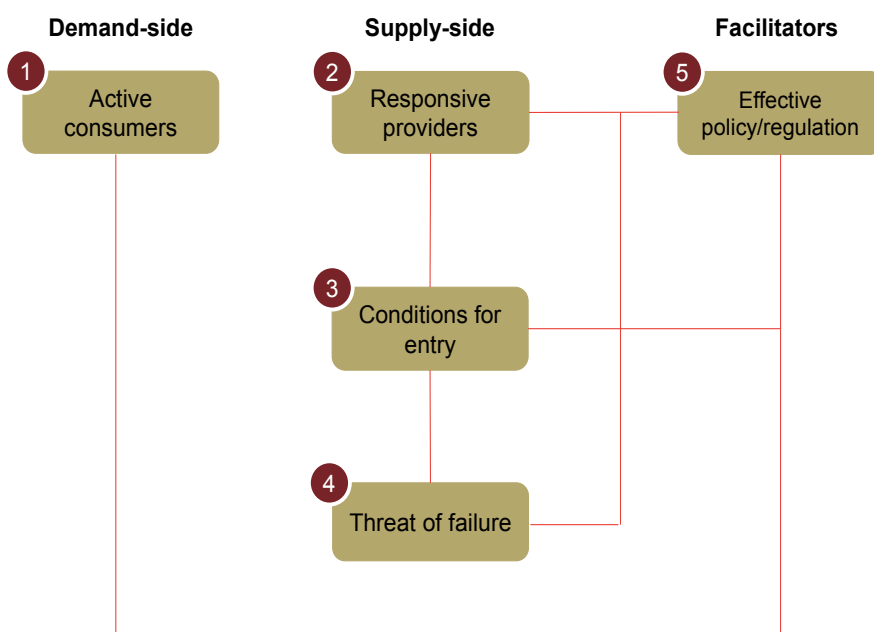
To frame our work, we posed the question: "what features would need to be observed across the FE market to ensure that it could, and is, functioning well as a set of markets?"

²⁰ Both groupings 3 and 4 address the technical and professional training that are currently government priorities. Here we split them according to capital intensive provision at all levels; and advanced (level 4+) training.

This “vision” of a well-functioning FE market (shown in Figure 2) is the benchmark against which we compared the FE markets we observed in practice. The comparison enabled us to make an assessment of what is working well and what is not in each of the seven sub-market groupings we have identified.

Akin to other market studies, we considered the consumer (demand) side and the provider (supply) side of the markets. We asked whether or not consumers and providers were incentivised and able to provide competitive pressure in this market. In addition we considered the role that policy and regulation play in this market. We considered whether policy and regulation are successfully targeting those areas where the demand and supply side do not provide sufficient incentives for driving up quality, efficiency and innovation i.e. where the market fails.

Figure 2. Features of a well-functioning FE market



- **Active consumers** – covering the features we would expect to see in a market that facilitate consumers being active. These include availability of choice; information about those choices and accessibility of that information; and confidence and ability to make an informed choice. Evidence of consumers making active choices is also considered.
- **Responsive providers** – covering the extent to which providers are incentivised and able to respond to market pressures unconstrained by structural market conditions, governance arrangements or policy and regulation. Evidence of providers being responsive is also considered.
- **Conditions for entry** – covering the extent to which the market is open to entry by new providers or whether there are significant barriers which could be structural in nature or policy driven.
- **Threat of failure** – covering the extent to which poor performers can straightforwardly exit the market and whether policy allows a clear and credible threat of provider failure.
- **Effective policy/regulation** - covering the extent to which policy and regulation ensure that competitive pressures are enabled (and not distorted or reduced), and supplemented where appropriate (e.g. where there are structural market failures) and that there are appropriate safeguards for consumers.

Our assessment of the market against that vision

Where the market is working well

Our analysis identified various aspects of the FE system and its sub-markets that display characteristics associated with well-functioning markets. Examples include:



Provider responsiveness: our analysis suggests that providers are generally very responsive to learners, competitors and policy. Many actively monitor the market to understand learner and employer needs and competitors' offers and adapt their FE offer accordingly.



Learner choice: Even though the market considered by learners is typically very local, learners generally do appear to exercise some local choice. Typically only 20-30% of learners use their nearest provider.



Ability to expand or change the FE offer: evidence suggests that most providers are not unduly constrained from adapting their FE offer. In recent years, some have expanded into new areas of provision in response to local demand and policy (such as apprenticeships), and others have actively chosen to withdraw from some forms of provision (such as A-levels) so that they can concentrate on providing other forms of FE.

There are, however, a number of barriers that prevent the market from working well and cut across several of the features we have identified.

Cross-cutting barriers preventing the market from working well

Our analysis suggests that there are some markets in which learners have a very limited choice of alternatives, and providers have a limited set of likely competitors. Our analysis shows that:

- learners typically have more choice for general courses than they do for more specialised courses;
- learners in some areas tend to have few college alternatives available within their catchment area²¹; and
- some courses such as specialised engineering courses, exhibit pockets of 'not spots' i.e. areas where there are no providers.

The lack of alternatives can be entirely the appropriate market outcome where structural features of the market including the nature of the investment involved, and the number of potential learners, mean that only a single or small number of providers can be supported viably by the market. For example, in some areas of the country the learner base may only be large enough to support one provider of a viable size (because of economies of scale in provision). For markets displaying these structural characteristics, competition may not


²¹ Defined as a 10km radius, reflecting the fact that 70% of learners are drawn from that radius. Traditionally, a cut of closer to 80-90% would be used to define geographical catchments but the data used for this study suggests that, in this context, 70% is an appropriate cut off.

provide sufficient incentives for efficiency, quality and innovation. These markets display “structural barriers” to competition.

However, in markets where the limited set of competitors is not the result of structural features, policy changes may be able to enhance the workings of the competitive market to improve outcomes. For these markets there are “policy barriers” to competition. These two sets of barriers are set out in

Table 1 below. Before turning to the table, it is worth noting that In many markets both types of barriers are likely to be at play, so detailed consideration at a market by market level is required to identify those markets where policy changes should be sufficient to enhance the market mechanism and those where other supplementary incentive mechanisms may be required.

Table 1. Availability of alternative competing providers

	Structural barriers	Policy barriers
Barriers to entry 	<ul style="list-style-type: none"> • Natural monopolies – low market demand coupled with a minimum efficient scale for provision can mean that few alternative providers can be sustained in some markets (entry will be limited). Likely to be an issue for areas with a low or dispersed learner base. • Large, predominantly sunk investment costs generate a barrier to entry in markets where they are fixed and difficult to recover post-entry. This is a particular issue for capital intensive parts of the FE market with very specific assets. It may also be important for college-based provision where reputation and history (requiring significant investment to overcome) can play a key role in learner recruitment. • Pension regulations for Colleges as defined in the 1992 Further and Higher Education Act can also represent significant liabilities for Colleges, acting as both a barrier to entry and exit. • Cost of switching Awarding Body (or working with multiple Awarding Bodies) can limit entry and hence the number of alternative providers in some parts of the market. • Staff shortages in some areas (particularly those where providers must compete against other teaching professions and the trade/industry) can limit entry and hence the number of alternative providers in some parts of the market. 	<ul style="list-style-type: none"> • Lack of direct SFA contracts - access to direct contracts is limited because there are very few, if any, new direct contracts and current direct contracts roll on as long as providers meet minimum standards. Range of providers may be constrained by this in some areas of the market as subcontracting is the only route of market. • Historic reluctance to close a college creates a barrier to entry as new entrants would not have the confidence that they would be able to displace the incumbent even if they are able to offer a superior training offer.

Structural barriers

Policy barriers

- Local economy – the availability of apprenticeships as well as the demand for other types of vocational training is very dependent on the composition of the local economy. Range of provision may be limited in areas where **local demand and opportunities are limited**.

Level playing field



- Narrow focus of some providers: the risk of not being able to adequately respond to or manage policy changes can be greater for smaller providers. For example, if policy priorities shift funding away from their core areas of business. These providers are **naturally more exposed to risk**.
- Colleges receive much greater **support** than independent providers **to avoid closure**, limiting the scope of independent providers to enter and expand in some markets where colleges have a heavy presence.
- Ability of those with direct contracts to use **subcontracting as a means of propping themselves up** in the event of poor performance. Again, limiting the scope of other providers to enter or expand.
- **Differential VAT regime** – Schools 6th Forms benefit from preferential VAT regime but Sixth Form Colleges and General FE Colleges do not affecting their ability to compete effectively in some parts of the FE market.

Barriers to exit



- **Pension regulations** for colleges can act as both a barrier to entry and exit.
- There are no **formal administration** and insolvency procedures for Colleges – a further potential barrier to exit
- **Lack of formal requirement to secure continuity of provision** for learners upon exit can increase reluctance to allow exit of large providers – this is a barrier to exit.
- **College assets** must only be used for educational purposes, limiting the ability for complete exit of some provision.

As well as cross-cutting barriers that restrict the range of alternative providers able to operate in the FE system and its specific sub-markets, there are a range of other barriers that may limit the effectiveness of the market mechanism as a means of driving up performance in FE. We consider the barriers to active consumers and responsive providers in turn. We then turn to the policy and regulatory challenges inherent in the system.



Further barriers affecting active consumers

A well-functioning further education market requires its consumers²² (learners and employers) to be **active**. That is, consumers – or perhaps ‘beneficiaries’ – of further education should be able to make informed decisions about learning options that meet their own best interests, and also send a signal to the market about what those interests (or needs) are. In turn, providers have an incentive to meet those needs.

For the purposes of this report, we have defined consumers as “active” in the context of FE if they have an available choice, an awareness of that choice, access to information to appropriately guide that choice and confidence and ability to make a good choice.

Table 2 summarises the barriers to consumers being “active” in this market that we have identified.

Table 2. Barriers to active consumers

	Structural barriers	Policy barriers
Awareness of choice/ access to information 	<ul style="list-style-type: none"> Limited direct communication between employers and learners means learners may not be aware of all their options or potential career paths. Too much information available on the internet can confuse learners about who to trust. Reliance on informal channels of advice (families, guardians, peers) could affect the perceived available choice. Lack of impartial advice from schools (they have the incentive to retain learners) could restrict learners’ awareness of choice Lack of information to certain groups, such as employees in low paid work, limits awareness of choice e.g. National Careers Service focuses on disadvantaged groups. 	<ul style="list-style-type: none"> Poorly targeted information – available information is not well targeted for different learners (e.g. some would like employment rates, salaries). Lack of awareness of some employers of options relating to apprenticeships.
Confidence and ability to make decisions 	<ul style="list-style-type: none"> Inability to judge quality or relevance of course can limit learners’ ability to make informed decisions. Individuals not actively seeking to participate: some disadvantaged groups are below the radar of the FE market. 	<ul style="list-style-type: none"> Lack of guidance and support to learners when making choices. Only 2/3rd of learners satisfied with the information they were given when choosing their course. Others decide on learners’ behalf – e.g. JobCentre Plus mentors; some employers choose the provider for their employees.

²² Or at least a meaningful subset of consumers.

Further barriers affecting responsive providers

For the FE market to function well in terms of meeting the interests and needs of learners, employers and the government, providers need to be **responsive**. They need to be incentivised to improve the quality and suitability of their offer to learners and employers as well as the efficiency of their offer to ensure they remain profitable at the prevailing funding rates. The incentives faced by providers are likely to vary according to the degree of competition they face from alternative providers and the extent to which the funding arrangements for their provision are a clear threat to their profitability.

For the purposes of this report, we have considered whether providers are constrained in some way from responding to those incentives. As with any diverse market, there are elements of good practice in terms of responsiveness such as providers that undertake studies of demand, engage actively with employers and sector bodies and keep active track of what their competitors are doing. But, there are also instances where providers appear not to be responsive, either because they lack the incentive to or because they face barriers in so doing.



Although there is evidence to suggest that many providers are responsive to learners, employers, competitors and policy, there are also some clear barriers that have limited responsiveness for some providers in some markets.

- **Limited scope of operation** – providers offering a limited range of courses are a common feature in the market but these providers may find it hard to respond to changes in learner and employer demands, competition or policy because of their limited scope.
- **Cost of switching awarding bodies** - providers must adhere to the awarding body requirements to be eligible for funding. Although awarding bodies allow some flexibility, this may be insufficient and there appear to be high costs associated with changing awarding bodies, further hindering their ability to respond quickly. Adding to that, few providers of FE are awarding bodies themselves, despite several providers commenting that they would like to be.
- **Short lead times of funding allocations and only a single year allocation** - these short lead times can hinder longer term planning and space for innovation and can make it difficult to invest in line demand.
- **Funding limits for independent providers** – independent providers face a cap on the level of provision they are able to deliver. This can constrain them amending their provision to meet higher than expected levels of learner demand.
- **Policy instability & uncertainty** - reduces the ability of providers to plan ahead and release resources for innovation. Specialised providers are arguably at greater risk of changes in policy priorities and funding because they have centred their business model on a certain type of provision.

- **Staff shortages** - there are staff shortages for many subjects for both teaching and assessment (e.g. maths) as FE providers compete with schools, Higher Education and with their associated occupations for skilled staff. Further education providers find it hard to attract skilled teachers away from other organisations that are able to pay more, including their trade or industry²³.
- **Local employment markets** - the employment and economic composition of a provider's catchment area can make a significant difference to their ability to respond to policy incentives. This is particularly true in the case of apprenticeships.
- **Inadequate provider governance** - weak governance and a lack of expertise and management skills are likely to be among the causes of provider difficulties in terms of responsiveness to market conditions. In some cases FE College leaders were not trained in how to manage such large 'businesses' as FE Colleges. In a minority of cases there are also problems around the length of board tenures.

Table 3 summarises these barriers.

Table 3. Barriers to responsive providers

	Structural barriers	Policy barriers
Ability to respond to learners and employers 	<ul style="list-style-type: none"> • Size of provider – smaller providers could find it more difficult to make significant changes to their FE offer • Staff shortages - can hinder the ability to provide those courses despite demand • High costs of changing awarding bodies – providers need to invest significant resources to re-train staff, purchase new teaching equipment 	<ul style="list-style-type: none"> • Difficulty in gaining awarding body status can in some cases hinder providers' ability to respond to employer needs. • One year funding allocations – these make it difficult to plan ahead and can deter investment to better respond to learner or employer demand. • SFA contracts for independent providers are capped and therefore it is difficult for providers to respond to changes in demand - they are not funded for any provision in excess of the cap.
Ability to respond to competitors 	<ul style="list-style-type: none"> • Natural monopolies and a minimum efficient scale can put some providers at a natural cost advantage • Large, predominantly sunk investment costs could hinder the responsiveness of providers to enter new segments of the market. This is particularly an issue for capital intensive parts of the market with very specific assets or where reputation and history can play a key role in learner recruitment. 	<ul style="list-style-type: none"> • Funding allocations based on previous year activity - where providers spot a market opportunity, in some cases it may not be straightforward to respond because funding will only change with a lag. • Multiple funding bodies - it may be difficult to change from focusing on one group of learners to another because of a required shift in funding streams e.g. EFA fund 16-19 year olds but SFA funds 19+

²³ The Teach Too initiative seeks to address this

Structural barriers

Policy barriers

Ability to respond to policy



- Local employment markets – the composition of local employers may limit provider's ability to respond to policy incentives, such as a shift to apprenticeships or to deliver 24+ Advanced Learner Loans.
- Underutilised or stranded assets - it can be difficult for providers to respond to policy incentives to shift to, for example, apprenticeships, if it leaves under-utilised or stranded assets from previous capital investments.

- Apprenticeships are only available as full time jobs (30 hours or more) which may limit attractiveness for some learners, making it hard for providers to recruit them.

Policy and regulation challenges

In the context of facilitating a dynamic FE market, policy and regulation have a specific role to ensure three main things:

- that competitive pressures are enabled (and not distorted or reduced), where they are appropriate;
- that competitive pressures are supplemented with policy and regulation where there are structural market failures; and
- that appropriate safeguards for consumers are available in the event of provider failure or for vulnerable groups.




In the context of enabling competitive pressures, we find there is a role for policy to enable effective consumer decision making, ensure a level playing field and stable policy environment for providers and ensure that providers have sufficient flexibility and incentives to respond to consumer needs.

There are a number of areas within the FE market where there appear to be structural or natural market failures that mean that the competitive process is likely to be impeded. There is a role for policy in recognising and regulating any true natural monopolies (created by a combination of economies of scale in provision coupled with small catchments). There is also a role for policy to ensure that there is a coordination of provision across larger geographical areas where individual providers are incentivised to focus on local demand.

In the context of enabling competitive pressures, policy plays an important role in ensuring that the market works effectively but also recognising where competitive markets are not appropriate and providing alternative incentives for efficiency and quality. It also acts as a safeguard to learners.

Our analysis of these policy and regulatory challenges for FE is summarised in Table 4.

Table 4. Policy and regulatory challenges

Challenges for policy and regulation	
Ability to enable competitive pressures	 <ul style="list-style-type: none"> • Lack of requirement for schools to provide impartial advice and guidance on the full range of options open to learners • Lack of targeting of public information sources towards the needs of different learner groups – lots of information available (e.g. FE Choices) but could be improved • Lack of rewards for activities to reach out to disadvantaged groups – funding system and quality assessments do not reward out-reach work with learners who may have lower retention rates • Single year funding allocations and little advanced notice of the next year's funding hinder longer-term planning and innovation • Funding system hinders new entry and competition in the market as direct contracts roll-on (as long as minimum standards are met) • Difficulty for FE providers to become awarding bodies could hinder innovation and ability for providers to meet employers' needs
Supplementing competitive pressures	 <ul style="list-style-type: none"> • Lack of regulatory framework to address any natural monopolies (economies of scale in provision coupled with low demand) • Lack of recognition in funding for the role of minimum efficient scale • Absence of systematic promotion of coordination of provision where minimum efficient scale means multiple providers would not be efficient, and without co-ordination, may lead to gaps
Safeguarding consumers	 <ul style="list-style-type: none"> • Lack of transparency around mechanisms to ensure quality of sub-contractors and workplace based training • Lack of widespread appropriate security of provision for learners in the event of exit of providers (SFA may not be appropriately involved, learners may discontinue their learning, administrative delays may occur) – many learners could be left stranded. SFA is only involved in finding alternative providers where direct contractors fail. • Lack of transparency and knowledge about interdependencies in the market caused by sub-contracting – this could lead to the impacts of a failure cascading widely to others in the market

Concluding remarks

The in-depth analysis undertaken for this study has found that in many areas of the FE market, we observe characteristics that are consistent with a well-functioning market. A key objective for policy is to therefore facilitate the continuation of what is working well and to identify those areas where there is a need for policy intervention. Some of the key policy implications are:

- **Recognising the limitations of competition in the FE market:** we have shown that in some cases, there is limited choice for learners and there are few competing providers. This could reduce the incentive for provision to be innovative and

efficient. However, in some cases competition would not be likely to lead to the best outcomes for learners and employers because the market dynamics make competition (involving several providers) unviable. In such cases, alternative mechanisms for incentivising efficiency, quality and innovation are likely to be worthwhile.

- **Addressing barriers to active consumers:** Our work suggests that learner decision-making is extremely complex and localised and choices may not always lead to the best further education or labour market outcomes for learners. The decision as to whether to participate in FE at all poses a particular problem for some key groups. Key issues include ensuring young people at school have access to impartial advice; engaging groups who might not otherwise participate in FE (often considered 'hard to reach'); and strengthening the links between potential learners and employers.
- **Addressing barriers to responsive providers:** our analysis suggests variability in the extent to which providers are responsive to learners, employers, other providers with whom they compete and government (often a primary source of funding). This is often expected within a market as some providers will be subject to more pressures than others and some will be better able to respond, with poorer providers entering financial difficulties. The route to exit of poor providers must be clear but must also ensure that learners are not stranded without provision. The intervention process for all providers must be transparent, based on the same principles and create the incentive to deliver high quality FE efficiently. In addition, quality assessments must be appropriate and timely; and funding should not unduly inhibit flexibility to local market conditions or hinder changes to provision where there is local, regional or national demand.
- **Addressing wider policy and regulatory challenges:** policy has a significant impact on the way the market operates, whether through funding, quality assessments or procedures for contracting. Sub-contracting offers clear value to providers and learners but aspects of it are not currently well understood, such as the interdependencies this creates across the FE market. Issues identified in this study include a lack of appropriately targeted impartial information for different learner groups; impacts of the funding market on the responsiveness of providers (such as short lead times for funding allocations) and the impacts of local structural barriers on the ability of providers and employers to respond to national policy signals.

1. Introduction

Context and objectives

Further Education (FE) in England refers to any study taken after the age of 16 that is not part of higher education (that is, not taken as part of an undergraduate or post-graduate degree)²⁴. FE is delivered by a range of public, private and voluntary providers. In general, FE equips a learner for further learning, including higher education (HE) or for employment.

The purpose of this report is to:

1. **Describe the FE market**²⁵: the economic structure, policy landscape and key players in the market;
2. **Investigate the extent to which we observe features in the FE market that are common to well-functioning markets** and to identify where such features would not be appropriate given the wider objectives of FE;
3. **Identify the barriers that prevent the FE market functioning effectively**; and therefore,
4. Stimulate discussion of **priorities for policy intervention** to improve effectiveness.

Scope

Our analysis in this report focuses on:

- **Publicly funded and regulated provision**: the main sources of funding from the government are £6.2 billion from the Education Funding Agency (EFA) an agency of the Department for Education (DfE), which funds further education for learners aged 16-19 years; and the Skills Funding Agency (SFA) provides £3.8 billion of funding for further education divided into the Adult Skills Budget worth £2.1 billion²⁶ and the Apprenticeship budget worth £1.4 billion in 2013/14. The remainder of the budget includes student/ learner support. We therefore do not directly include in our analysis the vast range of education and training that is funded privately by employers for their employees. For the purposes of this analysis we consider the funding mechanism as it currently is at the time of writing. We note that the current qualifications-based approach is under review – the consideration of alternative funding methods is outside of the scope of this study, as is the detailed assessment

²⁴ This is the definition used by the UK Government. See: <https://www.gov.uk/further-education-courses/overview>

²⁵ For the purposes of this study we are focusing on publicly funded and regulated FE (including direct funding and via loans) in England only. We are not including the wider work that some FE providers undertake, such as provision for those still in school (14-16), provision of programmes of prescribed higher education or overseas skills activities.

²⁶ This includes Adult Community Learning and funding for the Offending Learning and Skills Service (OLASS)

of private and social returns to further education learning (though we refer to these where relevant).

- **The provision of further education:** we do not consider the wider work that some FE providers undertake, such as provision for those still in school (14-16), provision of programmes of prescribed higher education or overseas skills activities.
- **Further education in England:** further education is a devolved matter so we do not look at the markets of FE provision in Scotland, Wales or Northern Ireland.

Approach

We have brought together a wide range of quantitative and qualitative evidence to inform this report. This includes:

- **Extensive literature and evidence review:** we have reviewed published literature including academic publications, research reports, statistical publications, guidance documents, government policy documents, provider annual reports and financial statements and legislation, among others.
- **Quantitative analysis:** we have used the most comprehensive datasets available. We have obtained permission to use very detailed data from the Individualised Learner Record (ILR) for 2013/14²⁷; the National Course Directory²⁸; and the Provider Information Management System (PIMS)²⁹.
- **Qualitative analysis:** to ensure that we have been able to develop a deep understanding of the functioning of the FE market from those that operate within it and those that use it, we have carried out a broad programme of stakeholder engagement. We have carried out a series of around 60 interviews with stakeholders as shown in Figure 3. These are grouped in terms of providers and their representatives; learner representatives and employers; and, market stakeholders (such as regulators and policy makers).

²⁷ The ILR provides detail on all learning aims that are delivered in England (other than for 16-19 year olds in School Sixth Forms), along with detailed anonymised information about the characteristics of learners (such as their home post code, their place of learning, their age etc.). The ILR includes all learning aims delivered by Colleges plus all learning aims that are delivered by other providers that are funded either by EFA or SFA. There are almost 15 million observations making this the richest possible source of data.

²⁸ The National Course Directory provides details on every course that is eligible for funding by the EFA or SFA. This covers over 100,000 learning aims.

²⁹ The Provider Information Management Information System (PIMS) is a financial dataset that allows us to interrogate the funding streams that flow to each provider.

Figure 3. Qualitative data: stakeholder interviews

Qualitative	Providers and representatives	Learner representatives and employers	Market stakeholders
	<ul style="list-style-type: none"> Independents, FE Colleges, specialist, SDIs, community, subcontractors AoC, AELP, HOLEX, LEAFA 	<ul style="list-style-type: none"> Careers advisers, NIACE Academics specialising in FE Sector Skills Councils, Local Enterprise Partnerships Employers, UKCES, FISSS 	<ul style="list-style-type: none"> Regulators: Ofqual, Ofsted Skills Funding Agency Awarding bodies FE Commissioner BIS policy leads

The work has also benefited from critical challenge from a ‘Critical Friends Group’ including the Association of Colleges, the Association of Employment and Learning Providers; the Education and Training Foundation; the UK Commission for Employment and Skills; and the National Institute of Adult Continuing Education.

We wish to thank all the stakeholders for their time and very valuable input to this study. A full list of stakeholders we have interviewed is in Annex 1.

Using these sources of evidence, the study has followed the five steps shown in Figure 4.

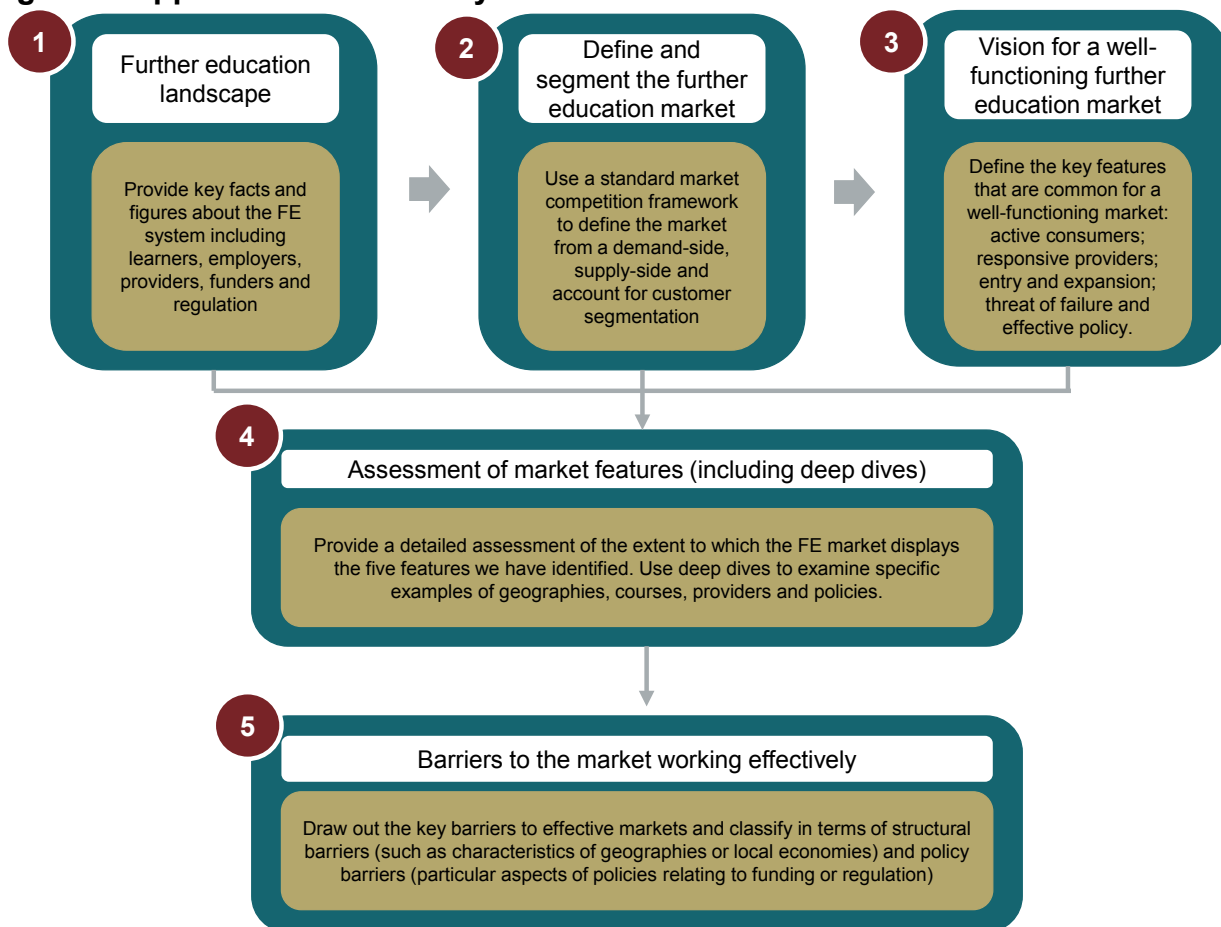
- Step 1 – Description of the FE landscape:** we have presented a wide range of analysis to describe in detail the breadth and coverage of the (publicly funded) FE market in England and the activities of key parties that engage with it. This includes information on learners, employers, providers, regulation and funding.
- Step 2 - Definition and segmentation of the Further Education ‘market’:** we have carried out a market definition exercise, commonly used by the Competition and Markets Authority to define and understand the different parts of the FE market at a disaggregated level. This considers the product and geographical markets from the demand-side (i.e. the extent to which learners and employers would be willing to substitute one aspect of the further education offer for another); and the supply-side (the extent to which providers can switch their offer from one aspect to another). Overlaying these perspectives is consideration of customer segmentation because it is important to recognise that a part of the FE offer considered equivalent to another from one party’s perspective is not likely to be considered equivalent from another party’s perspective. We therefore describe a series of sub-markets.
- Step 3 – Vision for a well-functioning FE market:** we have identified 5 features that well-functioning markets tend to display. These features are used as the basis for observing the extent to which the market mechanism is appropriate for each sub-market of the FE market.
- Step 4 – Assessment of market features (including deep dives):** combining evidence from the full range of sources used for this study, we have made assessments of the extent to which the different FE sub-markets display each of

the 5 features identified in Step 3. To make this analysis tractable given the vast range of courses and providers, we undertook a number of 'deep dive' assessments into particular sectors and issues. The sectors that were explored in more detail were Engineering and Manufacturing, Health and Social Care and Preparation for Life and Work. Issues explored in some depth were subcontracting, co-ordination of provision, substitutability of courses, and the impacts of geographical markets.

- 5. Step 5 – Summary of barriers:** using our assessment in step 4, we have identified a number of barriers that prevent specific FE sub-markets from operating effectively. We have categorised these as structural and policy barriers. Structural barriers are those which are intrinsic to the FE market or wider economy and policy barriers are those where the design or implementation of policy is causing a specific blockage or is failing to provide the right incentives to allow a well-functioning market.

Our analysis concludes with some overarching key findings.

Figure 4. Approach for this study



Limitations

This study has been carried out over a period of around 6 months. The length of this study means that there have inevitably been trade-offs in terms of the depth with which certain topics could be examined and the breadth of issues that needed to be covered. We have tried to strike an appropriate balance but inevitably there are issues that would merit further investigation and analysis.

We are very grateful for the time and input of our stakeholders. We designed the stakeholder engagement to cover as much of the FE market as possible in the time available (noting a 6-week necessary pause within the period because of the UK General Election). The breadth of stakeholder interviews has however been limited by the time and resource available for this study.

Given the context specific nature of the issues in the FE market, it has been necessary to carry out analysis both at an overarching and more aggregated level, and to complement this with more detailed 'deep dives' into particular courses, geographies, issues and aspect of the market. By their very nature, these deep dives are case specific and we have carried out the analysis to draw out lessons we can learn from these that are relevant

more widely. Clearly, other examples and case studies could be explored and for some issues, there is likely to be merit in doing so.

2. Further Education landscape

Key findings

The FE market in England is complex. Of the **4 million learners** participating in publicly funded FE with **1,150 providers** across England in 2013/14, the majority were participating at FE Colleges. Around 50% of FE learners participate in General FE Colleges (including Tertiary); a further 22% with private providers (publicly funded); around 20% with other publicly funded organisations such as Local Authorities and HE; and the remainder at School Sixth Forms, Sixth Form Colleges and Special Colleges.

The **total public budget for FE in 2013/14 was over £10 billion**. The Skills Funding Agency provides £3.8 billion of funding for further education divided into the Adult Skills Budget worth £2.1 billion³⁰ and the Apprenticeship budget worth £1.4 billion in 2013/14. The remainder of the budget includes student/ learner support. Some £6.2 billion is provided from the Education Funding Agency (EFA)³¹. A further £159 million was provided by the European Social Fund (ESF). The EFA funds young people under 19. Adult funding is administered by SFA and applies to all learners aged 19+.

Learners' choices about FE tend to be **very localised**. Most learners (70%) travel less than 10km from their home to the site of their provider, with 50% travelling less than 6km. The time taken by and the cost of travel are key constraints. This means that some learners in some parts of the country have a limited range of alternatives available to them. The **sparsity** of provision in some areas also has implications for the potential competitive constraints faced by these providers.

There has been **minimal entry** into the publicly funded FE market over the last 3 years (apart from subcontractors, school 6th forms and some publicly funded University Technical Colleges for example) but there has been **extensive merger and consolidation** activity and also reasonable numbers of **exits** (of private providers). But providers have been **flexing their offers** considerably over this period with more than 50% expanding into a new subject area and 35% withdrawing from a subject area.

Subcontracting is a significant feature of the FE market, accounting for £780 million of contract commitments in 2014. Subcontracts are typically long standing (>5 years), focused on 16-18 apprenticeship and 19+ apprenticeship provision and particularly present in the construction, care delivery and health and training sectors. Lead providers typically retain between 5% and 30% of subcontractor's funding as management fees.

FE providers in receipt of public funding are subject to a range of **regulations**. They must be on the register of training organisations and subject to appropriate due diligence. They are subject to regular quality inspections by **Ofsted** and financial health checks.

³⁰ This includes Adult Community Learning and funding for the Offending Learning and Skills Service (OLASS)

³¹ Covering funding for schools and FE providers.

Introduction

The FE market in England is complex. It engages with millions of learners (around 4 million publicly funded learners in 2013/14) from a wide range of backgrounds participating in learning with one (or more) of 1,150 publicly funded FE providers across the country.

The total public budget for FE in 2013/14 was over £10 billion. The SFA provides £3.8 billion of funding for further education divided into the Adult Skills Budget worth £2.1 billion³² and the Apprenticeship budget worth £1.4 billion in 2013/14. The remainder of the budget includes student/ learner support. Some £6.2 billion is provided from the EFA³³. A further £159 million was provided by the European Social Fund (ESF). It is worth noting, in the context of government funding that there is an important distinction in the publicly funded FE market between learners aged under 19 and those aged 19 and over. The former are predominantly funded on a per programme³⁴ basis by the EFA, and this provision is free for the learner; and, the latter are currently funded predominantly on a per qualification basis by the SFA, in some cases with an important element of co-funding by the learner or employer.

In this chapter, we describe in detail many of the components of the FE landscape. We provide a description of the types of study that can be undertaken within the FE market, the learners that engage with the market, what they engage with and how they engage, the providers that deliver the study programmes and, finally the role that policy and regulation play within the market.

The rest of the chapter is structured as follows:

- The different types of education and training available with the FE market.
- The learners that participate in FE as well as the employers who also benefit from FE.
- Detailed description of the publicly funded providers, setting out the range of provider types, their governance structures, their histories and also the evolution of provider types in the market (covering entry and exit).
- Key elements of policy and regulation that are associated with the FE market.

³² This includes Adult Community Learning and funding for the Offending Learning and Skills Service (OLASS)

³³ Covering funding for schools and FE providers.

³⁴ A programme must have a core aim – either a substantial academic or vocational qualification or work experience. The study programme must be tailored to each individual student, have clear study and/or employment goals reflecting the student's prior attainment, aspirations and abilities and include substantial qualifications or extended work experience, maths and English for students who have not achieved grade A*-C GCSE in these subjects by age 16, high-quality meaningful work experience and added value non-qualification activity.

Types of education and training available within the FE market

Education and training within the publicly funded FE market for adults is currently largely structured around qualifications. Funding tends to be routed via qualifications (even for 16-19 year olds, qualifications form a key part of their study programmes³⁵) and, as a result, the majority of learners are working towards one or more qualifications. There are over 15,000 different qualifications on the Ofqual Register of Regulated Qualifications. A complete list of all qualifications in England can be found on the National Course Directory. Qualifications range from courses of just a few hours like Health & Safety courses to A-Levels that take two years to complete, and some courses and apprenticeships that last longer still.

Qualifications are awarded by one of the 160 awarding organisations.³⁶ The largest awarding bodies are City and Guilds and Pearson. Although about to be withdrawn, the Qualification Credit Framework (QCF) is the current system of credit transfer to gain qualifications. One credit is broadly equivalent to 10 learning hours – learners can therefore estimate how much time they will need to gain the desired qualification. All QCF qualifications fall within three types: Awards (1-12 credits), Certificates (13-36 credits) and Diplomas (37 and more credits). There are also qualifications and other courses that fall outside of the QCF, such as Access to HE, A-Levels and GCSEs.

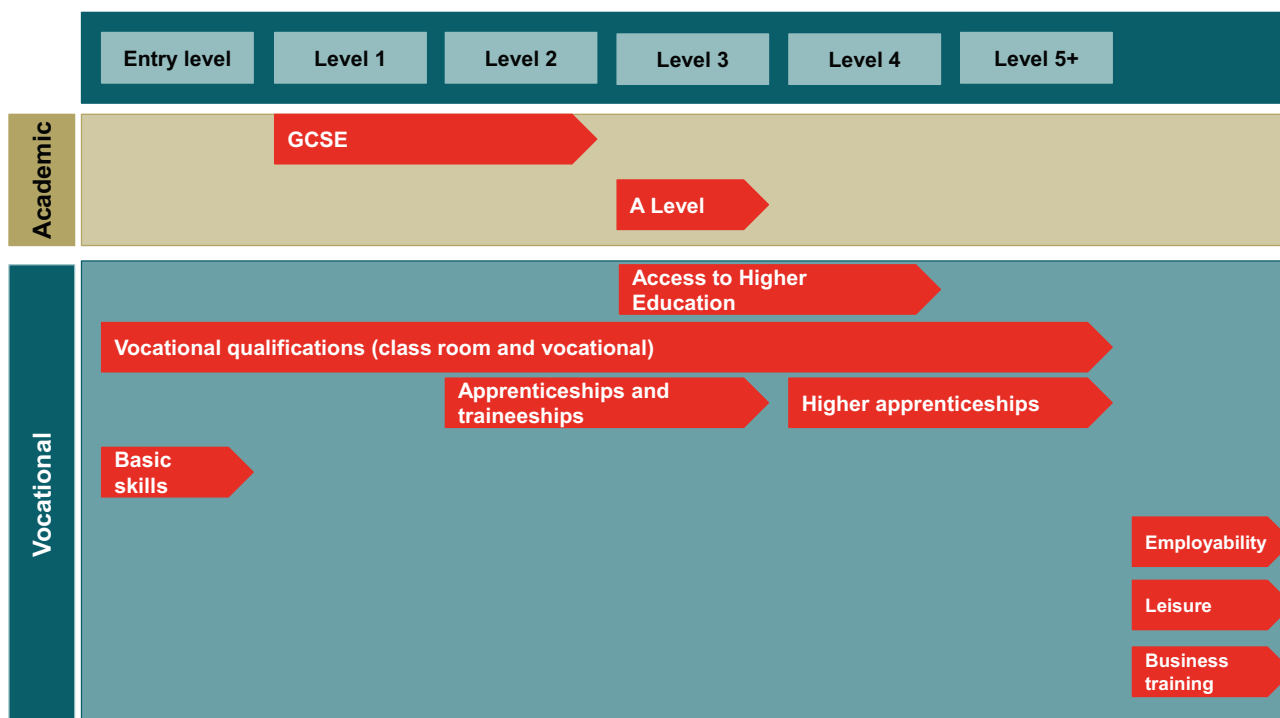
Learning methods vary depending on the course or programme. Methods include classroom-based full time or part time learning; workplace and community-based learning. The setting can be extremely important to the learner and may play a key role in their decision to participate in learning.

Given this diversity, it can be difficult to classify courses within the FE market in a succinct way. Figure 5 shows a characterisation of qualifications and programmes. It is worth noting that a learner may do more than one qualification as part of an apprenticeship.

³⁵ School and College Performance Tables (<http://www.education.gov.uk/schools/performance/index.html>) play a useful role in encouraging qualifications uptake

³⁶ The Office of Qualifications and Examinations Regulation (Ofqual) regulates qualifications, examinations and assessments in England and vocational qualifications in Northern Ireland. Ofqual recognise awarding organisations and AOs must meet their regulatory requirements (AOs can choose not to be recognised by Ofqual). Ofqual also has the authority to stop recognising a qualification if the quality slips. As a result, awarding bodies can be seen as indirectly regulated by Ofqual. Not all the qualifications mentioned in the report are regulated by Ofqual, such as Access to HE which is regulated by the Quality Assurance Agency.

Figure 5. Qualification framework with academic and vocational and level split



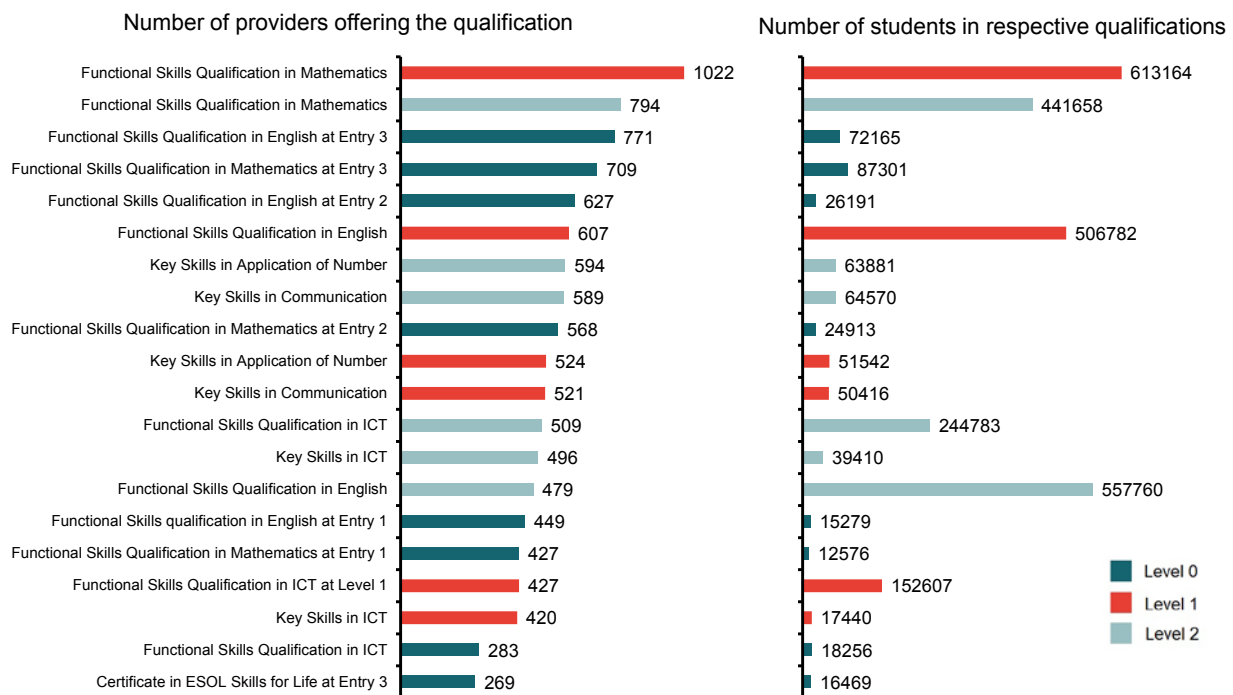
A deep dive into qualifications in three sectors

As noted above, the FE market provides qualifications across a wide range of sectors. There are 49 different SSA tier 2 sectors covered by FE, ranging from Architecture to Animal Care and Veterinary science to Hospitality and Catering, Travel and Tourism, Marketing and Sales and Preparation for Life and Work.

As the sector dimension is so important to understanding the FE landscape, the types of qualifications offered within three sectors have been explored in more detail (Preparation for Life and Work courses, Health and Social Care courses and Engineering and Manufacturing).

Figure 6 shows the twenty most common qualifications offered within the Preparation for Life and work sector. It shows the number of providers offering each qualification, the number of students taking the qualification and the level of that qualification. The three most common qualifications are the Functional Skills Qualifications in Mathematics at Levels 1 and 2 and the Functional Skills Qualification in English at Level 0. Other qualifications offered include Key Skills in Application of Number and Communication, Key Skills in ICT and Functional Skills Qualifications in ICT.

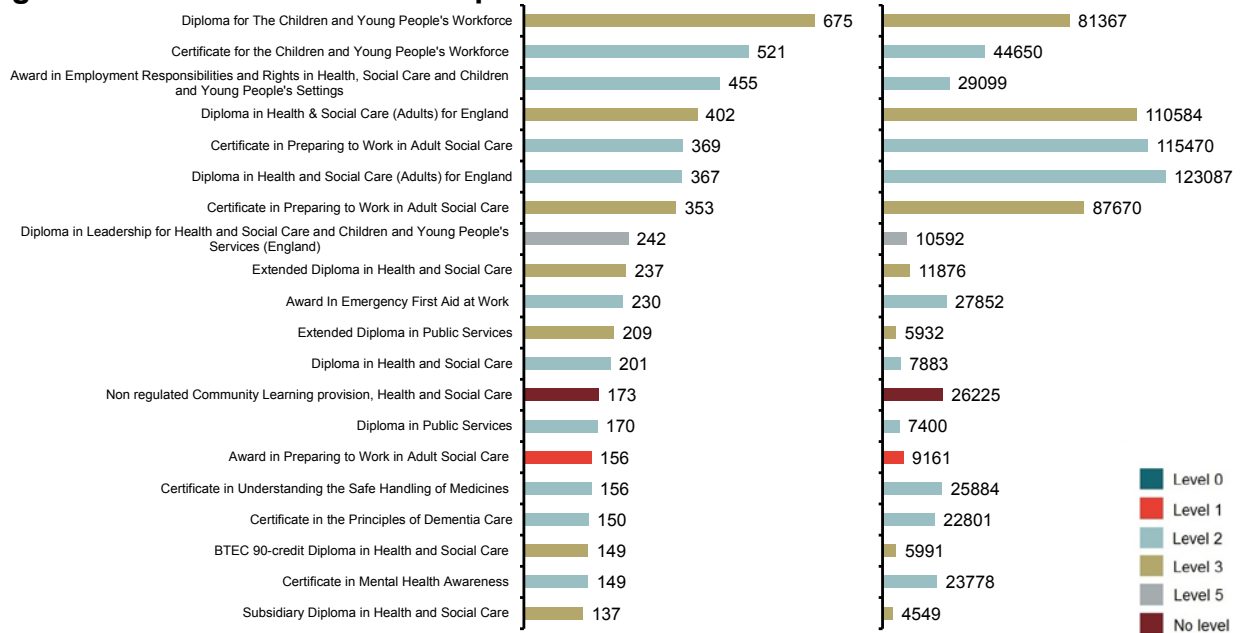
Figure 6. The 20 most common qualifications offered in the Preparation for Life and Work sector



Source: Frontier analysis of ILR data

Figure 7 shows the twenty most common qualifications offered within the Health and Social Care sectors. It shows the number of providers offering each qualification, the number of students taking the qualification and the level of that qualification. Qualifications span levels 1 to 5 within this sector, with the most common qualifications offered at Levels 2 and 3 including the Diploma and the Certificate for the Children and Young People’s Workforce and the Diploma and Certificate in Health and Adult Social Care.

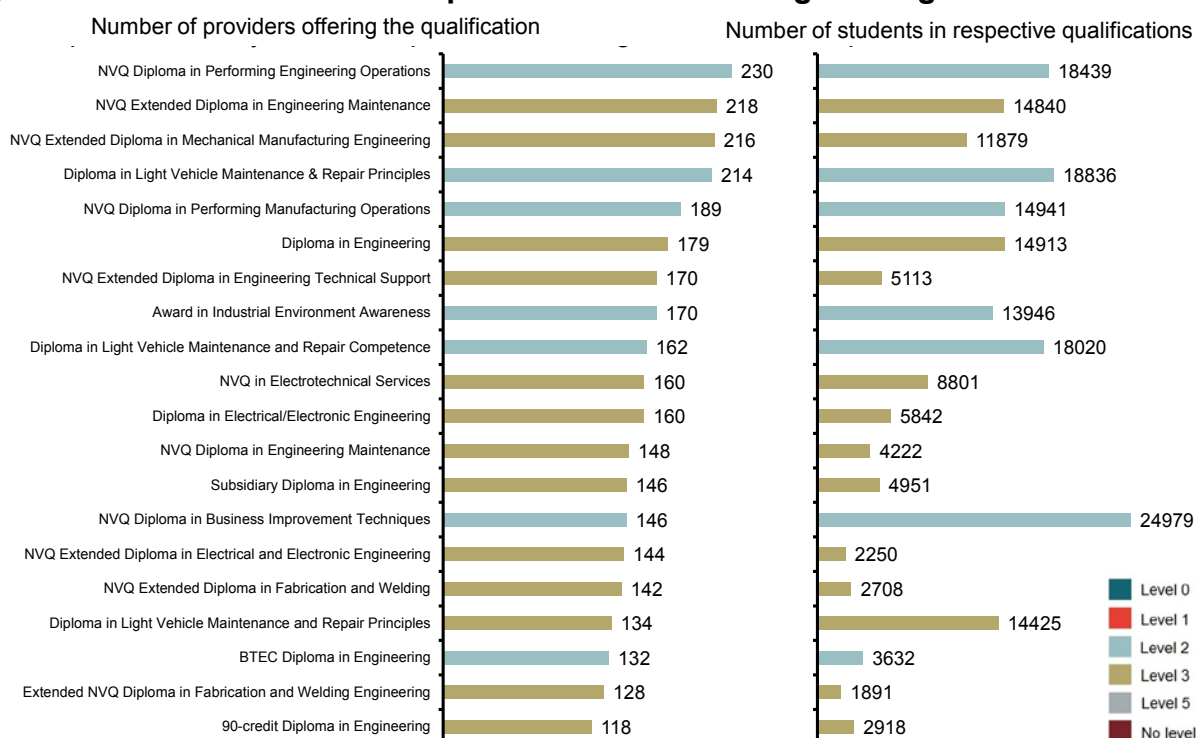
Figure 7. The 20 most common qualifications in the Health and Social Care sector



Source: Frontier analysis of ILR data

Figure 8 shows the twenty most common qualifications offered within the Engineering and Manufacturing sector. The most common qualifications offered are the NVQ Diploma in Performing Engineering Operations (Level 2) and the NVQ Extended Diploma in Engineering Maintenance (Level 3).

Figure 8. The 20 most common qualifications within Engineering and Manufacturing



Source: Frontier analysis of ILR data

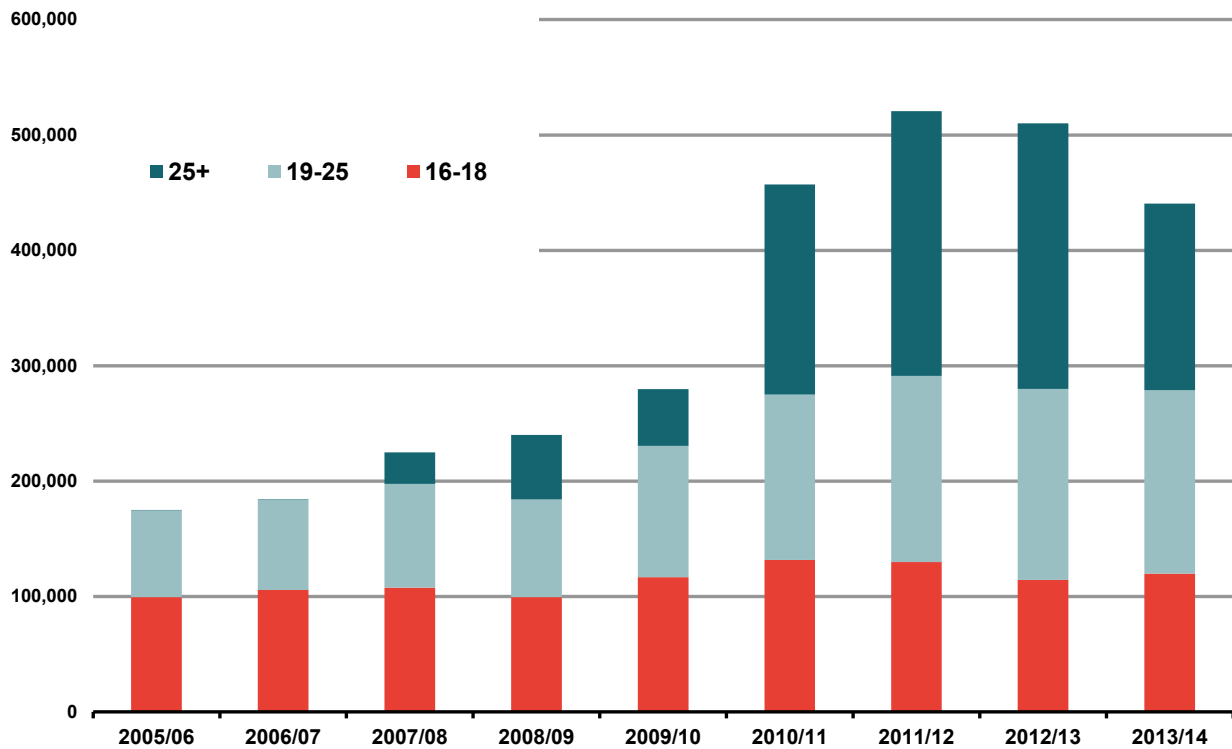
Apprenticeships

Apprenticeships have become a focus of government policy with a key target for 3 million Apprenticeships to be started by 2020.

As noted above, Apprenticeships incorporate on-the-job training and some incorporate day release to study for a qualification. Apprenticeships are paid jobs with at least 30 hours of work a week paid at or above the national minimum wage for apprentices. They are divided into subject framework areas e.g. accounting, blacksmithing, and hairdressing and there are over 220 different frameworks available in England. There are three levels of apprenticeships: Intermediate Apprenticeships which provide level 2 qualifications upon successful completion, Advanced Apprenticeships which provide level 3 qualifications and Higher Apprenticeships which provide level 4 qualifications or above.

Figure 9 shows the number of apprenticeship starts since 2005/06 and the breakdown according to the age of the learners. It shows that the number of apprenticeships has grown since the levels of 2005/06 and despite a recent dip in the last year, there are now consistently over 400,000 starts per year. It shows that the majority of apprentices are adults - around 68% are aged 19 years or above.

Figure 9. Apprenticeship starts 2005/6 to 2013/14



Source: Government FE data library: <https://www.gov.uk/government/statistical-data-sets/fe-data-library-apprenticeships>

Apprentices are employed and most of the training is delivered in the workplace on the job or off the job. Colleges account for 37% of 16-18 apprenticeships and 33% of 19+ apprenticeships; private providers account for 58% of all apprenticeships (53% of under-19s and 61% of over 19s). The remainder of apprenticeships are delivered by other publicly funded providers such as sixth form colleges, schools and special colleges.

The amount that the government contributes to apprenticeships depends on the age of the apprentice and the size of the firm. In general, for those aged 16-18, government contributes 100% of the cost (i.e. the funding rate is assumed to cover the full cost); for those aged 19+, employers are expected to contribute as government will fund up to 50% of the apprenticeship framework cost (i.e. 50% of the fully-funded rate). The funding formula reduces public funding by 25% for apprenticeship provision for those aged 19 and over and other workplace provision delivered to employees of large employers (more than 1,000 employees).

Learners

FE learners are considered to be those aged above 16 taking publicly funded programmes (at school or on apprenticeships) that will equip them for further learning including HE, a career or more effective engagement in civil society or a career. These courses can be apprenticeships, classroom-based training, vocational training or recreational learning.

Learner backgrounds

In 2013/14 there were around 4 million learners participating in FE, including around 851,000 learners on apprenticeships. Learners are located right across England and are from all age groups. Some 25% of learners are less than 19 years of age; the majority of learners – around 60% - are between 19 and 50 years of age with a further 15% who are over 50 years of age³⁷.

Further education attracts learners from a wide range of backgrounds. The ethnic composition of (adult) learners is diverse. Around 80% of FE learners are white with just under 10% Asian or Asian British and a further 6% black, African, Caribbean or black British³⁸.

Analysis for BIS in 2011 explored the employment status and earnings of learners in the year before they participated in FE³⁹. The research found that 12% of learners participating in FE training (excluding apprenticeships) were on benefits in the year before their learning and 56% were employed. This compares with those participating in apprenticeships where 3% were on benefits in the year before they took up the training and 47% were employed.

Learner motivations

Learners vary widely in terms of their motivations to participate in FE. Their motivation and what this means for the type of provider they are likely to engage with as well as the way in which they select and view their training is critical to understanding the complex landscape of this market. Some examples are:

- **Vocational education, pre-HE:** some learners leave school and would prefer to participate in vocational education to build their skills and experience (such as in engineering) before moving to a more advanced course in higher education
- **Vocational education, pre-employment:** some learners are attracted to vocational education in order to develop the skills they need to directly enter an occupation after they have completed their qualification. This may be for example hairdressing or catering.
- **Apprenticeships:** in order to be employed while also learning, some learners prefer to follow the apprenticeship route. Those typically employed as apprentices have either been in previous employment (with the same or different employer) or are at the beginning of their working career.

³⁷ Government FE data library: FE and skills participation: all ages demographic summary 2013/14
<https://www.gov.uk/government/statistical-data-sets/fe-data-library-further-education-and-skills>

³⁸ Government FE data library: FE and skills by geography and equality and diversity: achievement 2002/03 to 2013/14

³⁹ Reporting on Employment and Earnings using Experimental Matched Data, BIS 2011 (Table 2)
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32352/11-1037-reporting-on-employment-earnings-experimental-matched-data.pdf

- **Personal interest:** there are further education learning opportunities, often in the community, to participate in a course or qualification purely for enjoyment or interest.
- **Mandated by JobCentre Plus:** for some unemployed individuals who are claiming Job Seekers Allowance, they are mandated by JobCentre Plus (JCP) to enter into a study programme if they do not have a job.
- **Prison education:** prisoners have access to further education learning opportunities to allow them to build particular skills or qualifications in advance of being released.
- **Functional life skills:** for some learners with disabilities or learning difficulties, further education providers play a valuable role in building their life skills and preparing them for independent living.
- **Confidence building:** for disadvantaged groups, further education can play a vital role in providing the opportunity to participate in learning when otherwise they may not have done. This can bolster their confidence and ignite a passion for learning among some learners which they then continue through further learning.
- **Second chance learning:** for some learners who did not reach their potential in secondary school by achieving GCSE's or A-levels, FE can offer the opportunity of a second chance to achieve these qualifications to bolster employability.
- **Languages:** English for speakers of other languages (ESOL) is also provided by the further education market to help learners to get a job, participate in further learning and integrate in society.

Where learners are studying

Of the 4 million learners undertaking publicly funded FE with providers across England in 2013/14, the greatest proportion were learning at FE Colleges. Around 50% of FE learners were in General FE Colleges (including Tertiary); a further 22% with private providers (publicly funded); around 20% with publicly funded organisations such as Local Authorities and HE; and the remainder at School Sixth Forms, Sixth Form Colleges and Special Colleges.

A significant proportion of learners (40%) are studying for courses at level 2, equivalent to 5+ A* to Cs at GCSE level. Around 11% are studying entry level courses; 15% of learners are studying at level 1; and around 20% are level 3. The remainder of learners are spread thinly above level 3⁴⁰. When considering apprenticeships specifically, the majority (60%) are also at level 2 (the intermediate level). Around 350,000 apprenticeships (almost 40%) are advanced (level 3) with currently very few at the higher level (level 4 and above)⁴¹.

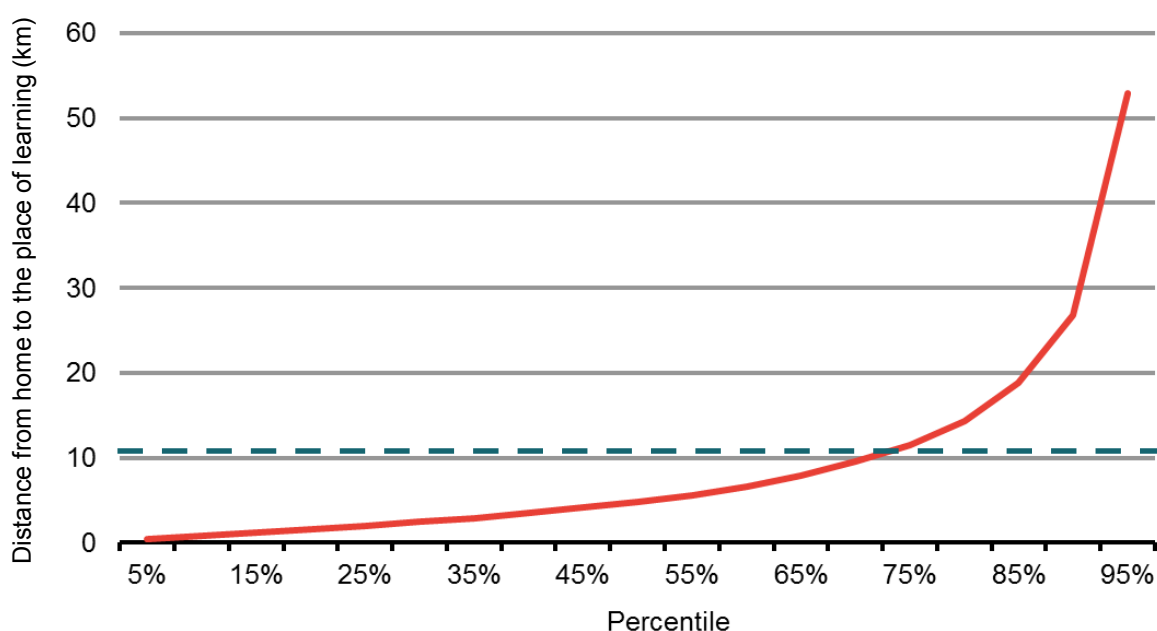
⁴⁰ Source: Frontier analysis of ILR data

⁴¹ Source: Frontier analysis of ILR data

Distance travelled by learners

The geographical characteristics of the FE market are extremely important to understand. Learners are often extremely constrained in terms of willingness or ability to travel. As shown in Figure 10, most FE learners (around 70%) travel less than 10km from their home to reach the site of their provider⁴², with 50% travelling less than 6km. The figure also shows that there are a small proportion of learners (5%) who travel great distances (more than 50km⁴³) to reach their place of learning.

Figure 10. Distances travelled from home postcode to the FE provider



Source: Frontier analysis of ILR data

Distance travelled increases with the qualification level. Learners travel on average 4.3km for a level 1 course, 5.1km for a level 2 course and 5.9km for a level 3 course. The distance travelled also varies according to the sector of the training. Learners travel short distances on average for ICT and Preparation for Life and Work courses (an average of 3.4km and 3.8km respectively). Learners travel the largest average distances to courses within the Construction, Planning and the Built Environment sector (7.3km), Engineering and Manufacturing (7.9km) and Agriculture, Horticulture and Animal Care (13.4km). These figures tell an interesting story. Even at higher level or for courses in more specialised sectors (e.g. agriculture) learners do not travel much further than 10km on average. The

⁴² We calculated the distance travelled by learners as the straight-line distance between a learner's home postcode and the provider's postcode. The analysis includes all learning aims and all providers' sites.

⁴³ It has not been possible to identify those instances where this observation may be due to the failure to update postcodes for some learners (meaning their actual postcode is not the same as their registered postcode) as opposed to the fact that the place of learning is close to the learner's workplace but some distance from learner's registered postcode or that learners genuinely travel a large distance for particular types of courses.

median distance travelled for a level 7 qualification is just 11.7km and it is 13.4km for an Agriculture and Horticulture course.

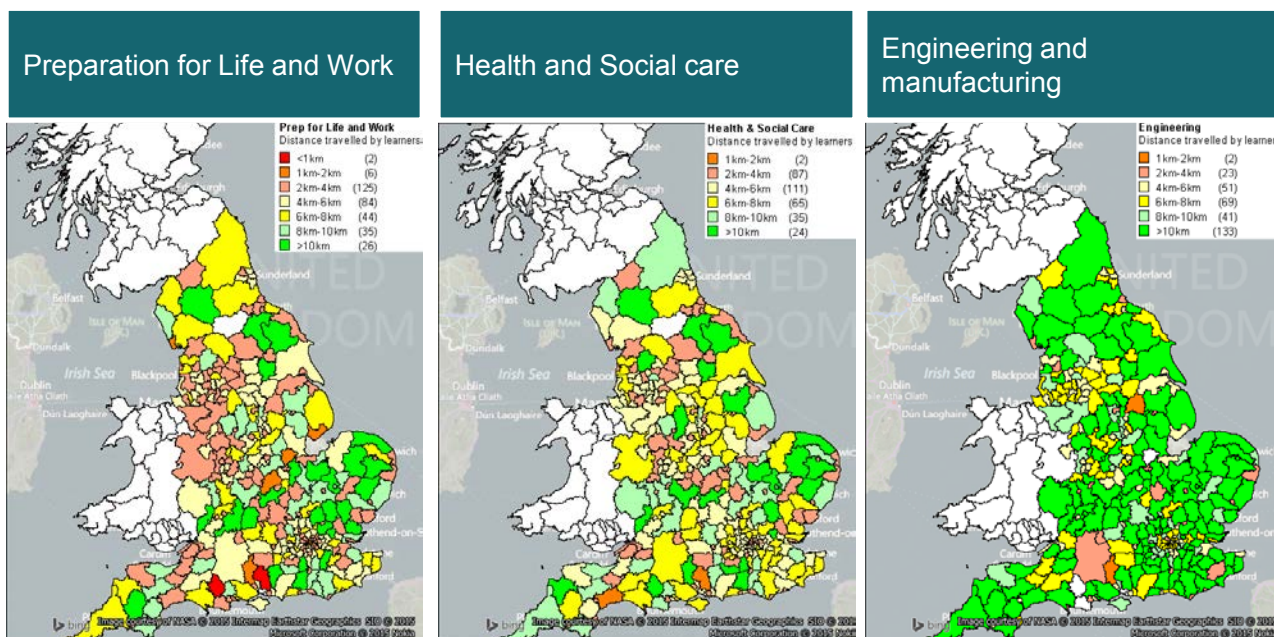
There is a degree of variation across the country that these averages hide. The maps in Figure 11 show the average distances travelled by learners to courses in our three deep dive sectors at a Local Authority District (LAD) level. The distance travelled by learners appears to be shorter for basic subject areas like Preparation for Life than for more specialised areas like Health and Social Care and Engineering and Manufacturing. In particular, most learners can be seen to travel less than 6km for Preparation for Work and Life and 8km for Health and Social Care⁴⁴. For Engineering and Manufacturing, the average distance travelled by learners is more than 10km across most of the country.

Learners appear to travel less far around big cities - such as London, Manchester and Birmingham – and further in more rural areas like Norfolk and Cornwall. Differences in how far learners travel are likely to partly reflect the extent of local provision. For example, learners in areas with 1 college within 10km travel 8km on average, whereas learners with 5 colleges within 10km travel 4.8km on average.⁴⁵ Although this illustrates the impact of supply on distance travelled, it is less easy to see the impact of demand-side factors, as these are likely to be more diverse.

⁴⁴ Note that at the individual course level, the distances travelled are likely to show even greater variation as providers will in some cases have built up expertise over many decades.

⁴⁵ Averages are medians calculated at LAD level.

Figure 11. Average distances travelled by learners to their FE provider, by subject area



Source: Frontier Economics analysis of ILR data

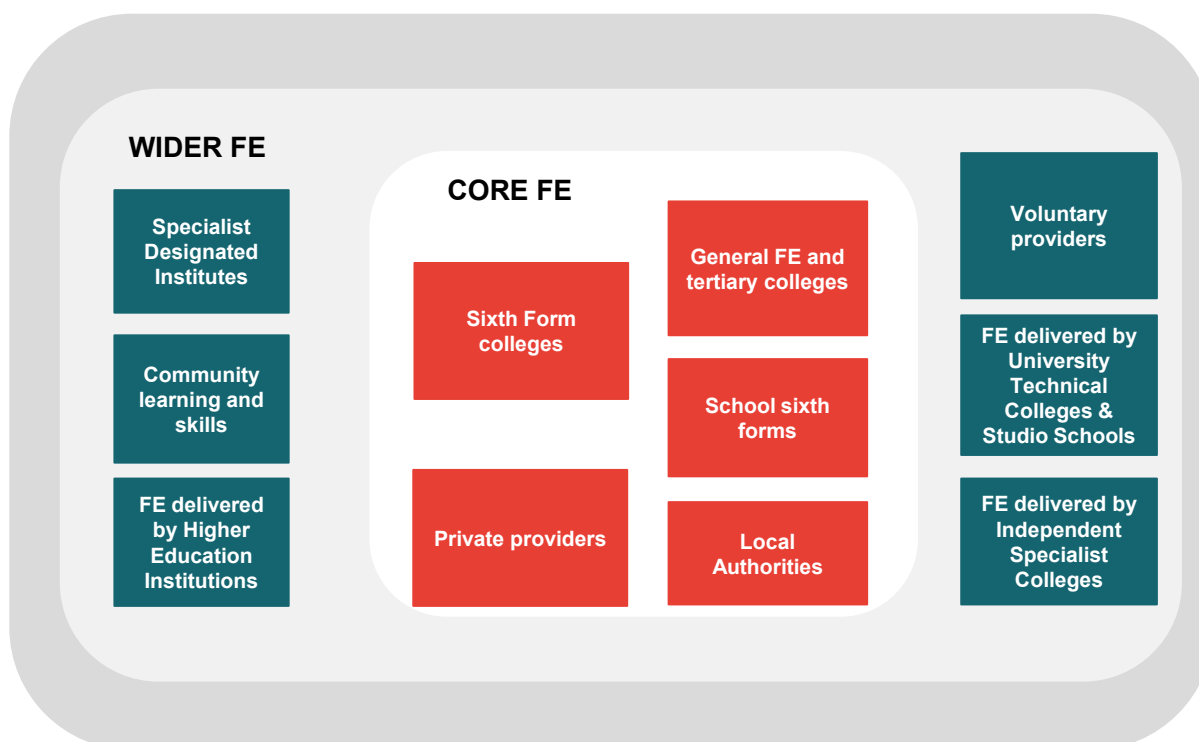
Providers

A Further Education provider is an organisation that delivers any kind of FE learning and, for the purposes of this report, receives public funding to carry out those learning activities.

Classification of providers

We distinguish between eleven broad categories of providers (as illustrated in Figure 12). They range from voluntary organisations to private companies and FE Colleges. We have attempted to classify providers as to whether they form part of “core” FE or wider “FE” for the purposes of simplification. The provider groups classified as “core” according to a combination of the proportion of total government funding they receive and the number of learners they offer training to are General FE and Tertiary Colleges, Sixth Form Colleges, Local Authorities, School Sixth Forms and Private Providers.

Figure 12. Categories of FE providers



The provider base is extremely diverse and classifications of providers into groups can become problematic as, whilst the history within groups may bear similarities, the actual learning they offer can be quite different. However, again, for the purposes of simplification, Figure 13 provides a broad overview of the key different provider types.

Figure 13. Overview of provider types

Provider type	Description
<p>General FE and Tertiary colleges</p> <p>(235 in England⁴⁶, providing for around 2.3 million learners)</p> <p>(Govt. funding worth approx. £5.1 billion)</p>	<p>General FE colleges were originally set up to provide FE to adults. 16-19 provision would generally have (historically) been provided by sixth forms within the same area. However, General FE colleges now tend to be large providers that offer a broad range of subjects for all age groups. Colleges are an attractive choice for many learners because of their wide course offering and multidisciplinary environment. Courses offered in a college typically span most sector subject areas, and they also provide most types of learning. The majority of colleges offer both full time and part time courses; ranging from A-Levels to vocational qualifications, apprenticeships, business training for companies, basic and employability skills, and leisure learning.</p> <p>Tertiary colleges were originally set up to combine the functions of an FE college and a Sixth Form college offering FE to 16-19 year olds and adults. Within areas with Tertiary Colleges, schools would historically tend not to operate sixth forms. However, these colleges also tend now to operate across all age groups and have similar offers to General FE colleges.</p>

⁴⁶ *Further Education and Skills 2013/14, Ofsted (p.2)*

Provider type	Description
<p>Independent providers (Around 600 in England with direct contracts with the SFA providing for around 950,000 learners. There are many more providers without such contracts and who operate as subcontractors to deliver their provision) (Govt. funding worth approx. £1.5 billion)</p>	<p>Independent providers that offer FE provision for all age groups. There are a large numbers of these providers and they are extremely diverse. They tend to be relatively small organisations (perhaps up to just a few hundred learners) with a sector-specific focus. However, there are some notable large providers such as Babcock International Group PLC, Skills Group and Hospitality Industry Training Ltd. with over 20,000 learners.</p> <p>Employers can be thought of as a subgroup of these providers as they are private companies that deliver some training to their employees, but training is not their core business. Both private training companies and employers tend to offer courses in specialised course areas. 60% of apprenticeships are delivered by these provider types as well.</p>
<p>School Sixth Forms⁴⁷ (1,160 providing for around 153,000 learners) (Govt. funding worth approx. £2.2 billion)</p>	<p>School Sixth Forms (including Academies) are co-located with a Secondary School and typically teach A-Levels to 16-19 year olds. Some also offer some vocational options in addition to a traditional academic offer.</p>
<p>Sixth Form colleges (93 Sixth Form Colleges in England, providing for around 160,000 learners) (Govt. funding worth approx. £0.7 billion)</p>	<p>Sixth Form Colleges tend to cater mainly for learners aged 16-19 and specialise in A-Level provision. However, may also offer other types of courses and adult learning.</p>
<p>Adult Community Learning and skills providers (247 Community learning and skills providers in England, providing for around 360,000 learners) (Govt. funding worth approx. £0.3 billion)</p>	<p>Local learning provision focused on improving the basic skills of adults and recreational learning. The setting for learning offered by these providers can be extremely important for encouraging hard-to-reach groups into the FE market.</p>
<p>Independent Specialist providers (Around 51 providers⁴⁸ with Govt. funding worth approx. £0.04 billion)</p>	<p>Specialist providers of education and training for learners with learning difficulties and/or disabilities who are over compulsory school age but under 25.</p>
<p>Agriculture and horticultural Colleges (Around 15 providers⁴⁹ with Govt. funding worth approx. £0.16 billion)</p>	<p>Specialist providers of land-based courses and programmes in agriculture and horticulture. They often have residential facilities.</p>

⁴⁷ This includes school sixth forms and academies

⁴⁸ *Further Education and Skills 2013/14*, Ofsted (p.2)

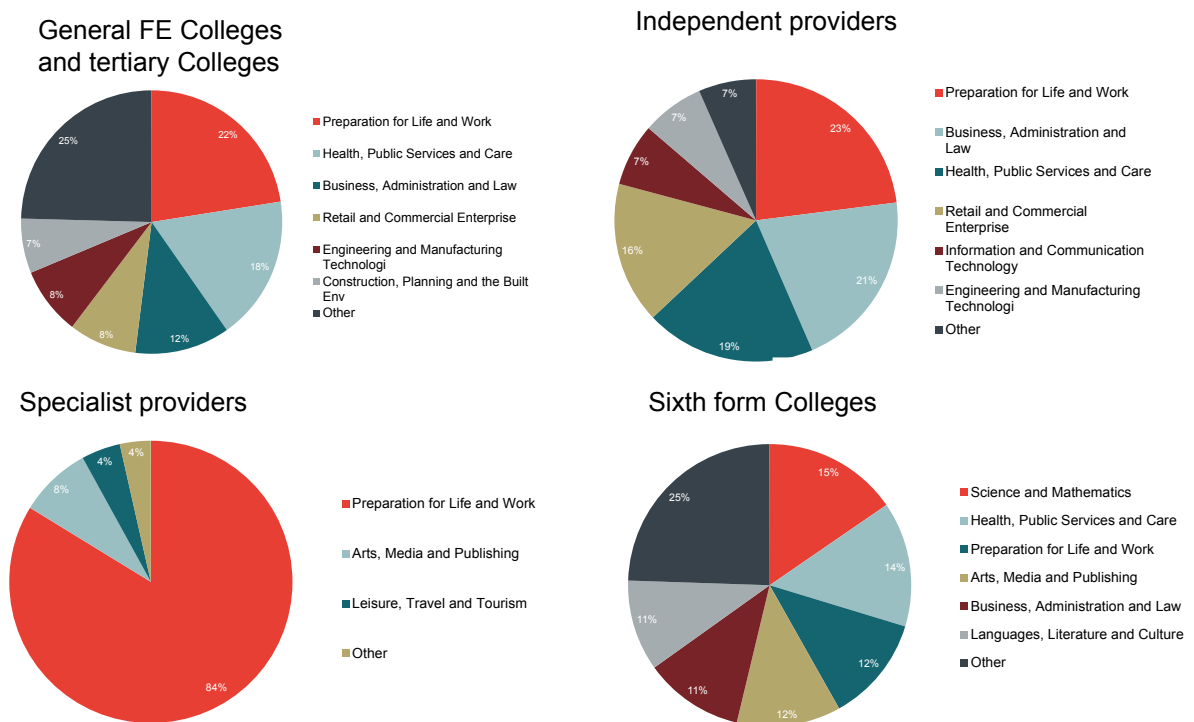
⁴⁹ As identified in the PIMS database

Provider type	Description
<p>Specialist Designated Institutes (9 Specialist Designated Institutes in England, providing for approximately 120,000 learners) (Govt. funding worth approx. £0.1 billion)</p>	<p>Independently constituted charities regulated by their own trust deeds. They are often large providers offering a variety of courses for adults, both in professional and recreational settings.</p>

The range of courses and programmes offered by providers differs. Figure 14 shows that the breadth of provision is far greater for Colleges than for any other provider. The top left pie chart shows how for these providers, around 25% of the offer is a combination of many other subject areas not listed; for independent providers (top right chart), only 7% of provision is other subjects that are not listed.

Specialist providers (bottom left chart) are, as expected, very focused on the subject of Preparation for Life and Work – their specialism in learners with learning difficulties and disabilities means this is a core area of their activity. In contrast, sixth form colleges (bottom right chart) are similar to FE Colleges in the breadth of their provision.

Figure 14. Subject areas provided across provider-types



Source: Frontier analysis of ILR data

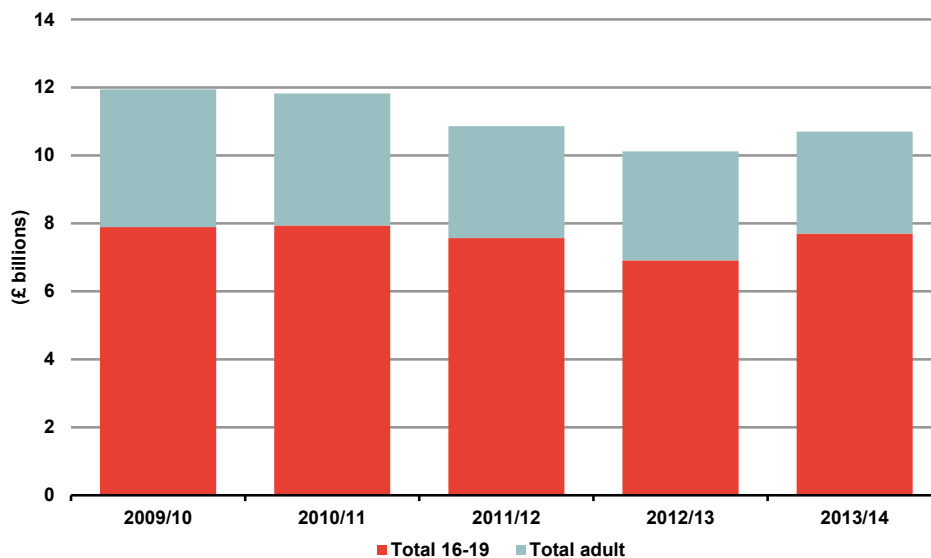
Provider funding sources

Total funding for FE is shown in Figure 15. This shows that current year funding for 2013/14 is £10.7 billion, around 70% of which is for 16-19 year olds.

Analysis of the allocation of these funds (see Figure 16 and Figure 17) across provider types clearly shows how FE Colleges and Tertiary Colleges account for the majority of both budgets. They account for 60% of EFA funding for FE; and 52% of SFA funding to the sector.

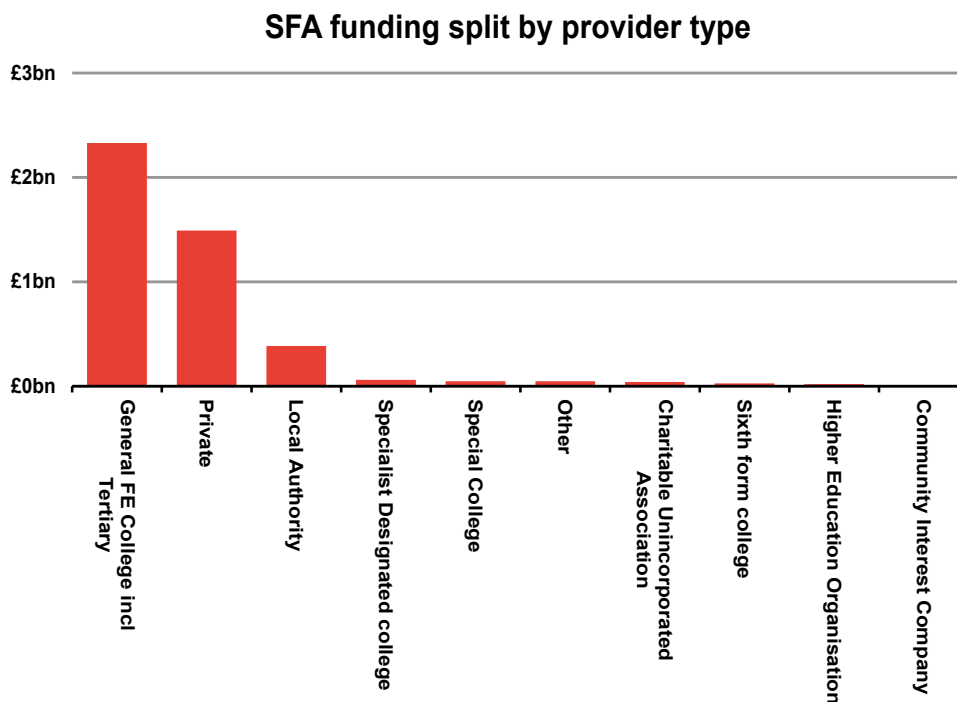
Independent providers account for around 4% of EFA funding whereas they account for around one-third of SFA funding. This reflects the current focus of independent providers on adult learners.

Figure 15. Total funding for FE



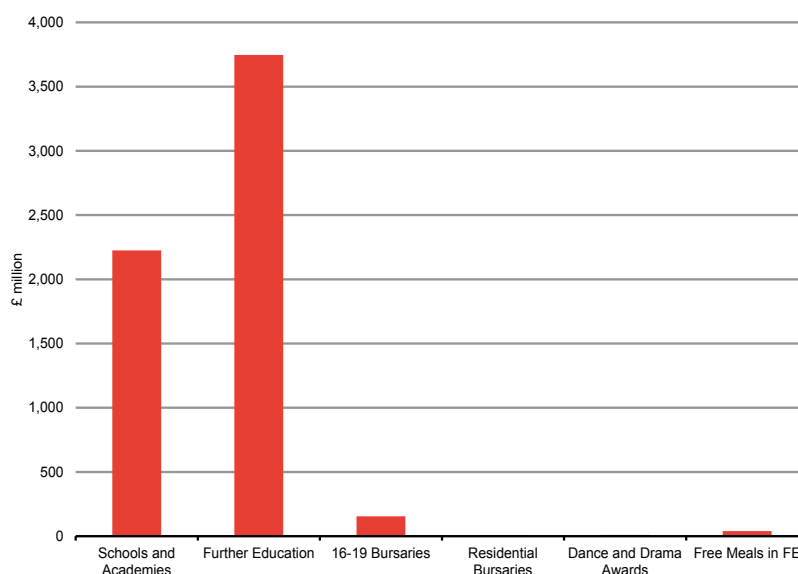
Source: Young People's Learning Agency Annual Report and Accounts 2010/11 and 2011/12, Education Funding Agency Annual Report and Accounts 2012/13 and Business Plan 2013-15; Skills Funding Agency Annual Report and Accounts 2010/11, 2011/12, 2012/13, 2013/14

Figure 16. SFA by provider type



Source: SFA Funding Allocations Spreadsheet

Figure 17. EFA funding by provider type



Source: EFA funding allocations 2014-15: <https://www.gov.uk/government/publications/16-to-19-allocation-data-2014-to-2015-academic-year>;

In order to understand the financial health of providers, we have looked at the latest financial monitoring exercise carried out by the National Audit Office⁵⁰. The report suggests that the financial health of FE colleges has declined over the last four years. In particular, the percentage of inadequate (with financial difficulties) and satisfactory (with limited capacity to respond to adverse circumstances) colleges increased from 5% to 12% and from 23% to 34% respectively from 2010/11 to 2013-14.

At the same time, the percentage of colleges in good (with robust finances) and outstanding (very robust finances) conditions declined from 32% to 28% and from 40% to 25% respectively over the same period.

These assessments are based on the following financial ratios:

- **Adjusted current ratio:** this looks at the solvency of the College i.e. whether it has enough resources to pay its debt over the next 12 months. The higher the ratio the better (above 2 is seen as outstanding – attracting 100 points)
- **Gearing ratio** (borrowing as a % of net assets): this reflects the extent to which the College’s activities are funded through its own assets or through debt. A higher ratio indicates greater risk so a ratio of less than 10 is outstanding – attracting 100 points.
- **Performance ratio** (cash-based operating surplus as a % of income): this reflects the ability of the College to generate a profit. The higher the number the better so a score above 9 is outstanding – attracting 100 points.

⁵⁰ *Overseeing financial sustainability in the further education sector*, National Audit Office, July 2015
<http://www.nao.org.uk/wp-content/uploads/2015/07/Overseeing-financial-sustainability-in-the-further-education-sector.pdf>

Total financial health is equal to the sum of these scores, with a maximum possible of 300. According to Association of Colleges guidelines, the final score falls in four possible categories:

- Outstanding: very robust finances (a score of 240-300)
- Good: sufficiently robust finances (a score of 180-230)
- Satisfactory: sufficient resources but limited capacity to respond to opportunities or adverse circumstances (a score of 120-170).
- Inadequate: financial difficulties (a score of less than or equal to 110).

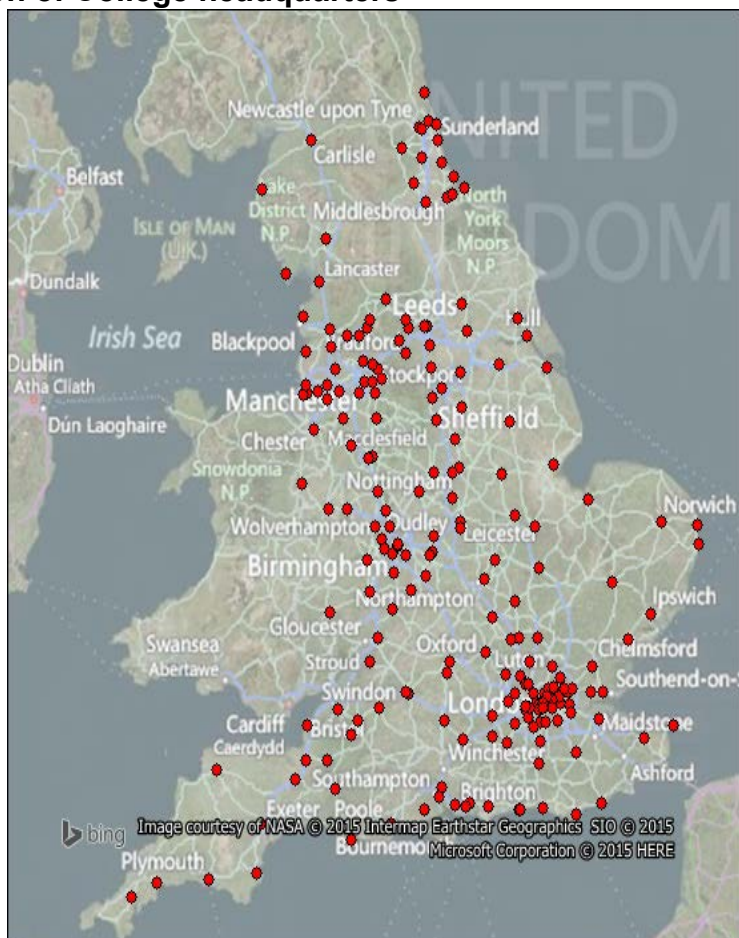
The SFA also publishes guidance on the assessment of financial health of non-college providers including those holding direct contracts, subcontractors and any other organisation applying to the Register of Training Organisations (or wider SFA procurement). As with Colleges, the financial health measures are based on an assessment of solvency, profitability and gearing. Such financial assessments feed into setting the Recommended Funding Limits (RFLs) which reflect the provider's capacity to deliver (and also reflect other factors). Colleges are not subject to RFLs.

A geographical picture of provision

FE provision is wide ranging and includes more than 15 tier 1 sector subject areas for different levels of qualification. However, provision varies across the country and, because learners tend to use local choices, this matters. Figure 18 shows the location of FE Colleges and Tertiary College providers in England⁵¹.

⁵¹ This plots general FE Colleges and Tertiary Colleges on the basis of the postcode of their headquarters.

Figure 18. Location of College headquarters



Source: Frontier analysis of ILR data

Figure 18 provides an initial indication of where provision may be sparse and where provision is dense. For example, there appear to be more Colleges around the major cities of London, Birmingham, Manchester and Newcastle. However, only when a detailed sector-based and local picture is considered is it possible to understand where provision is sparse and where there are many local alternatives for learners.

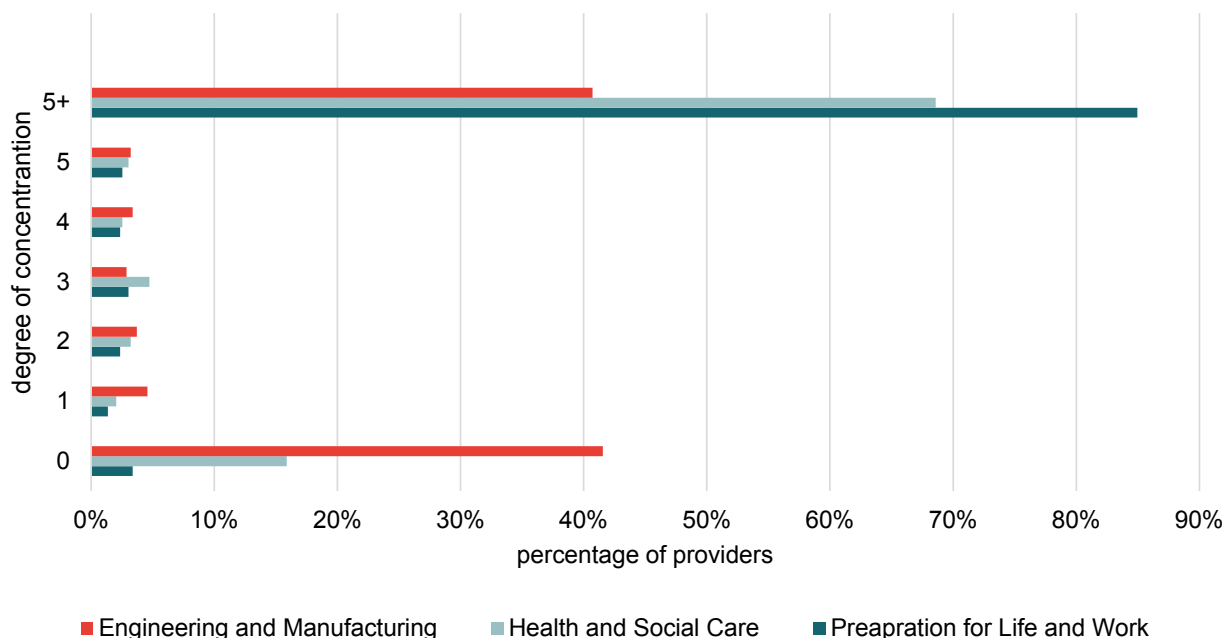
We have therefore selected three deep-dive sectors which are Preparation for Life and Work, Health and Social Care and Engineering and Manufacturing. For these, we have analysed the number of alternative providers in any given area in more detail.

Figure 19 shows the number of alternative providers (degree of concentration⁵²) within a 10km boundary of each starting provider. It shows that across all three sectors there are some providers who have no alternative providers within 10km. This proportion is highest for Engineering and Manufacturing (over 40%, as shown by the red bar) and lowest for Preparation for Life and Work courses (under 5%, as shown by the dark green bar). However, there are also providers that have 5 or more alternatives within 10km. This is highest for Preparation for Life and Work (85% of providers have 5 or more alternatives

⁵² The degree of concentration index shows the number of alternatives that each provider faces within a 10km radius.

within 10km) and lowest for Engineering and Manufacturing (just over 40% have 5 or more alternatives).

Figure 19. Provider concentration



Source: Frontier analysis of ILR data – analysis is based on sites of providers with 100+ learners (excluding workplace based providers)

However, there is likely to be a substantial variation even within each subject area in terms of available providers. For instance, a provider may offer different courses in Health and Social Care which cannot be considered as substitutes from either a learner’s or a provider’s perspective. This implies that the relatively high percentages of providers in areas with high number of alternative providers may hide the fact that these providers do not offer direct substitutes to each other.

Entry and exit of providers

The picture of providers is not a static one. The total number of FE providers directly receiving public funding (excluding School Sixth Forms) has fallen from 1550 in 2010/11 to 1,150 in 2013/14. This has been driven by consolidation amongst providers but also by administrative factors (for example, the SFA’s use of a minimum contract value of £500,000 for a few years - no longer in operation).

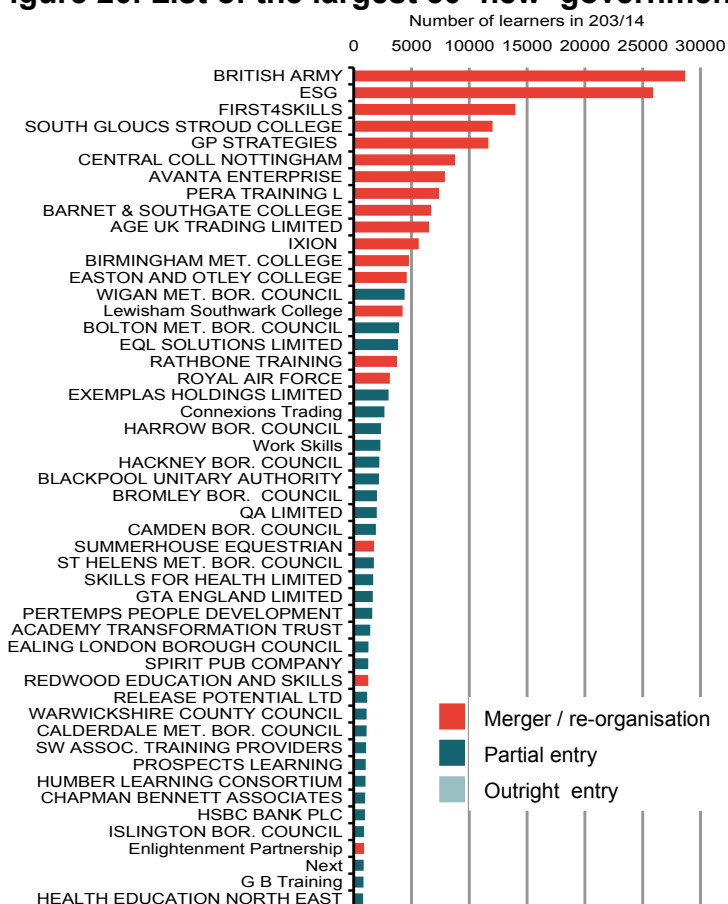
Although there has reportedly been substantial entry to the market via new providers who are sub-contracting to others, there has been minimal entry from large-scale providers in recent years. While over 172 new providers⁵³ have appeared over the last 3 years, the majority of these “entries” are the result of mergers or other consolidations or are what we might call “partial entry”, providers active in other sectors (within or outside FE) who have expanded into funded FE provision. It is not obvious that these ‘new’ providers are

⁵³ As defined by UKPRN code.

associated with the provision of new capacity – indeed there is likely to be less incentive to enter a market for public service provision against a background of declining budgets. College mergers have historically often been driven by the financial health of the merging parties, rather than pro-active efforts to expand provision. Likewise many of the internal re-organisations of providers involve activity being transferred between sub-entities with little change in the overall size of the entity.

Figure 20 shows the largest 50 entrants between 2010/11 and 2013/14 ranked by size. It can be seen that 13 of these largest 50 are the result of merger or reorganisation and include the British Army, ESG, First4Skills and a number of merged colleges – Central College Nottingham, Barnet Southgate College and Birmingham Metropolitan College. The “partial entrants” tend to be smaller (in terms of learner numbers) and include a number of Metropolitan or Borough Councils (e.g. Wigan, Harrow and Hackney) and some existing training providers moving into funded FE provision (e.g. EQL Solutions and QA Ltd).

Figure 20. List of the largest 50 ‘new’ government funded providers



Source: Frontier Economics analysis of ILR data

Entry and exit from the FE market represents only a part of the changes that occur in FE provision.⁵⁴ Much of the change in the FE market is driven by surviving providers expanding into new areas of provision or withdrawing from others. This can occur at both product market level or at the geographic level. In this section we focus on changes in terms of subjects offered using the 1-tier sector subject area (SSA) classification which groups subjects into 15 different categories.⁵⁵

Provider expansion and withdrawal from subject areas is relatively common. On average a provider was active in 8 subjects in 2010/11, increasing to 8.5 in 2013/14. Over that time period, more than half of providers expanded into at least one new subject area, and 16% expanded into at least 3 new subject areas. Meanwhile 35% of providers withdrew from at least one subject area and 6% withdrew from at least 3 new subject areas.

Figure 21 shows, for providers active from 2010/11 to 2013/14, expansion rates into different subject areas. The red bars show the proportion of providers offering each subject area in 2010/11. The light blue bars show the proportion of providers that did not offer the subject in 2010/11, but subsequently expanded into it. The dark blue bars show the proportion of providers that offered the subject in 2010/11 and subsequently withdrew.

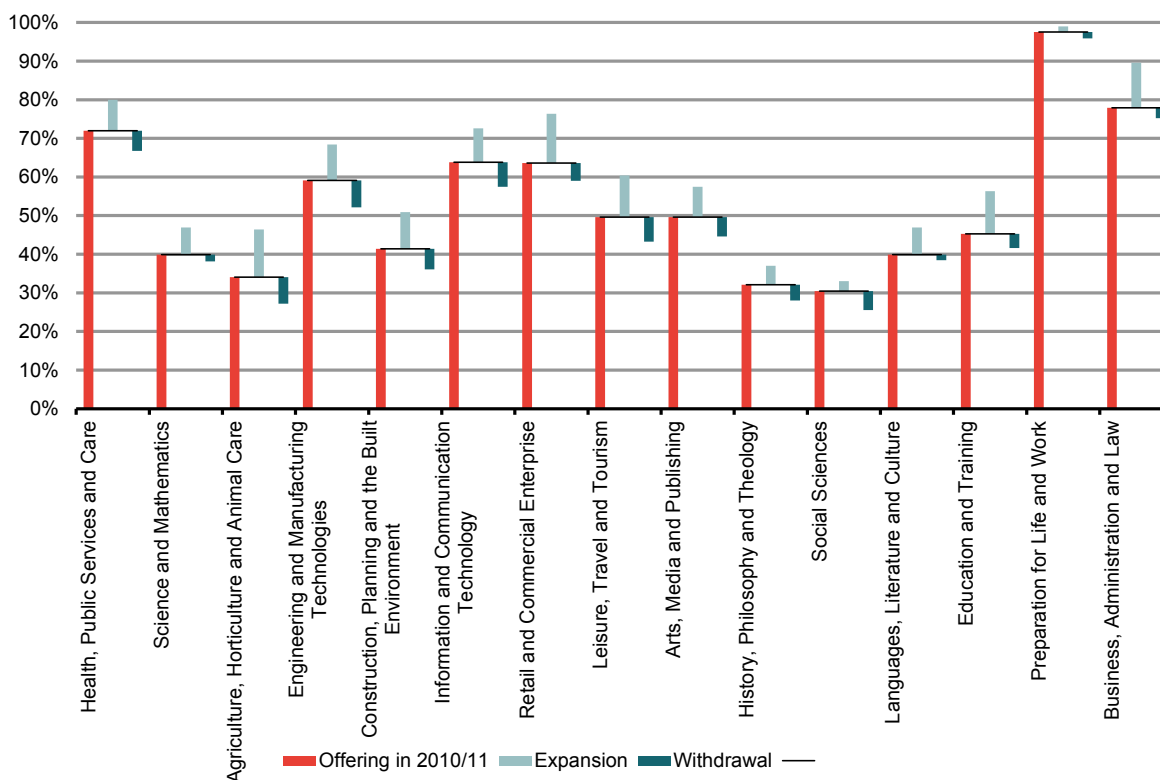
Figure 21 indicates that withdrawal rates are particularly low for science and mathematics and languages, literature and culture – core areas of provision within the sector.

The largest net expansion has been in retail and commercial enterprise (13% expansion, 5% contraction, so 8% net expansion), education and training (11% expansion, 4% contraction, 7% net expansion) and agriculture, horticulture and animal care (12% expansion, 3% contraction, 9% net expansion).

⁵⁴ The sum of absolute gains and losses in learner numbers at provider level between 2010/11 and 2013/14 is 2m. Of this 37% is associated with entry, exit, re-organisation and merger; the other 63% is associated with expansion or contraction of surviving providers. Beyond this there will be additional changes in provision, where a provider expands in one area but contracts in another, whilst remaining the same size overall.

⁵⁵ This analysis could alternatively be carried out at more granular level, e.g. SSA 2-tier level, or even at the level of individual qualifications. This would reveal significantly more expansion and contraction, associated with making more subtle changes to provision within their general product offering.

Figure 21. Proportion of providers offering subject, expanding into subjects or withdrawing from subjects



Source: Frontier Economics based on ILR data

Expansion rates across subject areas range between 1 and 13 percentage points, whereas withdrawal rates range between 1 and 7 percentage points.

Most subject areas have seen net expansion in terms of the number of providers offering them over this time period. There are several potential explanations for this widening of subjects offer at provider level:

- If learners are taking more ‘rounded’ programmes, in the sense of including aims from a number of subject areas, providers may need to expand their offer. For example, an apprenticeship might include functional English and maths, so a provider would have to cover these subjects in addition to the main subject covered by the course. As a result, some providers with narrow subject offerings will expand into new subjects.
- Acquiring another provider with complementary subject offer will result in that provider expanding its offer. Although our analysis includes only providers⁵⁶ existent in both 2010/11 and 2013/14, some of these will have acquired other providers during that time period. This could drive some of the net expansion.

⁵⁶ As defined by UKPRN

- Widening the subject offer may serve a risk-spreading function. Providers with narrower subject offers will be more prone to changes in demand at the subject level affecting participation rates.
- Subject expansion may also reflect saturation in the market. Providers that are struggling for learner numbers may see subject expansion as a way of accessing previously unmet demand.

Subcontracting

Subcontracting is such that one provider (lead provider) decides to subcontract-out part of its provision to another provider (subcontractor). Subcontracting is a significant feature of the FE market, accounting for £780 million⁵⁷ in 2014. It can be a useful tool for increasing a provider's capacity, engaging with new markets and delivering niche provision.

A survey conducted in 2012 by the Association of Colleges and the Association of Employment and Learning Providers for the SFA suggested that 86% of providers subcontracted out part of their provision⁵⁸.

Subcontracting arrangements mean that the actual place of learning is frequently not the organisation that the funding for the qualification was assigned to. Colleges are the most significant users of subcontracts⁵⁹. Analysis of contracted sub-contractor commitments suggests almost 50% of all subcontracting by value (and 45% by volume) is offered by Colleges. However, independent providers also offer significant numbers of subcontracts (making up 40% of the contracts by volume and 37% by value). Local authorities, trusts and other public bodies (labelled as 'other' in Figure 22) account for a smaller share by value and volume.

Independent providers (including employers) are the largest providers of subcontracting services (representing 77% of the total number of subcontractors). Independent providers' subcontracting provision makes up 81% of total subcontracting contract value and 66% of all such contracts by volume. This is shown in Figure 23. The role of FE Colleges as subcontractors is more modest. Indeed, they represent just 15% of all subcontractors, covering only 14% of the total subcontracting value and less than one-third in terms of volume. Again, the subcontracting provision for local authorities, trusts and other public bodies is small.

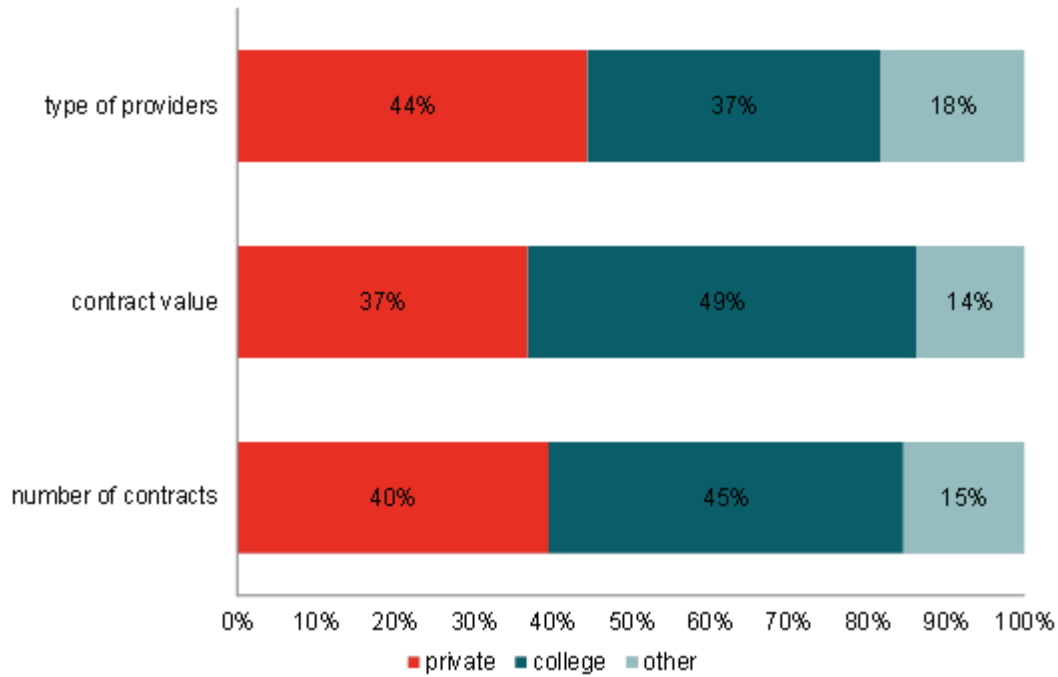
Therefore our analysis suggests that colleges and private providers are two important players in the subcontracting market. Some 81% of all contracts are between a FE College and a private provider.

⁵⁷ This is according to the SFA List of Declared Contractors which records only sub-contracts with a value over £100,000 and reflects contracted commitment, not actual earnings.

⁵⁸ Association of Colleges (AoC) and the Association of Employment and Learning Providers (AELP) research *SFA Supply Chain Survey*, 2012.

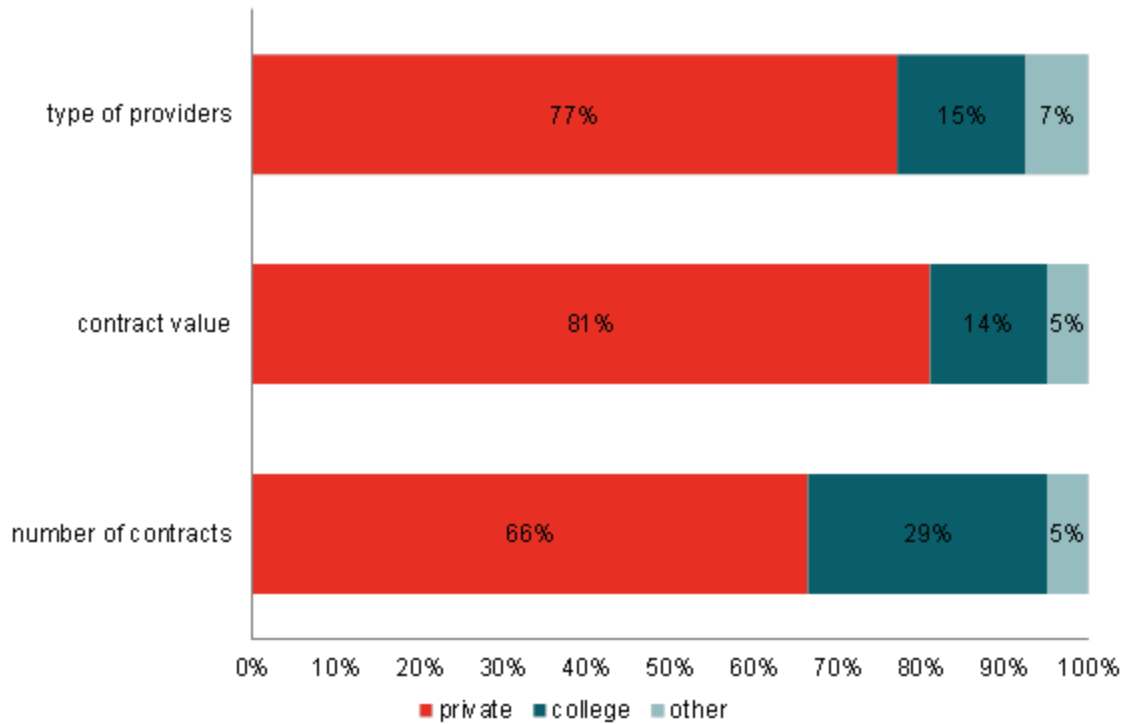
⁵⁹ Our analysis of subcontracting is based on data from the SFA for 2014 <https://www.gov.uk/government/publications/sfa-subcontractors-list>, which contained information about the provider name, lead provider type, subcontractor provider type and contract value for all subcontracts worth more than £100,000 per annum.

Figure 22. Lead providers: those commissioning subcontracting services of others



Source: Frontier analysis of SFA data (dated December 2014)

Figure 23. Subcontractors: provision of subcontracting services



Source: Frontier analysis of SFA data (dated December 2014)

Our analysis suggests that subcontracts are typically long standing (more than 5 years), focused on 16-18 apprenticeships and 19+ apprenticeship provision and particularly present in the construction, care delivery and health and training sectors⁶⁰.

Lead providers typically retain part of subcontractor's funding to manage and set up subcontracts and monitor the subcontractor's quality⁶¹. This portion of provision retained by lead providers – known as retained management fees – is expressed in percentage terms. Lead providers typically vary their management fees to reflect a range of factors including level of provision subcontracted, its duration and the subcontractors' performance. Management fees are found to range between 5% and 30%⁶².

⁶⁰ SFA Supply Chain Survey, 2012.

⁶¹ The lead provider is legally responsible for the quality of provision within its supply chain – a poor quality sub-contractor can lead to a low quality marking by Ofsted for the lead provider.

⁶² Association of Colleges (2012), "Supply Chain Management, A good practice guide for the post-16 skills sector". This is consistent with our analysis of data for the 15 largest lead providers and for 15 lead providers with medium-small contracts, which suggested an average management fee range of between 10% and 30%.

The FE workforce

It is estimated that there are over 326,000⁶³ staff working across the FE sector⁶⁴ with approximately 250,000 staff in colleges⁶⁵, 51,000 staff in Work-based learning training⁶⁶ providers and 25,000 staff working in Local Authority providers of Adult and Community Learning. Approximately 50% of the staff across the sector are teaching staff (including assessors) with the remainder providing managerial, service, or administrative and clerical duties.

The majority of staff working with the sector are aged 35 years and above with an average age of staff working in colleges of 46. Staff in work-based learning providers tend to be slightly younger on average and those working in Adult and Community Learning slightly older. Part-time working is extremely common with 60% of FE teachers working part-time, 92% of Adult and Community Learning teachers working part-time and around 25% of teachers in Work Based learning working part-time. There is also some dependence on volunteer teachers within the sector.

By far the most frequently cited subject areas with teaching staff recruitment difficulties are functional skills, mathematics/numeracy and English/literacy. Other subject areas in which providers identify that recruiting teaching staff is problematic are: ESOL, Family Learning, Health and Social Care, and Foreign Languages.

However, there is also a concern within the sector that high quality teaching and training relies on a clear line of sight to work⁶⁷ and a recognition that the knowledge required to operate effectively within the workplace is highly dynamic. This means that teachers and learners need to be continually exposed to new forms of knowledge and practice to perform at their best. It is reported that identifying either skilled professionals or teachers able to offer training in some localities and occupations can be a particular recruitment difficulty.

Funding

As noted above, funding for FE in England comes from two main sources. The EFA provides funds of £6.2 billion to fund the education of 1.6 million young people aged between 16 and 19. The SFA provides £3.8 billion of funding for further education divided into the Adult Skills Budget worth £2.1 billion⁶⁸ and the Apprenticeship budget worth £1.4 billion in 2013/14. The remainder of the budget includes student/ learner support. FE providers are also able to access capital funding, which is routed via Local Enterprise Partnerships (LEPs). There are also a range of other sources of funding including ESF

⁶³ This figure excludes staff working in School Sixth Forms.

⁶⁴ Workforce data across the Further Education sector – 2013-14, Education Training Foundation

⁶⁵ Including General FE Colleges, Sixth Form Colleges, Agricultural and Horticultural Colleges, Arts Colleges and Specialist Designated Colleges.

⁶⁶ Including independent training providers, third sector/charity training providers, Group Training Organisations and employers providing training.

⁶⁷ "It's about work... Excellent adult vocational teaching and learning", Commission on Adult Vocational Teaching and Learning, 2013

⁶⁸ This includes Adult Community Learning and funding for the Offending Learning and Skills Service (OLASS)

funding, the growth fund and the innovation fund from the SFA. The two main sources of FE funding (EFA funding for 16-19 year olds and SFA funding for adults) are below.

Funding for 16-19 year olds (EFA funding)

Funding for FE for 16-19 year olds is administered by the EFA. A set of funding rules are used to allocate funding to providers offering the relevant courses⁶⁹ (see Figure 24). Providers receive a funding allocation, based on lagged student numbers, reflecting the number of students enrolled last year and an adjusted national funding rate per student. The base national funding rate per student is £4,000 for a 16-17 year old and £3,300 for those aged 18. Depending on students' special needs and their timetabled hours this rate can vary further. This base national rate is then adjusted by a programme cost weighting⁷⁰, an area cost adjustment⁷¹, a retention factor⁷² and a disadvantage factor⁷³.

⁶⁹ The same funding rules apply to 14-16 year olds that have been recruited directly in a General FE college – these learners are funded at school rates for 14-16 year olds, which is different to the 16-18 year rates. Learners up to 24 years who have a Learning Disability Assessment are also funded in a similar way i.e. per learner.

⁷⁰ The programme cost weighting is a factor between 1 and 1.6 by which the funding rate is multiplied to derive the final funding rate for that programme. For example, a course in Health and social care is a factor 1 course and is funded at the base rate. A course in Agriculture is considered a specialist programme and may have a factor of 1.6. These programme cost weightings are derived from historic relative cost information.

⁷¹ The area cost uplift accounts for the fact that relative delivery costs are higher in London in South East England than they are in the rest of the country. The funding rate is uplifted by a factor of up to 20% to reflect these differences.

⁷² The retention factor can be a factor between 50% and 100% and is calculated from the provider's retention rate, i.e. the number of students retained until the completion of their qualification.

⁷³ The disadvantage uplift provides extra funding to support the most disadvantaged learners, recognising that they can be more costly to recruit and keep.

Figure 24. The funding model for 16-19 year olds

Factors in the funding formula	<ul style="list-style-type: none"> • Paid per student
Number of students	<ul style="list-style-type: none"> • Last year's full time numbers plus exceptional variations
Funding rate per student	<ul style="list-style-type: none"> • National rate per student • The rate used in the 2013/14 allocation was £4,000
Area cost uplift	<ul style="list-style-type: none"> • Reflects the cost of delivery in high cost local areas
Disadvantage funding	<ul style="list-style-type: none"> • Recognises that some students require additional support to participate and achieve if we are to achieve full participation and improve attainment
Programme cost weighting	<ul style="list-style-type: none"> • Takes values of 1, 1.2, 1.3 and 1.6 as a multiplier to the funding rate. • Recognition that some vocational subjects are more expensive to teach than others
Retention factor	<ul style="list-style-type: none"> • Retained means still studying a core aim on planned end date or leaves early and is recorded as completed the core aim

Source: EFA 16-19 funding update 2013

Adult funding (SFA funding)

Adult funding is administered by the SFA. The adult funding model applies to all learners aged 19+ and to offender learning. It is based on qualifications with each qualification assigned a funding rate according to the size of the provision (measured in units of 'credits' or guided learning hours) and a programme cost weighting⁷⁴. Similar to the EFA funding rates, these rates are derived from historic cost information⁷⁵. The basic funding rate is further adjusted by an area cost uplift⁷⁶ and disadvantage uplift⁷⁷, recognising the difficulty of recruiting and keeping disadvantaged learners. The total funding for one learner is derived as a combination of the funding rates for all the various qualifications that learner is taking.

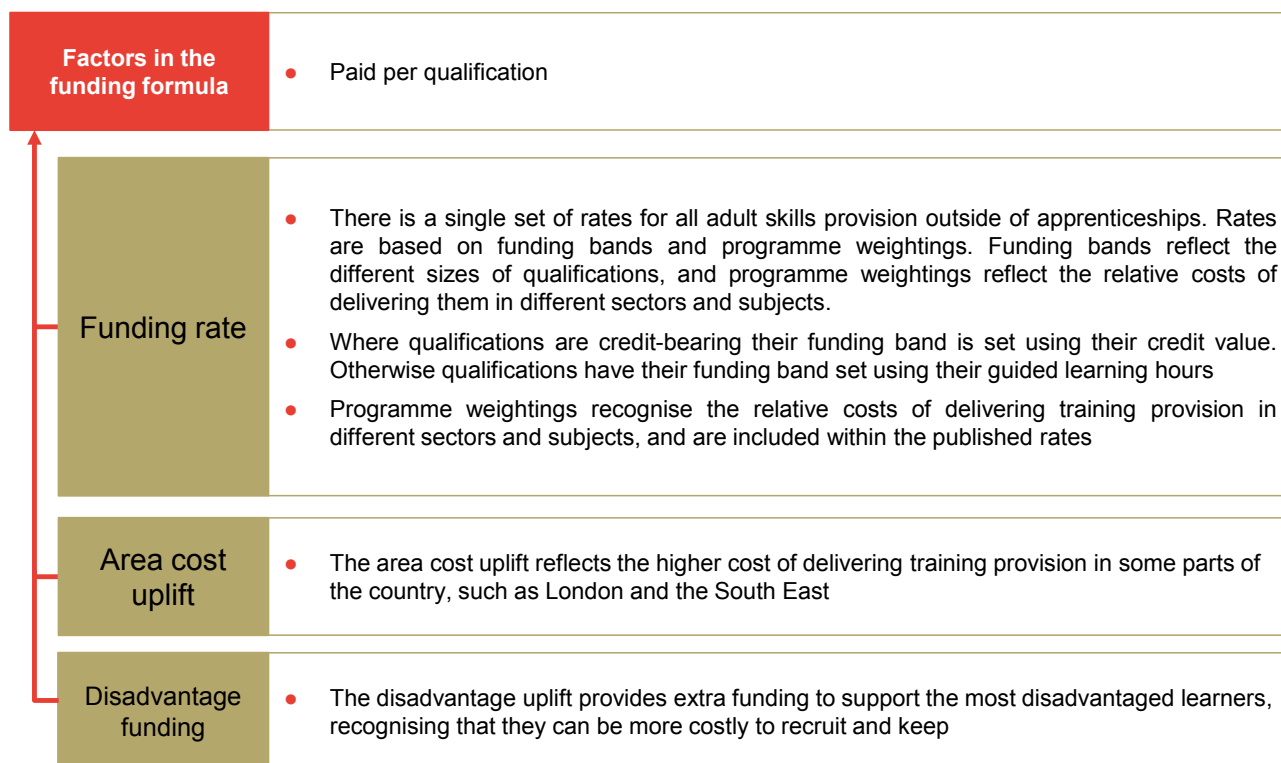
⁷⁴ For example, a base rate for a small provision of up to 12 hours is funded at £50 whereas the base rate for a Diploma of 370 hours receives £1,987. A specialist programme of 370 hours would receive £3,417.

⁷⁵ The funding weights date back over 15 years but were reviewed in 2011.

⁷⁶ The area cost adjustment is an uplift applied to the funding rate to recognise the higher relative delivery costs in London and in the South East. The uplift is a multiplier between 1.01 and 1.20.

⁷⁷ The disadvantage uplift, on the other hand, is a number between 1.08 and 1.32 and is applied to the learners living in the 27% most deprived areas of the country. A single uplift of 1.12 is applied to all offender learners.

Figure 25. The funding model for 19+ year olds



As of 1 August 2013, qualifications for learners aged 24 and older wanting to study at Levels 3 and 4 are no longer funded by the SFA. Those learners can instead apply for a 24+ advanced learning loan to pay for their studies. The loans are administered by the Student Loans Company (SLC) and loan payments are made directly to eligible providers by the SLC, on behalf of learners. There are maximum loan amounts for eligible qualifications which equate to the SFA's weighted funding rates for these qualifications. Loans cover the tuition fee element of the provision including all costs and charges for items without which a learner cannot complete their course.

Apprenticeship funding follows the same general model as the rest of adult funding, but the funding rates for apprenticeships are different. Apprenticeships (or 'frameworks') are assessed by an Activity Cost methodology in which the costs of training a learner new to the sector are assessed. The assessment is completed by an Issuing Authority who makes contact with at least 6 providers. A total cost is calculated from the Activity Cost information which is then used to set the overall framework rate which is then sub divided between the component qualification(s). The funding calculation will make further adjustments to the rates applied to the component qualifications to allow for area uplift, disadvantage uplift and large employer discount (this is a 25% reduction in funding for employers with over 1000 employees).

The amount of funding contribution from the SFA varies according to the age of the apprentice. For apprentices between 19 and 23, the SFA will pay 50% of the training costs (assuming the funding rate is cost-reflective) and for those aged 24 and above, the SFA

will pay up to 50%⁷⁸. The remainder of the funding is expected to be contributed by the employer.

The way in which providers receive their funding depends on their provider type. The adult skills budget is allocated by the SFA to two types of provider: providers funded through a grant (they have a financial memorandum or conditions of funding (grant), for example FE Colleges and Local Authorities); and providers funded through a contract (they have a contract for services, this would apply to independent providers). The approach to both types of provider is shown in Table 5.

Table 5. Funding approach for different types of provider

	Grant funded	Independent
How funding allocations are calculated	Mid-year funding claims (self-reported actual delivery plus forecast delivery for the remainder of year) used as the baseline	2014/15 contract minus increases made at performance management point 2 used as the baseline Baseline capped at the 2014/15 contract level excluding growth awarded at performance management point 2
Performance review	Providers submit funding claims three times a year Performance is reviewed at three 'performance management points' throughout the year"	Delivery is monitored on a monthly basis Performance is reviewed at three 'performance management points' throughout the year
Handling of under-performance	Funding levels may be reduced if evidence suggests providers will not deliver in full	Providers are paid on the basis of their actual delivery each month Contract value is reduced if performance is outside published 'tolerance' levels
Clawback arrangements	Year-end adjustments are made to funding allocations and unspent funds must be paid back	
Potential for additional funding	Providers can request an increase in their funding allocations at any of the three performance management points Depends on the availability of funds, the provider's track record, proof of demand from learners / employers etc."	Providers can request an increase in their funding allocations at any of the three performance management points Depends on the availability of funds, the provider's track record, proof of demand from learners / employers etc.

⁷⁸ Source: Apprenticeships Policy, England, Briefing Paper Number 03052, July 2015, House of Commons Library <http://researchbriefings.files.parliament.uk/documents/SN03052/SN03052.pdf>

As Table 5 shows, the main difference between grant funded providers (such as FE Colleges) and contract funded (independent providers) are:

- Colleges receive an annual allocation based on last year's activity (assessed at the mid-year point based on actual data for the first half of the year and forecasts to the end of the academic year). They receive this money in 12 instalments paid in line with a national profile; and
- Independents have an annual contract value based on last year's value (with some exclusions) and they are paid on the basis of actual delivery each month.

Regulation of Further Education

FE providers in receipt of government funding are subject to a range of regulations. They must be on the SFA Register of Training Organisations and subject to appropriate due diligence. They are subject to regular quality inspections (by Ofsted – see details below) and financial health checks and if they fail to pass either of these, or fail to meet minimum standards, further action is triggered. For independent providers with direct contracts with the SFA, they could be issued with a notice to terminate their contract. For FE Colleges, designated institutions and local authority maintained FE institutions, the FE Commissioner would be likely to get involved, as described below⁷⁹.

The quality of the FE market is monitored and regulated by the Office for Standards in Education (Ofsted). The Ofsted Inspectors' Handbook⁸⁰ states that Ofsted's role is "to evaluate how efficiently and effectively the education and training provision meets learners' needs".

About 1,300 organisations are in scope for Ofsted inspection. This includes colleges (FE Colleges and 6th form Colleges), independent FE providers, Local Authority organisations such as community colleges, not for profit organisations, employers and HE institutions that provide FE, 16-19 Academies, prime contractors for the National Careers Service and prisons. All organisations are subject to the same standards. Where an organisation uses subcontractors, those subcontractors are inspected as part of the overall inspection. It is the primary contractors' responsibility to ensure the quality of the subcontractors, so the Ofsted report would comment on the quality of oversight and regulation of the main provider over their subcontractors, not on the subcontractors themselves.

To date, Ofsted inspections have focused on subject areas by looking in-depth at a sample of subject areas within a provider but this approach is changing. However, they are soon to be moving to the same evaluation schedule as they use for schools and early years. This means that Ofsted will inspect by type of provision by funding stream, e.g. apprenticeships

⁷⁹ The guidelines on the minimum standards for providers is published by the SFA (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/398318/Minimum_Standards_2013_to_2014.pdf) and BIS publishes guidance on appropriate governance requirements (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344615/BIS-14-1012-college-governance-a-guide.pdf)

⁸⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/393485/Handbook_for_the_inspection_of_further_education_and_skills.pdf

or 14-16 provision, not by subject. Therefore, they will assess the learners' full programme (for example, apprenticeships) and not just individual subjects.

Ofsted rates FE and skills providers on the basis of a 4-grade scale: 1 (outstanding); 2 (good); 3 (needs improvement) and 4 (inadequate). Provider quality is focused on teaching and various other factors, all measured on the same scale.

Where a provider is rated as inadequate by receiving a grade 4 assessment, Ofsted shares this information immediately with the relevant funding body (such as the SFA) and with the FE Commissioner where appropriate (i.e. for types of provider that fall under the Commissioner's remit). For independent providers, as noted above, the funding body is likely to issue a notice to terminate the contract. For providers under the remit of the FE Commissioner, they are subject to a detailed inspection with recommendations made by the Commissioner for action to improve performance. They are then re-inspected within 15 months.

Most outstanding providers are currently inspected every 6 years. In between they are subject to a risk monitor that looks at data and local intelligence, senior staff changes, complaints and queries from funding agencies. Under the new approach to be introduced soon, there will be more frequent inspection of those rated 'good'. If they seem to be maintaining their standards then there will only be a short inspection to see if the actions have been taken to ensure quality is maintained and to enable problems to be identified quickly.

3. Market definition

Key findings

An economic definition of the market generally focusses on two aspects of a market: (i) the grouping of products or services that create together a distinct “product market” and (ii) a distinct geography over which competitive interaction for those products takes place.

With respect to the **product market**, within which we would expect consumers to consider the services on offer as sufficiently close substitutes, we found that learners were making their choice based on a range of criteria such as confidence, perceived benefits of the training, the qualification gained etc.

With respect to the **geographic market**, we considered that a radius of 10km was the most appropriate catchment area within which we should consider how the competitive interaction of providers and consumer choice to play out. Around 70% all learners come from within this radius of their FE provider. These learners are choosing from within local offers of FE. However, we also found that a significant minority of learners travel further for their education to regional centres and a small number of learners travel even further for specialist training.

Taking these two dimensions together, we have identified 7 market groupings within the FE market using a commonly applied market definition framework that considers the substitutes available to consumers, the ease of suppliers to switch between different products and geographies as well as the different choice conditions faced by some customer groups. What defines each grouping is the **nature and characteristics** of the FE delivered, not the providers that deliver it, so a single provider could actually be active across several groupings. The groupings are below.

Local markets

- 1. Local “core” mixed environment training**, covering levels 0 to 3 and leisure courses. (e.g. GCSE geography delivered within a setting in which other learners are learning a range of other subjects or on vocational qualification courses)
- 2. Local, “basic” community-based training**, covering levels 0 and 1 (e.g. entry level English delivered in a local community building) and adult community learning that does not lead to a qualification.

Regional markets

- 3. Capital intensive training, provider based, covering all levels with broadly regional markets (e.g. high tech manufacturing or horticultural courses delivered in a provider-based setting)**

4. Regional “advanced” sector-focused training, covering level 4+, low capital intensive training⁸¹ (e.g. advanced aeronautical engineering delivered within a highly equipped setting to which learners are willing to travel)

National markets

5. Sector focused training in the workplace, covering all levels with a distinct customer segment for large employers (e.g. apprenticeships for automotive manufacturing or apprentice chefs)

6. Specialist residential provision (e.g. programmes delivered in settings with highly trained staff to meet the needs of learners with learning difficulties or disabilities, sometimes residential)

7. Prison-based learning (e.g. learning that takes place within prisons – courses available will be determined by the SFA)

These definitions were reached following detailed consideration of the decision to participate in FE as well as the decision about what to provide.

Introduction

To enable a tractable analysis of the FE market, we undertook a market definition exercise, used commonly by the Competitions and Markets Authority (CMA), to define and understand these different parts of the market at a disaggregated level. This chapter sets out our definition of the Further Education market and the approach we used to reach this definition.

The FE market is complex and seeks to meet the needs of a wide range of groups within the context of heavy regulation to ensure quality, and substantial public funding to ensure broad accessibility to learning. Despite not being a typical ‘market’, this study investigates the effectiveness of the further education system through an economic lens. This study fully recognises that this is not straightforward but there are elements of the FE market that do demonstrate features typical to any market and for these, our economic framework is appropriate. We therefore apply our framework where it is appropriate to do so, while recognising the uniqueness and the various non-market objectives of the FE market.

The rest of this chapter is structured as follows:

- First we set out some context to help interpret our analysis of the FE ‘market’ as described later in this chapter

⁸¹ Both groupings 3 and 4 address the technical and professional training that are currently government priorities. Here we split them according to capital intensive provision at all levels; and advanced (level 4+) training.

- Second we set out the approach we have used to consider and define the different parts of the FE market. This accounts for demand-side and supply-side factors.
- Third we set out the demand-side considerations that affect our definitions.
- Fourth we set out the supply-side considerations that affect our definitions; and
- Finally, we describe the market groupings and how best to interpret them.

Context to our analysis of the FE ‘market’

The role of government in the further education market

The Government’s aim for the further education market in England is that it provides the skilled workforce employers need and helps individuals reach their full potential⁸². Sitting beneath this high level objective is a very complex market of over fifteen hundred providers offering a wide range of academic, vocational and work-placed based courses at different levels of qualification (ranging from entry-level to level 8 which is equivalent to a doctorate) to almost four million learners a year. FE is delivered through a range of channels and settings.

FE can take place in classrooms, workshops, or in the workplace; it can be part time during the day or evening or full time and occasionally residential, such as in specialist colleges catering for learners with learning difficulties or disabilities. Some FE is also delivered in other settings such as prisons.

Government has a keen interest in the FE market because skills and education are essential for a productive and efficient workforce, and therefore for sustainable growth in the economy. Although employers invest substantial sums training their workers – the UK Commission for Employment and Skills (2014)⁸³ estimates that about £36 billion is invested by employers in England in on- and off- the job training – there remains a case for government to also invest. This is for several reasons.

- **Labour mobility:** A mobile workforce means that if employers invest in expensive qualifications for their workers, many may not reap the return on that investment if their employees move jobs. This would be likely to lead to too little private employer investment, especially for widely recognised qualifications which make those employees more attractive to other employers.
- **Affordability:** There are many small businesses in England that do not have the resources to invest in skills and training development for their employees.

⁸² This was explained in the previous government’s policy strategy document *Rigour and Responsiveness in Skills* 2013 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/186830/13-960-rigour-and-responsiveness-in-skills-amended.pdf

⁸³ UKCES Employer Skills Survey 2013

- **Equity:** Many learners are not able to afford to pay for their own skills development, and without support or encouragement to participate in learning and skills development, many may not have the confidence to learn and reach their potential.
- **Uncertainty:** The returns on the investment in learning may be uncertain for some learners, and those returns are likely to accrue to society in addition to the individual (for example, health improvements and crime reductions) so they are not incentivised to invest as much as would be optimal for society as a whole.

Government is therefore a key source of funding for further education in England. It routes funding through the SFA, the EFA, the Student Loans Company, and other government departments who have an interest in building skills to increase employment, such as the Department for Work and Pensions (DWP). Additional funding streams are also commonly accessed by providers, such as the European Social Fund.

The role of learners, employers and providers in the further education market

The level of government funding and the role of government and public agencies in the way FE is delivered mean that as a whole, FE is not a typical ‘market’ in which ‘consumers’ and ‘providers’ interact with the resulting outcome presumed to be the best outcome for society. This is for several reasons.

Firstly, learners do not ‘consume’ learning in a conventional way but rather *participate* in learning to enhance their skills and capabilities – some choose to do so yet for some others, participation is a government requirement (for example, JobCentre Plus referrals). Many learners do not directly pay to learn (government pays for them) yet some do pay towards their learning. Employers do not consume learning either – they merely reap the rewards from having a more highly skilled workforce, and reflect the value of those skills in salaries. Both learners and employers can however be seen to benefit from learning.

Secondly, many providers do not compete on the price of their services as is common in many markets⁸⁴, but rather on the quality and relevance of their provision – though as this report will later show, some may not ‘compete’ with others at all. Plus, in some parts of the market consumers do not choose suppliers but suppliers (such as selective 6th forms) choose consumers.

Learners

‘Learners’ are considered in terms of those that are participating in learning of some form, and also those who are not, but could. This is important for our analysis because in a well-functioning market potential consumers are not excluded through lack of information or choice.

Many individuals may not have considered engaging in learning, or are aware of some possibilities but do not have the confidence to participate. An important role played by the further education market is therefore to reach out to those groups and encourage them to participate in learning. The value of this participation does not necessarily derive from the particular course they choose – often this is a secondary issue – because the primary

⁸⁴ Yet as we note later in this report, there are some areas in the market where there

benefit is to encourage participation to build confidence and enthusiasm to continue learning. The benefits both to the individuals (in terms of building their confidence to learn) and to the government (from increasing the skill-base) therefore build over time as the individuals move along their learning pathway towards employment and meeting their potential.

For those already in learning or who have made the decision to enter the further education market, learning goals are likely to be varied:

- Learning new skills and developing new knowledge and experience can help learners to increase their chances of gaining employment in a job (including apprenticeships) and advancing their career. The skills and knowledge may be both of an occupation-specific nature (such as adult social care or electrical engineering, for example) and / or a generic set of capabilities that increase the effectiveness of those individuals while at work (for example, good maths and English, or problem solving skills).
- Further education can provide a 'second chance' to learn basic skills if they were not able to achieve those skills in earlier education. For example, some learners may participate in entry-level courses to boost their maths and English, in readiness for higher level education or to enhance their employability.

To meet these goals, learners need the market to be able to offer high quality further education; transparency about what is available and from whom; responsiveness from providers to meet their needs; ability to fund the education (whether with support from government, other grants, employers or their own resources); and relevancy of courses on offer.

Employers

Employers play a key role in the FE market because they are the recipients of trained and qualified learners. Many work closely with providers and Local Enterprise Partnerships, and a range of other industry-focused bodies, such as sector skills councils, to help shape the further education on offer and ensure it meets their needs in a growing economy. Many employers also play an active part in the market by employing apprentices. The UK Commission on Employment and Skills estimates that approximately 15% of employers, both large and small, currently employ apprentices, with the potential for many more to do so.

Our engagement with a range of stakeholders in the FE market suggests that the main needs of employers are that the market is able to deliver learners who have the skills and qualifications they need, including basic skills, to perform well in the workplace. For those that employ apprentices, they need learners who have the aptitude to apply themselves to learn in the work-place, to achieve their qualification and to be an effective member of the occupational community for which they have been trained.

A key tension between the needs of learners and the needs of employers is that some learners do not want to study the courses or develop the skills that *local* employers would necessarily want. Moreover some want to develop new skills so that they can change

employer. This means that if, for example, local employers are focused on healthcare and hospitality, and therefore encourage local providers to offer courses that deliver the skills that would be of value to them, if local learners do not wish to study related courses then this is a challenge for the market to overcome.

Providers of FE

Providers that have direct contracts with the SFA have various business models (some are very large multi-disciplinary general FE Colleges; others are very small private sector providers, while others are very specialist providers targeting particular learner groups such as the disabled or focusing on community provision). They also vary in terms of their size, breadth of provision, geographical presence and ability to adapt as parts of the further education market evolve. The role of providers is to offer further education opportunities to learners to meet the needs of learners, employers and the government.

The way that providers function also varies, largely driven by their core mission. For example, some prefer to focus on academic programmes for 6th form students; independent providers often focus on apprenticeships and traineeships; some Colleges focus on specialised vocational skills, or second chance learning, for example.

The wide range of further education providers demonstrates the dynamic nature of the market. To ensure they remain current and viable, providers need to therefore be responsive to signals from a wide range of sources. These include:

- the market: where, for example, they compete with other providers
- learners: so that they can recruit enough learners to make their provision viable
- employers: in some cases they compete to be selected to provide education and training on behalf of the employer, and more widely they have the local incentive to ensure their offer is aligned with the needs of employers
- the government: significant public funding for further education provision means that they have an incentive to tailor their offer to secure revenue.

To operate effectively in the market, providers therefore need transparency about the funding signals from government as this is a key source of revenue. Two-thirds of College revenue in 214/15 is from SFA or EFA, for example⁸⁵. Good market intelligence about what learners want to study is also important because they need to recruit them to make their courses viable; as is understanding what employers need (so that they are well placed to provide education and learning on behalf of the employer).

Clearly, there are many other participants and stakeholders in the FE market that either influence, or have a vested interest in, how the market operates and what it delivers. Wider

⁸⁵ Source: Association of Colleges College Funding And Finance (Table 4), 2014
http://www.aoc.co.uk/sites/default/files/College%20Funding%20and%20Finance%201%20May%202014%20FINAL_0_0.pdf

participants and stakeholders include Local Enterprise Partnerships⁸⁶, local authorities, sector skills councils, employer organisations, learner group representatives, community representatives, Job Centre Plus, awarding bodies, FE market regulators (such as Ofsted and Ofqual), and many more. All of these organisations influence the way the market functions and how effective and efficient it is.

Our approach to defining the market is now explained.

Approach

To define the markets within FE, we have used a framework, which is commonly applied by the Competition and Markets Authority (CMA)⁸⁷ within competition case work⁸⁸. It is based on the hypothetical monopolist test and takes an iterative approach to defining and thinking about markets. There are four steps involved in this iterative process as shown below. This relies on a distinction between a product (or service) and geographic dimensions of the market:

- **Step 1 - Starting point:** Take an initial narrowly defined set of products and an initial geography (for example, NVQ diploma in performing engineering operations or a Functional Skills qualification in mathematics).
- **Step 2 - Demand-side substitution:** Given that starting point, consider whether if the price rose or the quality fell in this market⁸⁹ by a small but significant amount (say 5%), consumers would switch away to another product or geography. If consumers would switch away, then the starting definition in Step 1 is wrong and the products and/or geographies they would switch to should be included. This iteration of step 1 and 2 is completed until a satisfactory set of products and geographies is reached.
- **Step 3 – Supply-side substitution:** Once a satisfactory definition has been reached from the perspective of the demand-side (step 2), the supply-side is considered. By this we mean that we ask the hypothetical question “if the profitability of provision in the markets from step 2 rose by a small but significant amount (say 5%), would providers switch to providing that product or geography?” If we find that providers would switch then our starting definition is wrong and should also include the products or geographies that providers would switch from. This iteration is then repeated until a satisfactory set of products and geographies is reached.
- **Step 4 – customer segmentation:** the final step is to consider whether there is any further market segmentation based on customers. For example, does one type of

⁸⁶ Local Enterprise Partnerships are partnerships between local authorities and businesses to determine local economic growth priorities. There are currently 39 across England.

⁸⁷ Formerly the Competition Commission and the Office of Fair Trading

⁸⁸ Merger Assessment Guidelines, Competition Commission and the Office of Fair Trading (2010)
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf

⁸⁹ The concept of price rising is more commonly used for most market definitions, but as the consumer does not pay in some of the FE markets, the concept of quality also becomes relevant.

consumer face different competitive conditions from others such as a more binding constraint on how far they could travel or the set of products that they could select from? If this is the case, there may be separate markets for some of these consumer groups.

Demand-side considerations

To understand the extent to which different products and geographies are substitutes for each other from a consumer perspective involves a careful understanding of consumer decision making in the context of FE. As part of our analysis, we have identified a number of important dimensions (alongside cost and quality) that affect the decisions that consumers in this market make. These are shown in Figure 26 and described below.

Figure 26. Dimensions of choice

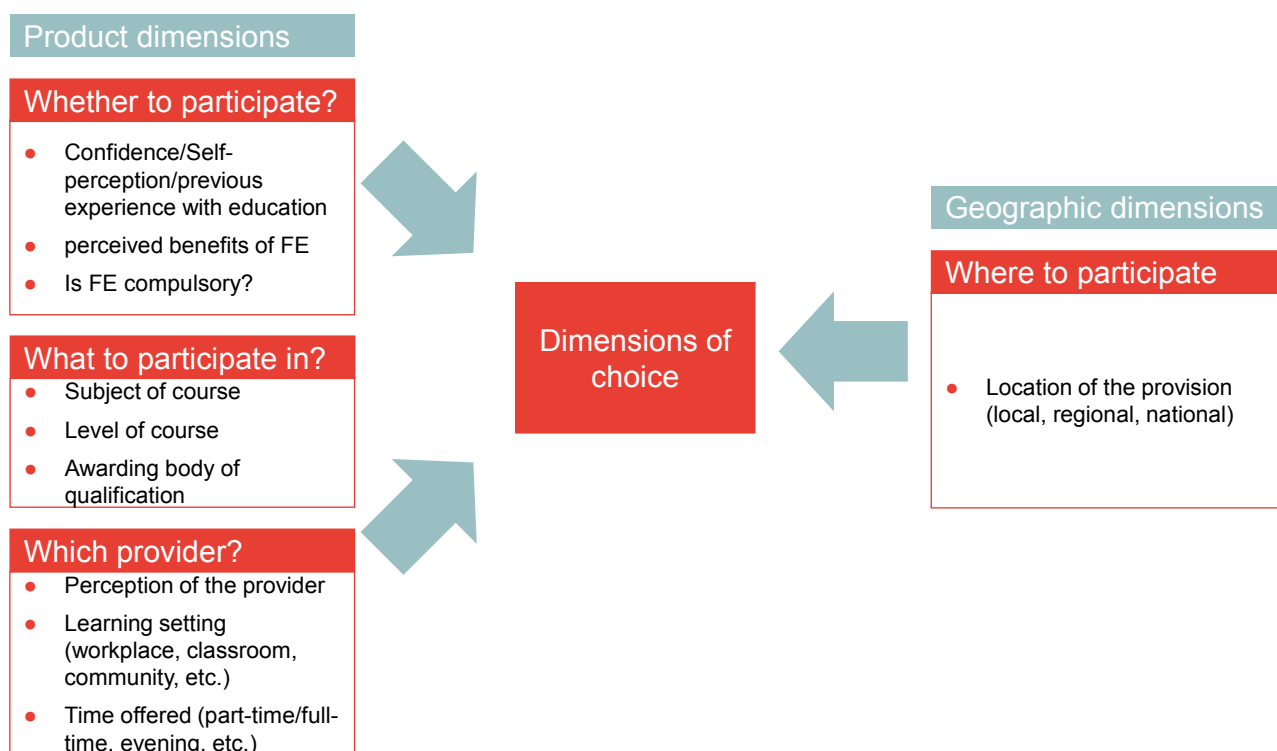


Figure 26 indicates that there are four separate components to a decision to participate in FE provision, though it is important to recognise the interdependencies of these components. We treat them separately in the text that follows to bring a level of simplification to the analysis.

Whether to participate

The first dimension of a decision about FE is whether to participate. It will involve, at some level, a weighing up of the likely costs and benefits involved with undertaking FE. For some groups of learners this decision will be a straightforward one. However, for others, particularly those that are far removed from the world of training and are hard-to-reach, the decision to participate may be extremely complex and involve tackling difficult issues of confidence and self-perception and previous (perhaps negative) encounters with

educational establishments or employers of apprentices. At the other end of the spectrum, there are those who may face little or no choice over whether to participate in training. For example, this could include those learners who are required to participate in FE by an employer or a legal regulation. From the perspective of market definition, the decision about whether to participate is likely to place consumers into three groups:

- Learners who may need the FE market to reach out to them (hard-to-reach groups);
- Learners/employers who can choose whether or not to participate in learning and will do so if the perceived benefits are sufficient ; and
- Learners with no choice over whether or not they participate in learning.

These groupings are considered again from the perspective of customer segmentation within the market definition framework.

What to participate in

The second dimension of choice relates to what to participate in. For some groups of consumers, this decision will be driven by a strong sense of the type of sector they wish to look for employment in or they are currently working in and would like to progress further within. They will have a clear idea of what subject they would like to study and may also have identified the particular type and level of qualification that they require. For these types of learners, other courses within the same sector, or courses within different sectors, will not be substitutes for their chosen course. For other learners the choice may be driven more by the setting than the subject or type of course. For example, younger learners may identify the type of environment they wish to study in first (or concurrently) with identifying the particular course they wish to study. For these learners, there may be a greater degree of flexibility over specific course options, but a much lower degree of willingness to accept a course in a different setting. For example, a learner that values a multi-disciplinary environment like a school sixth form or FE college may be unwilling to consider a small independent provider even though the course offered is the same. Similarly, learners who may be intimidated by certain formal settings such as schools and colleges may not see those as substitutes for a more informal setting.

This means that from the perspective of market definition, consumers can be grouped into two main groups - those for whom the **setting** is the key driver of what to participate in and those for who the **course** is the key driver of what to participate in.

Which provider to choose

The third dimension of choice is the choice of the provider. This decision will combine many factors such as the perception and knowledge of the provider and the convenience of the FE options offered by that provider (e.g. part time provision or evening courses) and some may be told where to enrol by their employer. The mode of study offered is also important. Many learners are extremely constrained and must have training options that fit around work or childcare commitments. For these learners, full time courses are not a substitute for part time courses and daytime course options may not be a substitute for evening or weekend courses.

Where to participate

From the geographical perspective, the location of a provider is key to many choices. Around 70% of learners choose learning providers located within 10km of their home and 50% do not travel further than 6km. These learners therefore choose their FE locally. However, this catchment area appears to apply to particular groups of learners such as those choosing the basic and core levels of FE (Level 0 to 3).

A significant minority of learners who choose higher level courses (Level 4+) are prepared to travel further with most of them being able to access their chosen course at a regional level. The typical geographic catchment for these courses will be 20km.

The most specialist courses are offered and accessed on a national basis, i.e. the learner has no option but to travel to the provider which supplies the course. This can be because the course is so specialist that it would not be possible to offer it on a smaller scale locally or regionally, or because the scheme is employer specific and the learner is expected to locate towards the employer rather than vice versa. Some adults, such as those in prisons, also do not have choice with respect to the location of the courses.

Supply-side considerations

To understand the extent to which FE providers are able to substitute between different products and geographies within FE, involves a detailed understanding of provider decision making in relation to their FE offer. When we think about supply side substitution, we are considering the extent to which existing providers can quickly and easily switch to offering the products or supplying the geographies where the profitability of provision has increased. This is a slightly different range of factors that may affect entry into the market over a longer time frame. Our analysis has uncovered an array of factors that can affect and constrain provider's responsiveness to these changes. We have summarised these factors in Figure 27.

Figure 27. Factors affecting speed of provider responses

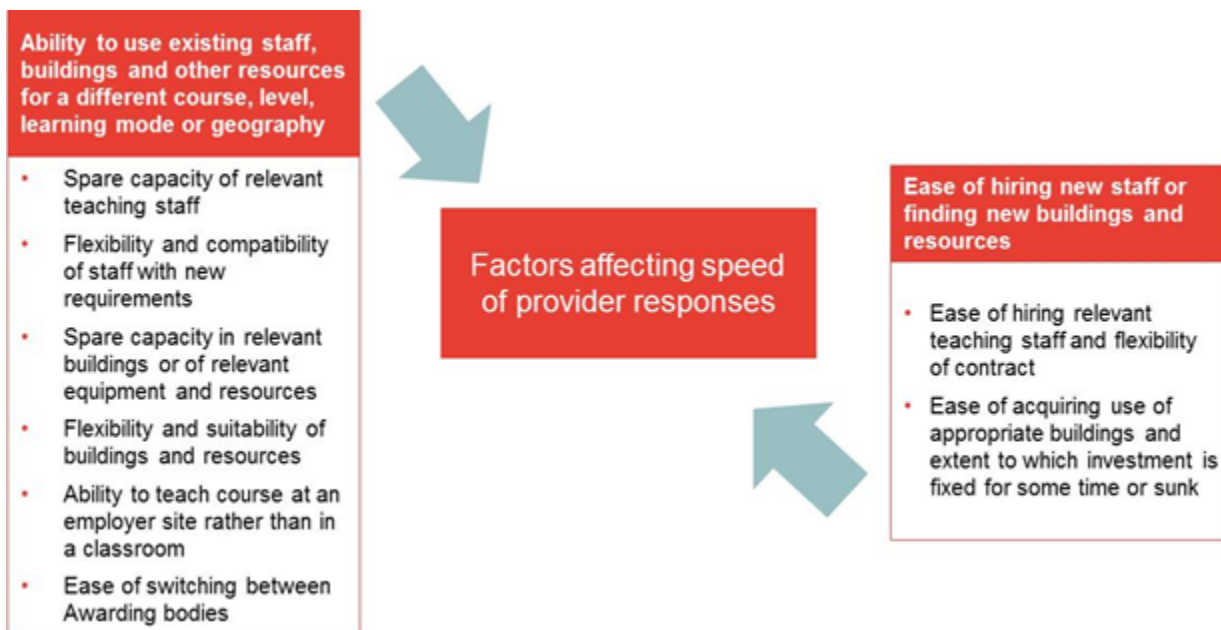


Figure 27 indicates that there are two dimensions that affect the speed with which providers are able to respond to changes in the profitability of offering a particular product or geography. We discuss each dimension in turn in the text that follows.

Ability to use existing resources for a new purpose

A key factor affecting the speed and ease with which providers can respond to a change in the profitability of a particular course offering or within a particular geography is the flexibility and spare capacity of its teaching staff, buildings and other resources. Adapting existing resources is likely to be one of the quickest ways to serve a new segment of the market.

The ability to switch quickly into providing new courses and geographies will be strongly affected by the compatibility of existing staff and buildings to the requirements of delivering the new product. If a provider has staff teaching similar courses in similar sectors that have some spare capacity to teach, the provider may be able to respond quite quickly to a change in market conditions. It tends to be easier for staff to be able to switch between courses within similar subject areas and at similar levels of difficulty with a switch becoming harder the further away from the teachers' original area of expertise the new course is. Thus, one would expect providers to be able to switch relatively easily to new courses which are within the same subject or sector area as existing courses but to find it more difficult to switch to offering new subject areas.

To the extent that larger, more diverse providers like colleges already offer a range of provision, the range of courses they could switch into at short notice is likely to be greater than for smaller, more specialised providers.

The speed with which staffing can be changed is also likely to be affected by the nature of employment contracts used by the provider and other employment conditions they must abide to. Providers able to use flexible, short-term contracts or sub-contracting are more likely to be able to respond quickly to changes in demand without the need for significant investment in new staff.

The ability of existing buildings, equipment and other resources to deliver a new course or provide in a new geography is also likely to be strongly affected by the suitability or flexibility of the buildings used to deliver the course. If buildings are unsuitable for the new course or inflexible and investment is required, the response of providers will be slower. The closeness of match of the new course with existing provision, the more likely that buildings and equipment could be utilised quickly. Alternatively, if provision can be made available on an employers' premises rather than in a classroom then the ability to respond quickly is likely to be enhanced.

Another factor affecting the speed with which existing staff and buildings can be utilised to deliver a new course is whether it requires negotiation with a new Awarding Body. There are costs associated with changing from one Awarding Body to another and providers tend to only deal with a small number of Awarding Bodies at any one time. Thus, it is likely to be easier to switch into providing a course that is offered by one of the providers' existing Awarding Bodies compared to switching to a new Awarding Body.

Ease of accessing new, flexible resources

Where providers are unable to make use of their existing staff and buildings they may still be able to offer provision of a new course or in a new location relatively quickly if they are able to hire relevant staff or acquire the use of relevant premises. Where new staff are required, the ease of doing this will depend on the availability of such staff in the market place (certain teaching staff e.g. maths teachers are in short supply at available wage rates) and the flexibility of the contract on which they can be employed. If staff can be employed flexibly on short-term part-time contracts then providers may be able to respond to market changes much more quickly compared to the case where they must offer standard employment terms.

One route to hiring new staff (and often buildings) quickly is to take over another training provider or enter into a sub-contracting relationship with them. Where appropriate providers exist, this may increase the speed of response by existing providers in the market.

Finally, if it is possible to deliver training within premises without the need for significant investment that is fixed or sunk in some way, then responses are likely to be quicker. For those markets where significant investment is made, providers are unlikely to be able to offer substitute products at short notice. The more specific the investment in equipment or buildings is for particular types of courses, the less likely a quick short term supply response would be expected.

Another factor is the assessment cycle. If a course like A-levels is assessed in June it is only really possible to start it in September 2 years before. Very short courses can normally start any time.

Customer segmentations

The main drivers of market definition have been discussed above but there is an important further dimension to account for: customer types. This is because some customers face different competitive constraints to others.

As we noted above, the main 'customers' are learners (the participants of learning); and employers (the recipients, and sometimes funders, of skills provision). Understanding how they interact within the FE market is important and in turn can in some cases impact on the actions of providers, but importantly, in some cases they cannot impact on providers. Understanding where these situations arise and for whom is important.

Before discussing the key customers, it is first necessary to again acknowledge the role of government in the FE market because its role is to address a market failure – i.e. to ensure high quality and accessible further education where the market would otherwise not deliver it. It is therefore the major funder of FE. By changing the funding and regulatory incentives that the different players in the market face, government can play a role in affecting what is delivered by providers. For example, if government shifts funding from classroom based courses to workplace-based programmes such as apprenticeships, it can help to incentivise provision of those courses. There is a proviso to this however, because learners have to want to take up these places and employers have to want to offer them. Government can therefore affect the incentives of providers but only to the extent that the rest of the market will fall in line with those incentives as well.

Its ability to influence the market is in some ways asymmetric because it can more easily stop provision of some programmes by simply ceasing to fund them; but its ability to shift the balance of provision is arguably more difficult because of the interactions in the market. This means that government is unable to independently drive demand for courses and, as a result, the only constraints that matter in the context of market segmentation are those that affect learners.

Learners

There are three key groups of learners for whom different competitive constraints may exist. These are:

- **Learners aged 16-18:** may face a different set of alternative providers compared to learners making choices about similar types of courses that are aged 19+. Younger learners are more likely to have a wider range of choices available as they will be able to consider school sixth forms as well as sixth form colleges, FE colleges and other FE providers. Older learners will not tend to have the same set of sixth form options available to them. This division is most important for the first market for local classroom based, mixed environment training at levels 0 to 3. There may be a separate market for this group.

- **Learners for whom FE choices are largely made for them:** two particular examples are learners referred to FE by JobCentre Plus, and those in prison. These learners may, in effect, have very little choice at all. For these groups of learners, the funder is the consumer i.e. JobCentre Plus or the SFA. As they are commissioning providers to deliver these forms of FE to large numbers of learners over time, they may therefore be able to exert more buying power than any individual consumer in their own right.
- **Vulnerable learners in hard to reach groups:** these learners may not place “demands” on from the FE market in a conventional way and their decisions are likely to be influenced by the setting as much as or perhaps more than the specific course. For example, the setting will be chosen so that they feel comfortable (large providers could be daunting for some) and it is practical for them to get there. This group has already been identified separately as it is likely to have different consumer preferences and decision making process when compared to other groups of consumers in this market.

Employers

Employers also demand training in this market for up-skilling their employees or by offering apprenticeships that combine an offer of employment with training, plus they benefit from being able to employ those who have already been trained. In the workplace-based, sector specific training market, both employers and learners are acting as consumers. For many employers, the competitive constraints they face will look very similar to learners. They will have a range of alternative options they can consider and will weigh up on the grounds of cost, quality and suitability of what is offered. Their individual purchase decision will have very little impact on the overall functioning of the market.

However, there is one group of employers whose influence is greater and whom may be able to exert more competitive pressure in the market. These are the large employers, who because they are able to offer up a large number of individuals to be trained, may be able to exert considerable pressure on providers to compete heavily for their business. They may also be able to withdraw from the market entirely and create their own in-house training arm. For this reason, giving separate consideration to this group in some contexts may be important.

Identifying the relevant FE markets

Our analysis has identified 7 market groupings within the publicly funded FE market in England. Each grouping refers to the nature and type of FE in which learners participate i.e. the groups describe the characteristics of the FE itself, not the types of providers that deliver it. Therefore, providers can be active across different market groupings. For example, a FE College is likely to be active in many groupings such as grouping 1: local “core” mixed environment training (e.g. delivering entry level English and maths provision to ‘second chance’ learners); grouping 3: sector focused training in the workplace (e.g. delivering apprenticeships); grouping 4: capital intensive training courses (e.g. delivering high tech manufacturing vocational qualifications); and grouping 7: prison-based learning (e.g. holding a contract to deliver this provision in prisons).

Within each of these groupings there are likely to be a number of sub-markets and customer segmentations.

Market grouping	Nature and characteristics of FE in this grouping
Local markets	
<p>1. Local, “core” mixed environment training</p> <p>(e.g. GCSE Maths delivered within a setting in which many other learners are learning other subjects or on a wide range of vocational qualification courses)</p>	<p><i>Local, classroom-based, mixed environment training provision covering levels 0 to 3 and leisure courses</i></p> <p>Only providers within a 10km radius of the consumer (learner or employer), offering a course on the same subject at the same level (0 to 3) with the same learning mode within a mixed learning environment would be considered substitutes. Some qualification-specific sub-markets. There are likely to be distinct customer segments for 16-18 year olds (who have a wider range of choices compared to those aged 19+) and those learners routed via JobCentre Plus (whose choice may have been made for them).</p>
<p>2. Local, “basic” community-based training</p> <p>(e.g. entry level English delivered in a local community building, in which other learners are able to undertake other courses; or Adult Community Learning in a local setting)</p>	<p><i>Local, community or voluntary led, setting-specific training at levels 0 and 1 or community learning with no qualification</i></p> <p>Only providers offering community or voluntary sector-led provision of a similar set of courses within a similar setting within a 10km radius of the consumer may be considered substitutes. Providers are likely to be able to switch between offering similar courses within the same setting because switching between courses is likely to be relatively easy. As the setting is important, other community or voluntary providers offering similar courses may not be viewed as substitutes even if they offer equivalent courses. In some cases, courses will not lead to a qualification but will serve a valuable purpose in engaging learners that might not otherwise seek out learning opportunities.</p>
Regional markets	
<p>3. Capital intensive training courses</p> <p>(e.g. high tech manufacturing or horticultural courses delivered in a provider-based setting)</p>	<p><i>Regional classroom-based, high capital intensity courses</i></p> <p>Only providers offering classroom-based provision of the same capital-intensive course would be considered substitutes. From a supply side perspective, as this group of courses are capital intensive to deliver, providers operating within this sector but not with the required level of investments would not be able to expand quickly into this group of courses.</p>
<p>4. Regional “advanced” sector-focused training</p> <p>(e.g. advanced aeronautical engineering delivered within a highly equipped setting to which learners are willing to travel)</p>	<p><i>Regional, classroom based, sector-specific training at levels 4+, low and medium capital intensive courses</i></p> <p>Only providers offering classroom-based provision within the same sector at level (4+) within a 20km radius of the consumer would be considered substitutes. From a supply-side perspective, providers tend to be able to switch to providing other courses within the same sector relatively easy. There may be sector by sector variation in this according to the specific skills required to teach particular courses as well as the scarcity of those teaching staff.</p>

Market grouping	Nature and characteristics of FE in this grouping
National markets	
<p>5. Sector focused training in the workplace</p> <p>(e.g. apprenticeships for automotive manufacturing or apprentice chefs –learning is delivered by being employed in a workplace while working towards a qualification in parallel)</p>	<p><i>Work-based sector-specific training covering all levels</i></p> <p>Only providers offering workplace-based provision within the same sector are likely to be considered substitutes. There may be sector by sector variation in the extent to which there are sub-sector markets. This will depend on the ease of providers within that sector to switch between different levels and specific courses, but for most providers, presence within a sector is likely to mean they will be able to expand to other sector-specific courses relatively quickly. There is likely to be distinct customer segments for large employers. Location of providers does not play such a key role in this segment as provision can be provided in the workplace and tailored to meet needs.</p>
<p>6. Specialist residential provision</p> <p>(e.g. programmes delivered in settings with highly trained staff to meet the needs of learners with learning difficulties or disabilities, sometimes residential)</p>	<p><i>Specialist classroom learning</i></p> <p>Only providers offering residential, classroom-based provision of a set of relevant courses would be considered substitutes.</p>
<p>7. Prison-based learning</p> <p>(e.g. learning that takes place within prisons – courses available will be determined by the SFA)</p>	<p><i>Offender prison-based learning</i></p> <p>Only providers willing to offer prison-based courses will be considered as substitutes.</p>

4. Vision for a well-functioning market

Key findings

To determine whether the FE market is currently working effectively, we first asked the question: “what features would need to be observed in the different parts of the FE market to ensure that it could, and is, functioning well?”

This is useful because it allows us to compare this ‘vision’ with what is actually observed to inform an assessment of what is working well and what is not. We identify 5 features that would need to be observed across the FE markets identified in Chapter 0 to ensure that they are able to function well:

- **Active consumers** – covering the features we would want to see in a market that facilitate consumers being active. These include availability of choice; information about those choices and accessibility of that information; and confidence and ability to make an informed choice. Evidence of consumers making active choices is also considered.
- **Responsive providers** – covering the extent to which providers are incentivised and are able to respond to market pressure unconstrained by structural market conditions, governance arrangements or policy and regulation. Evidence of providers being responsive is also considered.
- **Conditions for entry** – covering the extent to which the market is open to entry by new providers or whether there are significant barriers which could be structural in nature or policy driven.
- **Threat of failure** – covering the extent to which poor performers can straightforwardly exit the market and whether policy allows a clear and credible threat of provider failure.
- **Effective policy/regulation** - covering the extent to which policy and regulation are ensuring that competitive pressures are enabled (and not distorted or reduced), where appropriate; that competitive pressures are supplemented with policy and regulation where there are structural market failures; and, that there are appropriate safeguards for learners.

Introduction

The FE market has historically been subject to government intervention of a range of forms. These have been implemented to overcome market failures that would mean the FE market, left to its own devices, would not fully deliver the outcomes desired by society.

In this chapter, we ask the question of what features would need to be observed in the different parts of the FE market to ensure that it can function well as a market. Akin to other market studies, we consider the consumer (demand) side and the provider (supply) side of the markets we identified in the previous chapter. We ask whether or not consumers and providers are incentivised and able to provide competitive pressure in this market. In addition we consider the role that policy and regulation play in this market. We also consider whether policy and regulation are successfully targeting those areas where the demand and supply side do not provide sufficient incentives for driving up quality, efficiency and innovation.

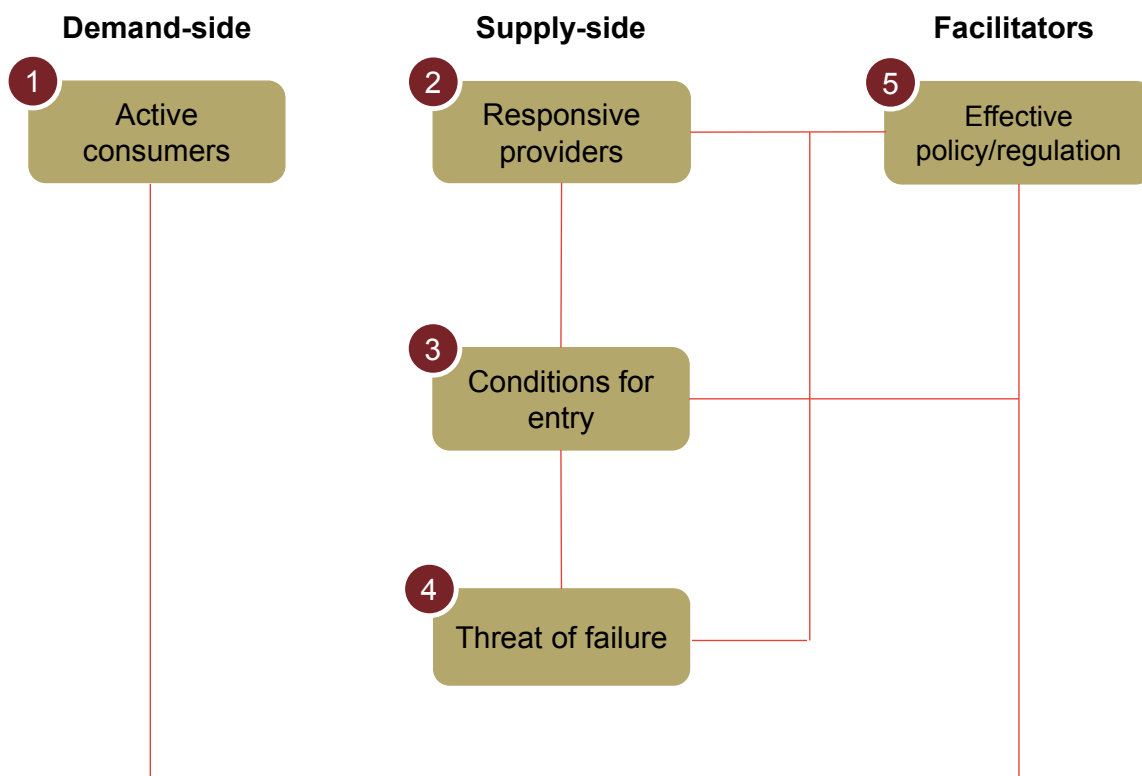
The rest of this chapter is structured as follows:

- First we set out the overarching framework we have used to assess the FE market.
- Second we discuss the demand side features in detail.
- Third we discuss the supply side features.
- Finally, we discuss the facilitating features.

The framework

We have developed a framework that identifies five features that should be present in a well-functioning FE market. These features are illustrated in Figure 28. On the demand-side of the market, the first feature relates to active consumers. On the supply side, there are three relevant features: responsive providers, conditions for entry and expansion and a threat of failure. Finally, there is one facilitating feature, that of effective policy and regulation.

Figure 28. Features of a well-functioning further education market



For each of these features, we have identified a set of drivers that allow us to determine whether or not the feature is contributing effectively to a well-functioning FE market. In the chapters that follow, we make an assessment of the health of each driver and each feature in the context of the range of FE markets.

This assessment draws on extensive data work and stakeholder engagement and allows us to identify those areas where a market can and is functioning well and those where there may be an enhanced role for policy to ensure that the market is delivering for learners, employers, government and wider stakeholders.

Demand-side features

On the demand-side of the market, the feature is the presence of “active consumers”. In a conventional market, consumers choose which of a set of competitor products or services to select based on price, quality and other important characteristics. The making of an informed choice in this way, and its associated purchasing power, incentivises providers to ensure that they are delivering what consumers want so that their product or service is selected.

There are a number of features in the market that we would want to see that indicate whether consumers are able to be “active” in a market:

- Availability of choice and awareness of the choice;

- Access to information to guide that choice; and
- Confidence to make an informed choice.

We discuss each in turn below.

Availability of choice and awareness of choice

For consumers in FE to be able to be active in such a way that they provide competitive constraints on providers, the market must be able to offer them a degree of choice of provider, course and mode of learning. In addition, they must be aware of that choice. If consumers have more than one provider of the type of FE they seek in their area, they can choose between the providers to select the one that best suits their needs, driving up the quality, efficiency and innovation of the providers in that market. However, if there is only one provider or consumers are only aware of a small subset of providers, the choices they make may not have the necessary incentivising effect on FE providers.

Access to information to guide that choice

For there to be active consumers in the FE market, those consumers need to be able to make informed choices between providers. Decisions about which course to take are complex and consumers need high quality and relevant information about a number of factors that are important to them (and this will differ across learners) to assess the degree to which the providers and courses they are considering are suitable for them. If consumers make choices that do not reflect the extent to which an offer is well suited to them, then the provider has little incentive to improve those aspects of their offer in the fear that consumers may switch away to other providers.

In some cases, it will be necessary for providers, communities, voluntary groups or others to pro-actively reach out to individuals who are not yet considering participation in learning. In these cases, it needs organisations to be proactive in engaging hard to reach groups and tailoring their form of engagement and information. For example, they may need to find a way of communicating which makes learning attractive and for the learner to feel comfortable in overcoming any pre-conceptions or past experiences that might otherwise hinder those individuals from participating in FE.

Confidence and ability to make an informed choice

Although necessary, it is not sufficient for high quality and relevant information to be available. For consumers to be active, they must be able to exercise a choice, and to have confidence in doing so. In some cases, this may mean providers offering FE in a way which makes it attractive for individuals to want to learn when they might not have otherwise done so. In other cases, it may mean that learners have the appropriate support to increase their confidence to choose what is right for them. Where consumers are not able to make this informed choice, again providers do not necessarily face the right incentives to improve their offer.

Supply-side features

On the supply-side of the market, there are important features that need to be in place to allow the market to deliver:

- Responsive providers;
- Conditions for entry and expansion; and
- Credible threat of failure.

Responsive providers

In a conventional market, providers face two key pressures to improve their offer. The first pressure comes from active consumers who will switch to an alternative provider if they are dissatisfied with the training they are receiving. The second pressure comes from their competitors who are continually striving to improve their offer and thus attract consumers away.

What matters in a well-functioning market is that providers are able to respond to these pressures and are not constrained by structural market conditions, governance arrangements or policy and regulation. We therefore assess the extent to which providers are able to respond to the incentives that they face from consumers (including learners, employers and government) as well as to efficiencies and innovations made by competitors.

In addition, it is important to consider the extent to which there are variations across providers in how they are able to respond to their competitors. This is often referred to an assessment of whether there is a 'level playing' field or whether there are peculiarities about the policy or regulatory environment, or of the market itself, which mean the ability to be responsive is easier for some than others.

We consider the extent to which providers are responsive to consumers (learners and employers); competitors and policy.

Conditions for entry

In most markets, the ideal scenario in a market is a range of alternative providers who compete fiercely for consumers. Under these situations, such competition would be expected to lead to providers being very efficient (if not then they will be higher cost than competitors and therefore not be able to compete); to deliver what consumers want (assuming consumers are also active and if providers do not deliver what they want, consumers can simply go to a competitor); and to deliver consistently high quality (if not, again there will be a competitor that is better and more attractive for consumers).

In addition, the ideal would market would welcome the entry of new providers over time as a way to increase the competitive pressure yet further. Such entry encourages innovation, efficiency, quality and increases choice for consumers allowing their needs to be more closely met.

In markets where the level of concentration is high (i.e. there are few or no alternatives), providers may still face incentives to improve and innovate if there is a credible threat of an alternative provider being able to set up in the market relatively easily and quickly.

This is also true for markets where an existing provider may be able to expand into a new area of provision relatively quickly if they recognise that there is a key gap.

However, if there are significant barriers to entry to a market, then the threat of new entry will be lowered and incumbent providers do not need to worry that new providers might enter the market and outperform them. These barriers may be structural in nature, for example, if there are sizeable fixed costs that cannot be recouped in the event of subsequent exit. They may also be policy driven, for example if due to funding arrangements, the only way to be viable is to be able to offer a wide range of courses.

We consider the extent to which the market conditions facilitate entry, or whether there are barriers that hinder it.

Credible threat of failure

Poor performing providers should not be able to operate in a well-functioning market. A clear and credible threat of failure is important as it means that providers, who do not respond to the demands of consumers, or offer low quality, are driven out of business. This places a competitive threat on all providers, even those that face very little competition in their market.

We consider the extent to which the market and the way it is funded and regulated sends an appropriate signal that poor performing providers face a credible threat of being driven out of the market.

Facilitating features

Public funding and regulation are important within FE so as to ensure accessible and high quality FE is available where the market would not otherwise deliver it. The design and implementation of funding mechanisms and regulatory frameworks should aim to deliver the same outcomes as though the market were operating effectively and efficiently, and also appropriately addressing equity and accessibility concerns (by being open and accessible, and proactively engaging individuals who otherwise would not participate in FE).

Policy and regulation are facilitating features of the market and should ensure that:

- competitive pressures are enabled (and not distorted or reduced), where appropriate;
- competitive pressures are supplemented with policy and regulation where there are structural market failures; and
- appropriate safeguards for consumers are available in the event of provider failure or for vulnerable groups.

For policy and regulation to be appropriate, government must be clear about where there is a role for competition within FE and what factors will enable that to work more effectively. It must also identify those parts of the market where competition may never be able to take effect and instead develop alternative policy tools (such as market mechanisms or competitive methods of procurement) or regulatory tools that mimic market pressures and incentives as much as possible.

Finally, whatever the market conditions, policy and regulation have a role to play in markets where competition is effective and those where it is not. For example, they play an important role in protecting consumers in the event of provider failure or misconduct.

5. Active consumers

Key findings

- The decision of whether to participate in further education is critical for a productive and skilled workforce. The FE market plays a key role in reaching out to disadvantaged groups to offer learning opportunities (which could then lead to better employment opportunities); as well as up-skilling and providing high quality education to those that have already decided to participate in FE.
- Learners' choice of providers varies significantly across courses. Learners typically have more choice for more general courses than they do for more specialised courses. Learners in some areas have few local colleges and, to the extent that this type of provision is important for them, may lack a real choice. Here it is imperative that providers offer consistently high quality and sustainable education.
- Learners typically have a greater choice of provider around the major cities such as London, Manchester and Birmingham. For some courses such as specialised engineering courses, there are pockets of 'not spots' i.e. areas where there are no providers. These are typically observed in the South West, the South and the North West (though this could change over time given plans for new colleges).
- Choice of apprenticeships depends on local employment markets as well as the willingness of the learner to travel. Apprenticeships with high profile large employers can have more than 20 applicants per job. Providers can play a key role in matching learners to apprenticeships.
- Awareness of choice for further education is generally low for some groups. In particular for (i) disadvantaged and hard to reach groups, such as those in poverty or who are isolated, where they lack confidence and do not proactively seek information (ii) those in low paid work where they do not realise they have training and further education possibilities (iii) those without access to impartial information such as students in school 6th forms where their provider has an incentive to retain them or those on benefits for whom FE is chosen by JobCentre Plus.
- Learners generally do appear to exercise some local choice. Typically only 20-30% of learners use their nearest provider. So although the geographic catchment of learning is very local, most learners appear to exercise local choice.
- Only two-thirds of learners aged 16-18 were satisfied with the information they were given when choosing their course (SFA, 2014). There is an apparent lack of information on provider quality and on the interface between learners and the labour market, despite the evidence suggesting these pieces of information would, if done well, help with learner expectations and matching skills to employment opportunities.

Introduction

A well-functioning further education market requires its consumers (learners and employers) to be **active**. That is, consumers – or perhaps ‘beneficiaries’ – of further education should be able to make informed decisions about learning options that meet their own best interests, and also send a signal to the market about what those interests (or needs) are. In turn, providers then have an incentive to serve those interests and meet those needs in order to be sustainable and thrive.

Active consumers, who are able to choose whether to participate in learning, what to learn, from which provider, in which area, and through what means (such as full time class-room based or workplace-placed based) can reward and incentivise providers to improve quality, efficiency and innovation by selecting those providers that deliver the services that most suit their needs.

In the further education market, the diversity of learners and employers, in particular, means that for some, being active and engaged in their choices is natural and straightforward. But for others, this is not the case. An important distinction in relation to learners, as noted in Chapter 0 is that we must be conscious of three groups:

- Those who have made the decision to participate in further education and are therefore already learning, or are making decisions about what to learn and where.
- Those who are not currently learning and for whom participating in further education learning is not even being considered as they feel it to be out of reach; or because they do not have the confidence to participate in learning (hard to reach groups).
- Learners with no choice over whether or not they participate in learning or not as it is requirement for them receiving benefits e.g. those referred by JobCentre Plus.

The further education market has a role not only to cater for the interests and needs for those who have already made the decision to participate in learning, but it also plays a valuable role in accessing hard to reach or disadvantaged groups and encouraging them to participate. Both of these groups of learners are acknowledged below.

Diversity across employers is also critical to understand, as noted in Chapter 0. Some choose to actively engage with providers and the further education market by working with them to develop courses or to recruit apprentices for example. Others choose to be much more passive and merely act as recipients of learning outcomes when learners enter the labour force. Therefore, where possible, we highlight the particular groups for which observations are more relevant.

This chapter considers the extent to which learners and employers have:

- **Availability of choice:** whether there are various options for courses, providers, locations and means of learning from which they can choose;
- **Awareness of choice:** whether learners and employers know the choices they have open to them from the range of providers in their area;

- **Access to information:** whether learners and employers have impartial, informative and appropriate information to guide their choices; and,
- **Confidence and ability to make decisions:** where learners are engaged with further education learning and are able to make their own decisions about what to learn, where and through what means.

Availability of choice

‘Availability of choice’ refers to two issues in the context of this chapter:

- First: the choice relating to whether to participate in further education learning; and
- Second: for those that have made the decision to participate in learning, choices relate to what to study, where, etc., recognising the constraints for some around the cost or ability to travel to providers that are outside of their local area (as we found in Chapter 0).

For the former, there is a clear role for the further education market to reach out to those people who would not otherwise engage with further education, perhaps because they do not have the confidence to (possibly relating to a negative previous experience of learning); or because they haven’t considered it to be a realistic option for them; or because of other perceived barriers such as cost or time commitment.

Encouraging those members of society to participate in learning is likely to provide benefits to those individuals and to wider society. For those individuals, learning of any form (perhaps just something they are interested in such as photography or drawing) can play an important role in building confidence and a sense of achievement, as well as igniting a further thirst to learn and build new skills. In turn this leads to further work or learning opportunities. For wider society, welcoming more people into the learning environment and supporting them to build their confidence, skills and desire to reach their potential can, in the longer term, increase the chance that they gain employment or move to a better paid job (i.e. higher productivity).

After the decision to participate in further education has been made, having access to a range of choices increases the chance that learners’ interests and needs will be met effectively.

In Chapter 0 we found that there are substantial differences across subject areas and geographies in terms of the distances that learners are willing to travel and the number of alternative providers they have available. We observed that learners generally travel shorter distances at lower levels of further education (lower than level 3) and there are typically a wider range of providers available in a local area for basic skills and functional subject areas. We also found that learners generally travel longer distances at higher levels of further education (level 4 and above) and there are fewer alternative providers available in specialised subject areas.

However, subject areas may be very broad and to really understand the choice that learners have in the market, it is necessary to investigate the evidence at a much more detailed level. This is because within any particular subject area (such as health and social care), a provider may offer various courses which are not direct substitutes for each other. That is, a learner may not be willing to switch from one health and social care course to another because they are too different. Dental nursing and adult social care are two examples of courses within the same subject area (health and social care) that clearly align to very different career paths.

For learners to be able to make choices about what to study and where, they need alternative providers of their chosen course to be available. By looking at a sample of three courses – one for each of the subject areas of Preparation for Life and Work; Health and Social Care; and, Manufacturing and Engineering – we can build an understanding about whether some learners have a greater degree of choice than others. In particular, by exploring access to alternative providers at a geographical level, we can begin to identify areas across England where learners have greater or lesser choice, or in the extreme cases, no choice at all (i.e. one or fewer providers of a particular course). We are able to go to quite a detailed level by looking at the number of providers in each local authority district (LAD)⁹⁰.

The three selected courses are shown in Table 6.

Table 6. Courses used for the analysis of learner accessibility

Subject area	Course
Preparation for Life and Work	Key Skills in Communication (keycom)
Health and Social Care	Diploma for the Children and Young People's Workforce (dipcy)
Engineering and Manufacturing	NVQ Diploma in Performing Engineering Operations (nvpeo)

Using these courses, we have investigated:

- **The extent to which learners have one provider within reach:** the percentage of learners across England with access to at least one provider within 10km of where they live. This is for three example courses (one in each subject area);
- **The number of providers within reach of learners:** the average number of providers across England within 10km of the learners; and
- **Whether or not the closest provider is selected:** the extent to which learners frequent their nearest provider for their learning, or use alternatives local to them.

⁹⁰ We define learner's accessibility to FE providers as the percentage of learners with access at least to 1 provider within 10km. Therefore, we measure how many learners have a provider within 10km from their registered postcodes. We consider just LADs with more than 10 learners. Then, all local areas with less than 10 providers are considered "not spots" for the purpose of this analysis.

Because apprenticeships are a policy priority, we have also specifically examined the availability of apprenticeships across the country.

To complement this analysis, given Colleges differ from other providers, mainly because of their size, breadth of provision, multi-functional role and community presence we have also investigated the percentage of learners with access to at least one College within 10km of their home address. This accessibility is of particular interest because Colleges are a core group of the providers serving one of our markets (the Local, “core” mixed environment training market”) – they are often multi-disciplinary and multi-purpose (offering learning opportunities alongside careers advisors, libraries, refectories, sports facilities etc). Such an environment is particularly appealing to some learners as it means they are able to learn alongside their peers who may be studying courses completely different to their own⁹¹. For some learners, they might prefer to learn in a setting that caters only for young people, whereas other learners may prefer settings that attract learners of all ages.

Whether at least one provider is within reach

Figure 29 shows the percentage of learners with access to at least one provider of the selected course for each Local Authority District in England. The figure demonstrates a clear variation across courses in the extent to which learners have access to at least one local provider. The map on the left of the Figure relates to key skills in communication and shows that right across England learners have a good level of accessibility. In almost all local authority districts, 100% of learners have access to at least one provider, with only a handful of areas like Northumberland, Dorset and Durham where 0-15% of learners have access to no provider within 10km.

For the diploma for the children’s and your people’s workforce, the picture is a little more mixed, as shown in the centre map. This clearly shows large areas of England where 100% of learners have access to at least one provider, but there remain pockets where far fewer learners have a choice of providers. There are several areas in the north of England where fewer than 90% and in some cases as low as 75% of learners have access to at least one provider for this course.

For the diploma in performing engineering operations – a highly specialised course – there are many more learners without access to at least one provider. The map on the right of the Figure shows several areas where there are zones of red which indicate more than 25% of learners have no access to providers, mostly the east coast and Cornwall. In addition, the map also has areas shaded with a diagonal pattern – in these areas there are no providers of this course at all. We call these ‘not spots’.

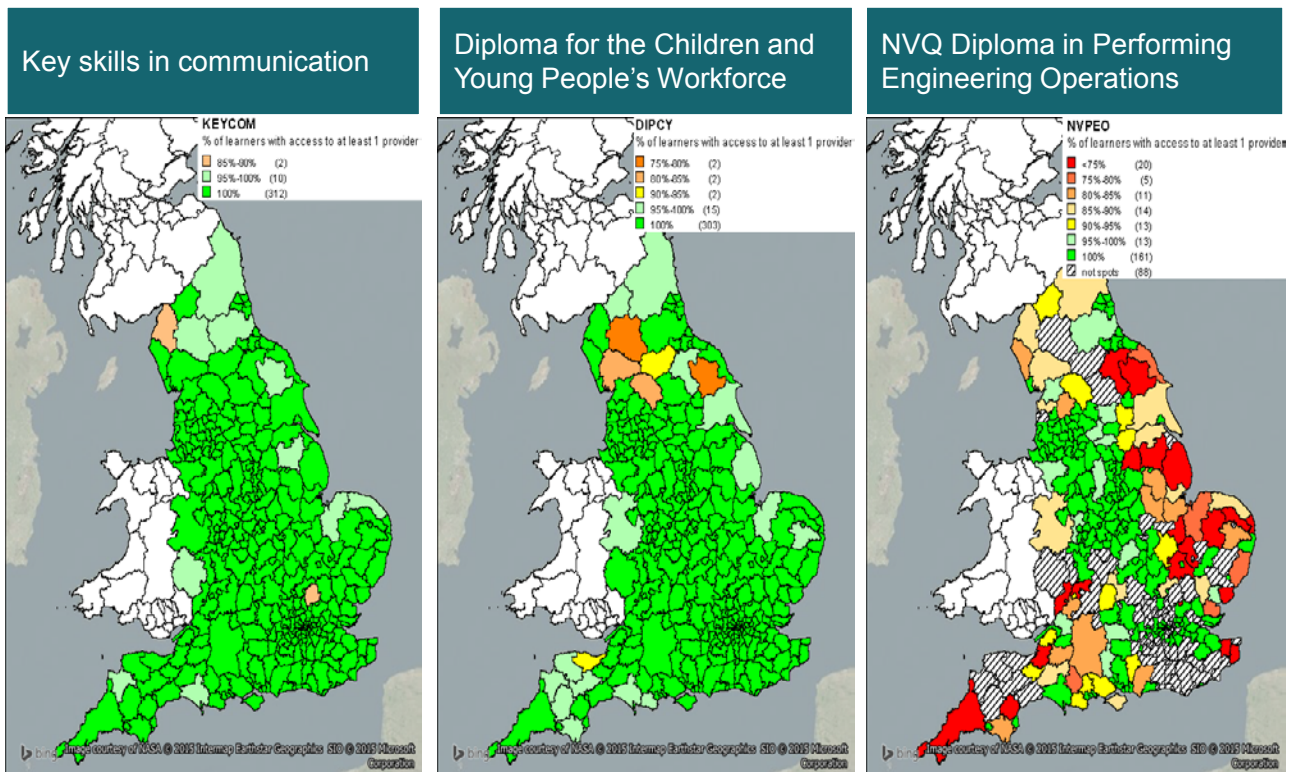
We can therefore infer from this analysis that although we have only looked at three specific courses, it appears that learners have greater choice where they are participating in more general courses than they do for more specialised courses. And this is intuitive.

⁹¹ This analysis is based on all learners whose learning is in a mixed subject classroom environment. This is a site within which at least 9 different subjects are taught, and which is not predominantly work-based provision. Note that the maps refer to the postcode of the registered head office of each provider.

Indeed, for some courses, the nature of the market dynamic (low demand or high costs of provision for example) may mean that only one or two providers would be viable

However, a lack of access to choice for learners means they are not able to exercise choice as a way to signal their preferences. Their ability to impose pressure on providers to improve is therefore limited.

Figure 29: Percentage of learners with access to at least one provider⁹²



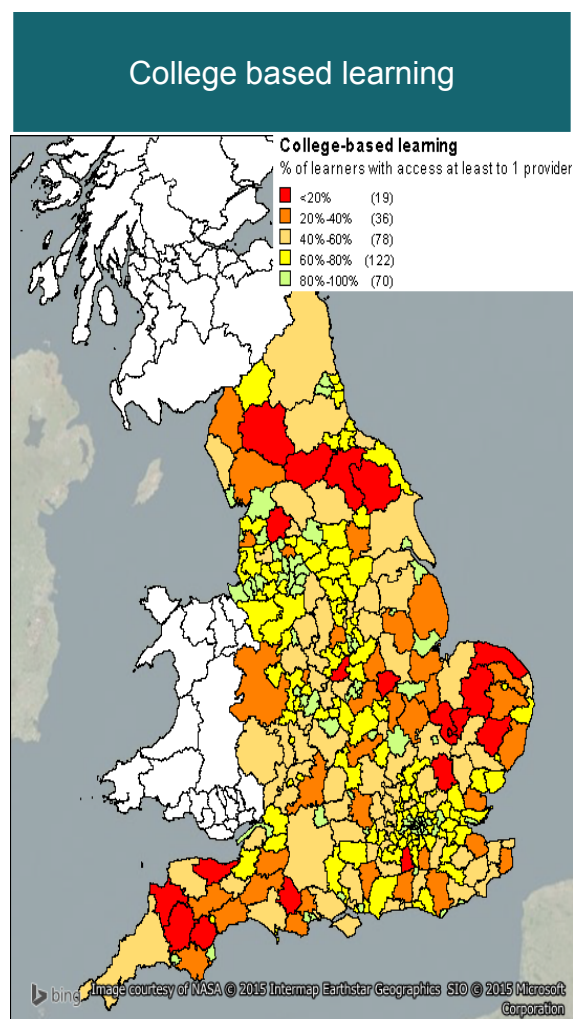
Source: Frontier analysis of ILR data

Overall, evidence shows that in most local authority districts, at least 90% of learners have access to at least one provider.

When we consider college-based learning, the picture is stark, as shown in Figure 30. There are 335 colleges in England (of which 216 are general further education colleges); Figure 30 shows significant variation across the country in terms of the percentage of learners who have access to at least one college provider within 10km. There are some areas – North of England, East England and Cornwall – where less than 20% of learners have access to a college within 10km. In general, it seems that in most local authority districts, at least 40% of learners have access to at least one FE College. We find that there are no areas where no learners have access to college-based provision. Our analysis suggests that college-based learners are less likely to use their nearest provider than other types of learner are, indicating that colleges appear to attract learners from a wider catchment.

⁹² Note that the maps plot the registered head office of each provider

Figure 30. Percentage of learners with access to at least one FE college within 10km⁹³



Source: Frontier analysis of ILR data

The number of providers in a particular locality

The number of providers in a particular area can be a useful indicator of the extent to which learners have choices available as well as the potential competitive threat faced by providers (as discussed later in Chapter 0). As we noted above, from the learners' perspective, having access to a greater number of providers implies that learners are likely to have more choice.

We have therefore explored a slight variation on the analysis above which is that for each of the three illustrative courses we used earlier (Key Skills in Communication; Diploma for the Children and Young People's Workforce; and, NVQ Diploma in Performing Engineering Operations), we have explored the average number of providers of those

⁹³ Note that the maps plot the registered head office of each provider

courses within 10km of each provider. Figure 31 shows the maps associated with each of these three courses in turn.

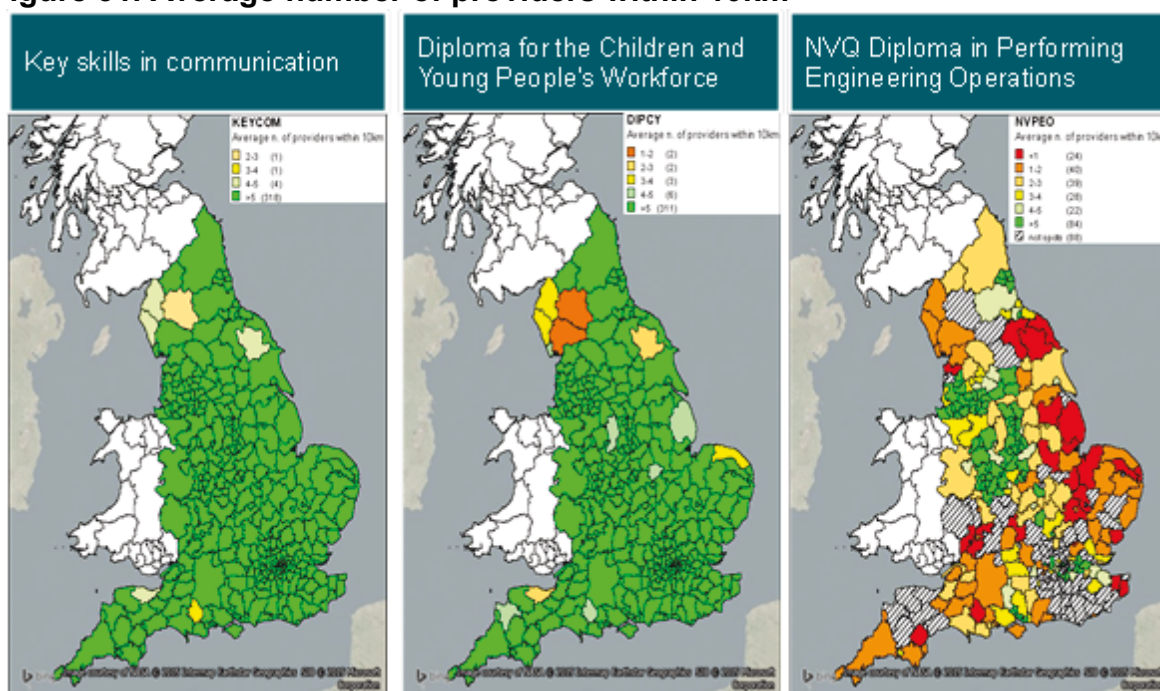
On the map on the left of the Figure relating to Key Skills in Communication, we can see that providers across almost all of England have on average at least 5 other providers within 10km of where they are. There is only one exception to this is in the North West of England, where the average number of providers is between 3 and 4.

For the Diploma for the Children and Young People's Workforce (the middle map in Figure 31), again there is generally a very good level of choice available for learners because for the most part across England, providers are surrounded by an average of 5 other providers of that course within 10km of where they are. There are however several exceptions to this, as highlighted in yellow and orange as opposed to green. In some areas of the North West and North East there are a few areas where there are between 2 and 3 providers, and in some cases just 1 or 2 providers of this course. In these areas (such as Cumbria and Ryedale), learners have little choice but to go to their nearest provider, unless they are willing to travel further.

Finally, for the NVQ Diploma in Performing Engineering Operations as shown in the right hand map in Figure 31, there is far greater variation in the average number of providers of this course within 10km of each provider. In almost half of the local authority districts, the number of available providers within 10km is three or fewer, with several areas where the average number of providers is less than 1 (indicated by areas shaded in red on the map). Greater choice for the learners appears to be observed around the major cities of London, Manchester and Birmingham.

So, again we observe that the choice that learners have varies by course with choice being less available for more specialised courses.

Figure 31. Average number of providers within 10km



Source: Frontier analysis of ILR data

Access to apprenticeships

In 2013/14 there were 851,500 apprentices in England, of which 503,500 were intermediate apprenticeships (level 2, equivalent to 5 GCSE passes), 351,900 were advanced (level 3, equivalent to 2 A level passes) and 18,100 were higher apprenticeships (level 4 qualifications and above). The majority of apprentices are adults with 78.2% of apprentices over the age of 19.

An important role played by providers and careers advisors in the context of apprenticeships is that of matchmaker between learners and employers. This is needed because in recent years the demand for apprenticeship jobs has exceeded the supply from employers. Our stakeholder engagement has revealed that in some cases, major well-known employers have experienced 50 applicants per apprenticeship job available. On average, there are typically around 4 applicants per apprenticeship.

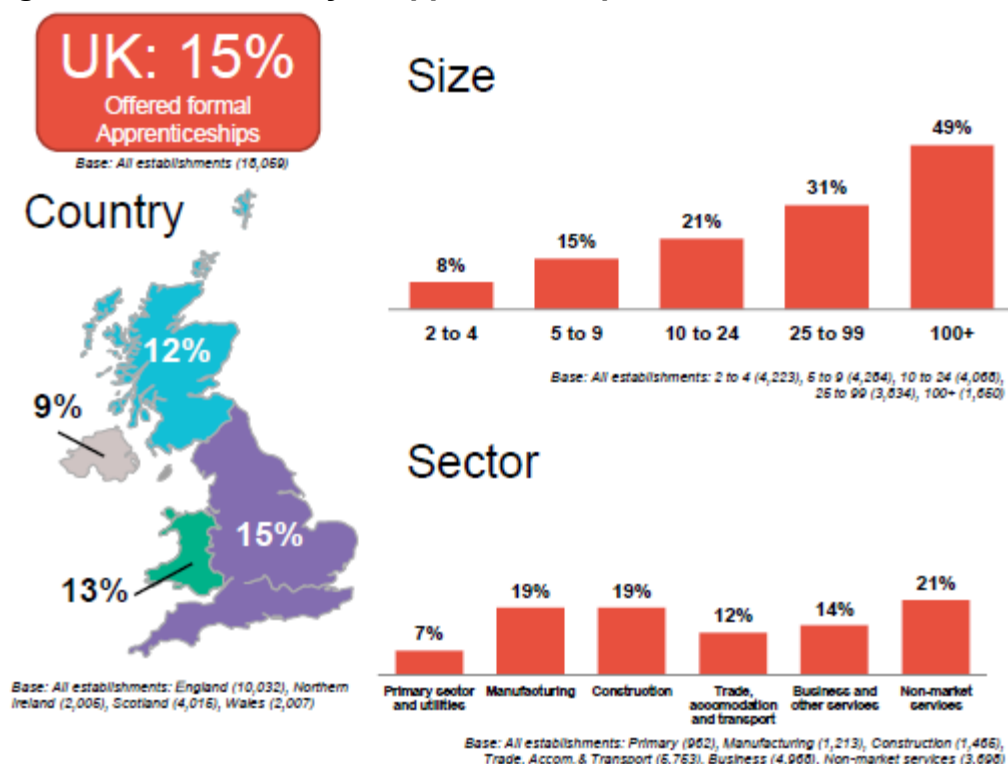
The UKCES Employer Perspectives Survey (2014) asked employers about their views on apprenticeships and found that around 15% of businesses in England offer formal apprenticeships; this is shown in Figure 32. These employers are mainly medium or large firms (i.e. more than 10 employees); and are predominantly in the non-market services, manufacturing or construction sectors.

The capacity to increase the number of employers offering apprenticeships was also explored in the Employer Perspectives (2014) survey. This found that of the pool of employers who do not currently offer formal apprenticeships, some 24% were planning to do so in the future. When combined with the 15% who already do and netting off 7% that want to discontinue their provision, this leaves around one-third of employers with the potential to take on apprentices in the future.

Accessibility to an apprenticeship is therefore likely to be dependent on a number of factors such as:

- **Composition of the local economy:** if the learner wishes to stay local then they are dependent on local employers offering apprenticeships. This may be more of a challenge for learners if those employers are in sectors where employers don't feel they need an apprentice; or if those employers are downsizing; or if employers are offering apprenticeships only to existing staff in whom they have greater confidence of success.
- **Perception of employers towards apprenticeships:** our stakeholder engagement work, and the Employer Perspectives Survey (UKCES, 2014) both highlight the influence of employers' personal perspectives about apprenticeships for whether they take on apprentices. Some state that where senior managers have been employed as an apprentice themselves, they are more likely to hire apprentices.
- **Competition for available placements:** for some firms that are well-known for their apprenticeship roles, such as Rolls Royce or other major employers, the demand for those jobs far exceeds availability. In these cases, it will be important for learners to complete a high quality application and present themselves well in the interview (skills which some learners may not have developed at that point in their career).
- **Ability and willingness to work full time:** apprenticeships must be full time (at least 30 hours per week) so this may not suit those who need part time learning or more flexible working patterns.
- **Access to training provision:** most employers use an external training organisation to provide the relevant apprenticeship training. Access to relevant training providers will therefore be important for the employers.

Figure 32. Accessibility to apprenticeships



Source: UKCES Employer Perspectives Survey 2014

Awareness of choice

The FE market, as with other markets, is characterised by multiple layers of decision making. For example, most learners make some form of decision about what they study; which provider; whether to do an apprenticeship and if so, with which employer (subject to interview); what mode they want to study (full time, part time, distance learning etc.). This package of decisions tends to be a one-off.

Employers also make decisions because they need to decide whether to provide or invest in education and training for their staff; how that education and training can best be delivered; which providers should be used; whether they want to hire apprentices; where they want the education and training to be delivered; how specific to their business they want the education and training to be etc. These decisions may be repeated.

To inform decisions, in an ideal world, learners and employers would have access to information about the choices they have and make informed decisions about the FE that would best meet their interests or needs. This section considers how decisions are made by employers and learners and the information available to help inform those decisions.

The decision making process

Figure 33 presents many of the key factors that influence the decision-making processes of learners and employers (i.e. consumers or 'beneficiaries' of FE).

From the learners' perspective, informal channels such as friends, family and guardians are likely to be among the top sources of information and guidance (and those advisors are likely to vary in the degree to which they have full information).

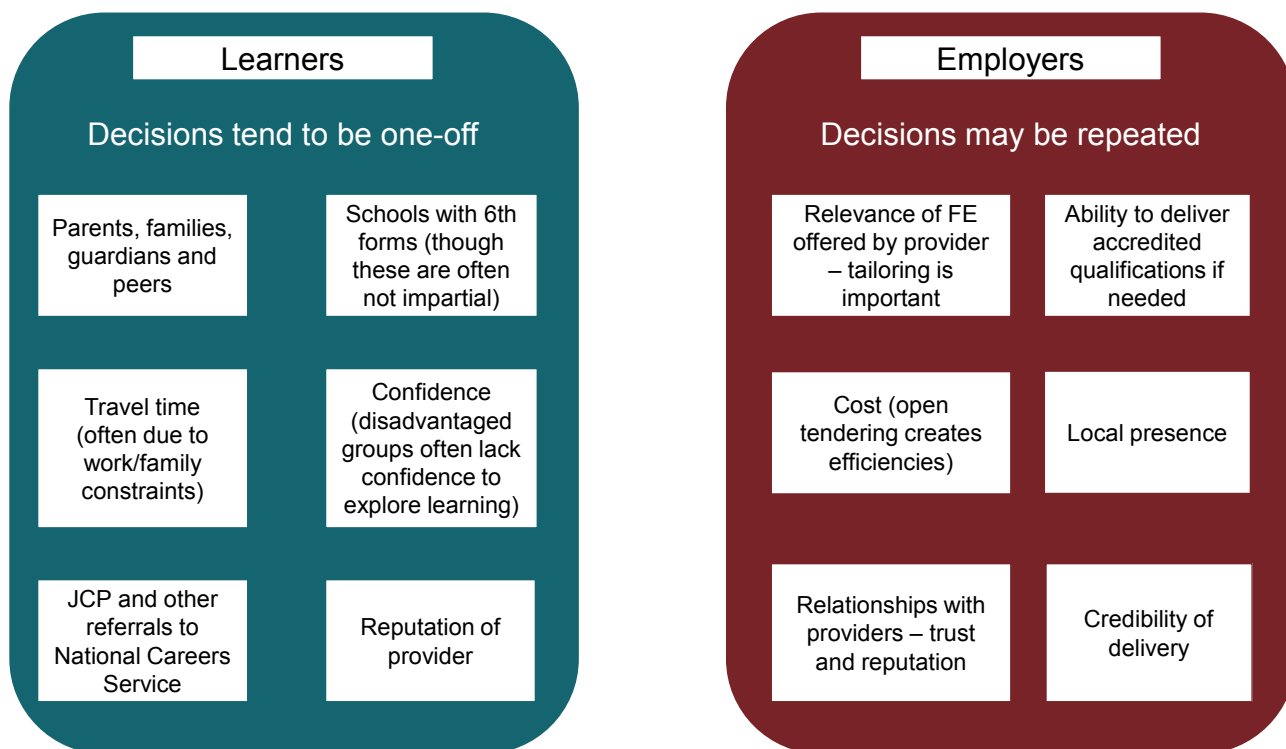
Travel is often a key factor that learners take into account because of the associated cost of travel, and the time to travel if home or work commitments constrain the time an individual has available. This means that learners typically focus on local markets as we explored in detail in Chapter 0 though where travel is free (such as for some learners in London) they are often willing to travel further.

Formal information channels open to learners are also important, though the extent to which these are relied upon varies across different types of learners, and the types of information learners find useful also varies by learner group. For example, learners considering higher levels of FE and having particular sectors or employers in mind are likely to have a greater interest in labour market outcome data (such as anticipated salaries) than would learner groups exploring entry level FE.

Information can be very helpful where it is impartial and accurate but where it is not, for example, in some school 6th forms, it could lead to learners considering a narrower set of options than is actually open to them. The National Careers Service was set up to be an impartial and comprehensive advisory service to learners. Often, much of their activity is focused on disadvantaged learners or the unemployed who are regularly referred to the Service from JobCentre Plus (JCP). In this context, learners are able to hear about the range of options open to them and they can filter down their preferred options. With JCP learners however, the JCP coach is involved in the decision and has the final say over which provider the learner will sign up with.

Perceived reputation of the provider is also likely to be an important factor in some learners' decisions. For example, there are some FE providers where reputation is very important to the learner, such as the Royal Academy of Dramatic Art (RADA) or other arts colleges, agricultural colleges, sixth form colleges and some school 6th forms.

Figure 33. Factors influencing learners' and employers' decisions



From the employers' perspective, as shown in Figure 33, our stakeholder engagement has revealed a range of factors that influence the decision about which provider(s) to use. These factors include the relevance to their own business of what is on offer from the provider; the extent to which the desired qualifications that are relevant to their business are available; the quality of what is on offer as reflected in the credibility that the provider will deliver as promised. Linked with this is the importance of the relationship between the employer and the provider – trust is developed which helps to ensure the provider tailors its offer to meet the employers' needs. This also points to a further factor which is a local presence – this is likely to be particularly important where the employer needs off-site day training for example.

Obviously, cost is an important consideration for employers because they have the incentive to make sure they receive the training they need as efficiently as possible. Costs of training to the employer are not only the financial costs of procuring training but also the opportunity cost as workers are not delivering productive output while they are being trained. For this reason, training contracts for employers are typically competitively tendered, with several providers competing.

Understanding these factors of the decision-making process is important because choices can only be made if learners and employers are aware of what their choices are. Our stakeholder engagement across the FE market has suggested that awareness of choices is generally low. Of particular note are the following:

- **Disadvantaged and hard to reach groups:** individuals in these groups are not likely to be aware of the FE choices that are open to them. Individuals in deprived

areas are not likely to realise or consider that FE is even a possible option for them. This could be for several reasons, for example, an unsatisfactory previous learning experience; a lack of confidence in relation to their ability to learn; general unawareness of the possibilities related to learning etc.

- **Those already in work:** there is a perception among some stakeholders that the FE market focuses largely on getting individuals into employment, whether by upskilling with a provider in a classroom setting, or by learning in the workplace, such as on an apprenticeship, rather than upskilling those already employed. This is seen to be a problem mainly for those in low paid work where they do not realise that training and further education are possible with a potential to move to higher paid work.
- **Lack of impartial information:** market places don't work if consumers don't have access to trustworthy relevant information to inform their investment decisions. Many sources of information are seen to be partisan. For example, schools with 6th forms have the incentive to retain learners in their environment rather than provide them with information about their broader set of options; and educational and training organisations may stand to profit from young people pursuing programmes of study not in their ultimate interest. Employers are also likely to be partisan where they seek to attract learners and apprentices. In addition, online and media accessed careers information is often too voluminous making it hard for the learners to know what is trustworthy and how to make sense of it.

Factors that impact on decisions: does quality matter for learner choices?

It is worth noting that there are likely to be many factors that impact on learners' decisions, not all factors are likely to have equal weight. An example we have explored in this respect is whether the Ofsted quality rating of a provider is likely to impact on learners' decisions. To explore this, we looked at the relationship between the number of learners at particular providers, and the associated Ofsted rating of those providers. In particular, we have examined the observed change in learner numbers between 2011 and 2014 for particular providers and we have taken this as an indicator of the responsiveness of the learner, and compared this to the change in the Ofsted rating over the same period⁹⁴.

Overall, results suggest that learners are not responsive to changes in Ofsted measures of quality.

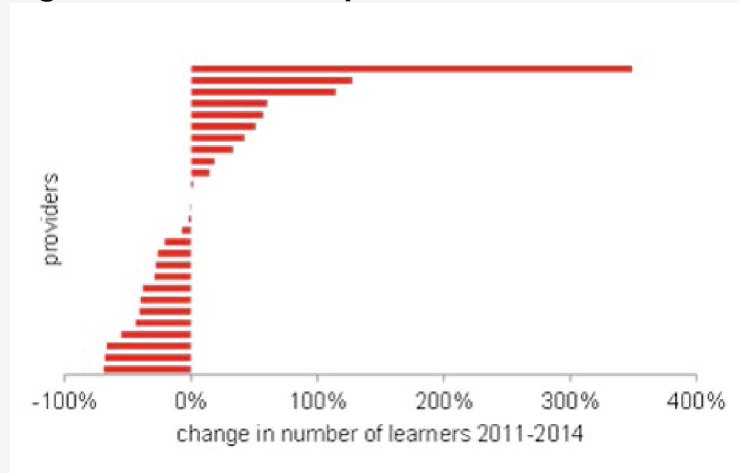
⁹⁴ In order to capture learners' responses as closely as possible, we removed from our sample all providers engaging in some form of administrative re-organisation like a merger, acquisition, exit or entry. For this analysis, we mainly used ILR and Ofsted data. It should be noted that this analysis is illustrative only because we do not control for any other variable which may drive this relationship between quality and learner numbers such as the type of learners, type of providers or type of provision. Also, we do not know the chain of causality i.e. we are not able to assess whether the Ofsted rating affects learners' number or the other way around.

Figure 34 shows learner responsiveness to an increase in the quality of provision. Learners do not appear to be consistently responsive across the selected providers. Some providers experience an increase in their learner numbers, other experience a decline. A similar observation is made for providers who have experienced a decline in their quality rating. This is shown in Figure 35.

This result may imply that learners do not have this information and therefore are not able to make conscious decisions on this basis. Other possible reasons may be that some learners may not have alternatives so would not be able to change provider even if they wanted to. More likely it could be that learners attach more importance to other factors which are not captured by the Ofsted rating.

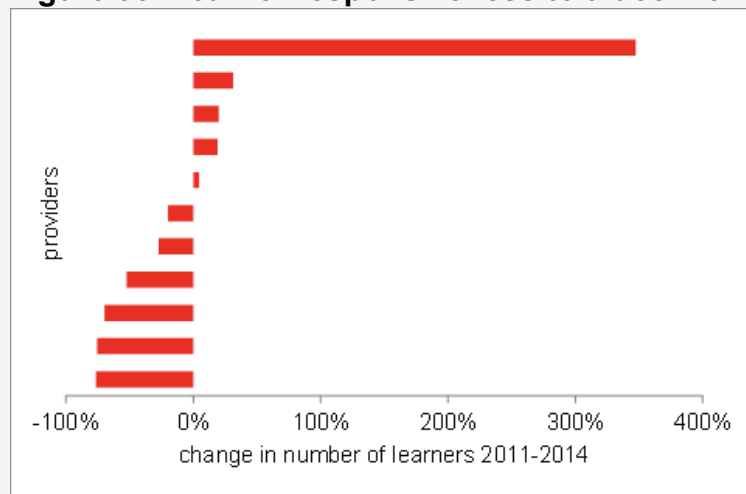
Also, Ofsted results are reported for the provider, not by site level. So this could make it difficult for the learner to know which site is being referred to in reports. Also, Ofsted only inspect the publicly funded aspects of provision and not the providers' full activities.

Figure 34. Learner responsiveness to an increase in quality



Source: Frontier analysis of ILR and Ofsted data

Figure 35. Learner responsiveness to a decline in quality



Source: Frontier analysis of ILR and Ofsted data

Awareness of choice: analysis of learner behaviours

Learners' awareness of their choices could be reflected in the choices they make, compared to what else was available. This analysis therefore explores the extent to which learners choose their nearest provider for the particular course they are studying. If the nearest provider is chosen, this could be because learners have defaulted to their nearest provider, even if alternatives are available within a travel time and distance that they would also consider acceptable. It could of course alternatively be the case that learners are aware of the range of choices available and actively choose their nearest provider because the travel cost to them of studying further away outweighs the benefit of studying at, for example, a higher quality institution.

There are many factors that affect use of nearest provider, including:

- the extent of choice locally, both in terms of numbers of providers and diversity of provision;
- whether the local providers have gone to the effort to reach out to particular learners. To the extent that groups are targeted with different levels of intensity, this could also affect observed behaviour patterns;
- learners' personal circumstances, and whether learning is related to work; and
- the opportunity cost of travel and ability to travel.
- promotional activity of providers, attractiveness of the buildings and campuses and how they tailor their offer to different groups

Whichever of these factors is at play, if learners are seen to have a disproportionate focus on using their nearest provider, this would limit the competitive constraint that providers impose on each other and raise the risk that providers do not have the incentive to be responsive to learners, employers and to deliver the highest quality of learning. Other things being equal, we might expect to see learners with more limited awareness of their choices to be more likely to use their nearest provider.

For a selection of courses, we have identified the proportion of learners that use their nearest provider. This varies greatly by type of course and the extent of choice available to learners. This is done by calculating the distance between the learners' home address and every location in which that particular course is delivered.

In summary, this analysis demonstrates that:

- Higher prior attainment (level 3+) is associated with decreased use of the nearest provider. This is consistent with our earlier finding that the higher the level of education, the further learners are willing to travel.
- Older learners are more likely to use the nearest provider.

- Males and unemployed learners are both less likely to use nearest provider.
- Learners residing in more deprived areas (defined at the postcode level) are less likely to use their nearest provider. This of all results is perhaps the least intuitive.

Table 7 shows our results. The first column lists the courses for which we have undertaken the analysis in the three subject areas of health and social care; engineering and manufacturing; and, preparation for life and work. The middle column shows the 'nearest provider usage rates' (i.e. the percentage of learners who have chosen their nearest provider). The final three columns to the right show the average number of providers active within 10km of the learner's home address, according to the type of location – work-based provision, classroom-based specialist provision, or classroom-based mixed provision.⁹⁵

Table 7 shows that the nearest provider usage rates are often in the region of 20-30%. So although the geographic catchment of learning is very much local, with 4km or 5km being a typical learner-provider distance, most learners appear to exercise some choice locally, within their limited geographic catchment. Where nearest provider rates are considerably higher, local choice tends to be considerably lower. And the extent of local choice varies greatly by course – for some learning aims there may be 30 or 40 providers active in a local area, whereas for others the extent of provision is lower.

⁹⁵ These site types are defined as follows:

Work-based provision - At least 90% of aims delivered for an employer OR at least 90% of aims delivered in workplace. This includes both learning delivered by the employer and learning delivered in workplace by third party for the employer

Classroom-based mixed provision - less than 90% of aims delivered for employer AND less than 90% delivered in workplace AND active in 9 or more tier 1 subject areas in widest location

Classroom-based specialist provision - less than 90% of aims delivered for employer AND less than 90% delivered in workplace AND active in fewer than 9 tier 1 subject areas in widest location

Table 7. The proportion of learners using nearest provider, and number of providers by type of site

Course	Proportion using nearest provider	Average number of providers in 10km		
		Work-based provision	Classroom-based specialist provision	Classroom-based mixed provision
Health and social care				
Diploma for The Children and Young People's Workforce	10.9%	31.9	2.4	3.4
Diploma in Dental Nursing (QCF)	21.7%	3.9	0.0	0.2
Certificate in the Principles of Dementia Care (QCF)	29.6%	1.2	0.4	3.0
Engineering and Manufacturing				
NVQ Diploma in Performing Engineering Operations	23.1%	4.0	0.2	1.1
Diploma in Light Vehicle Maintenance & Repair Principles (QCF)	10.6%	10.2	0.1	1.2
Certificate in Introduction to the Role of the Professional Taxi and Private Hire Driver (QCF)	28.0%	1.6	2.3	1.2
Preparation for Life and Work				
Key Skills in Communication	8.1%	37.3	1.3	1.1
Certificate in Employability	60.6%	0.0	1.4	1.4
Functional Skills qualification in English at Entry 2	24.6%	2.9	6.0	9.5

Source: Frontier analysis of ILR data

As may be expected, the level of local choice closely affects the likelihood of a learner using a provider that is not their nearest. For example, in the case of widely provided courses such as Diploma for The Children and Young People's Workforce and the Diploma in Light Vehicle Maintenance & Repair Principles (QCF), there are many local choices available, and a learner can use their preferred provider without having to travel much further. However, with Certificate in Employability, learners on average only have access to 3 providers within 10km, and 61% of learners use their nearest provider.

We also explored whether there is any relationship between type of learning location and use of nearest provider. For example, if all those using nearest provider did so using colleges (classroom-based mixed provision on a large scale) rather than other location types, this would suggest a 'size' or 'gravity' effect whereby those located near a college inevitably use this provider rather than others. In fact we do not find any evidence of such effects. On the whole we see that the mix of location types learners use is similar for those using nearest provider as it is for other learners. If anything we see colleges taking a lower-than-normal share among those using nearest provider. This would suggest that colleges can attract learners from slightly further afield than other types of provider can.

This finding is consistent with the hypothesis that colleges have greater visibility than other providers do among the local population

Access to information

After the age of 16, learners have important decisions to make about what they want to do next and where to do it. For some this decision could be about whether to stay on in their School 6th form; whether to leave school and go to College; whether to carry on and study for vocational qualification or do an apprenticeship.

Information sources and degree of impartiality

As we mentioned in the section above, learner decisions about whether to participate in further education and, if so, what to study and where are very complex. The choices young learners make at this stage can also be quite impactful as they may determine the sector they will work in for a substantial part of their lives. In this sense, the decision about what to study and where is also an investment decision: learners invest time and money into education that will hopefully eventually earn a return in the form of a salary and the wider benefits that are associated with working, including the ability to develop and learn more skills while working. However, that return is often uncertain, so having access to high quality and impartial information may improve their decision-making, and their future career prospects.

Information is likely to play a significant role, whether informally via word of mouth, for example, or through more formal published channels. Information requirements may vary across different learner groups. For example, potential beneficiaries of basic skills and employability training may often be unemployed or hard to reach, so they may not be aware of such courses or who is offering them. On the other hand, learners who already completed a sector-specific training and are considering the option of pursuing higher level courses may be aware of potential providers to go to. The information they need in order to take a decision about their next step on their learning and employment pathway is therefore different.

There is a wide range of information sources available to learners such as FE Choices⁹⁶, National Careers Service, National Apprenticeship Service, provider websites, social media and Ofsted ratings. However it is unclear whether these published information sources provide the type of information that learners need in order to make good decisions. Moreover, information sources such as provider websites and FE Choices provide mainly information about *inputs* and *outputs* – such as which providers there are nearby, what Ofsted rating they have, and what courses are offered. The extent to which

⁹⁶ FE Choices is the independent and official website for comparing performance information about all further education colleges and other organisations that receive Government funds to offer education and training to people over the age of 16. It focuses on provider comparisons with less on comparing courses, sectors, regions etc.

they reveal information about *outcomes* such as in which sectors learners are likely to work in is more limited.

In particular, other types of information that do not appear to be generally available to learners, but which would greatly enhance the quality of their decision making, are:

- **Signals about where employment opportunities are in the local, regional and national labour market** – matching of skills that learners are developing and the skills that employers need can arguably be done more effectively if there is an interface between the education system and industry. This would help to avoid notable mismatches which leave employers searching for appropriately skilled workers, and learners investing in skills which do not boost their chances of employment as hoped. A 2012 study conducted by the Centre for Social and Economic Inclusion⁹⁷ for example analysed the match between supply and demand in the FE market. The study compares the number of vocational qualifications of teenagers coming out of FE Colleges against job vacancy data across 12 occupational sectors. Among others, the findings are that in five areas (including automotive industries and construction) there is potentially an undersupply of workers; in three areas (including Hair & Beauty and Hospitality, leisure, travel & tourism) there is a potential oversupply; and , in the remaining four (such as creative & cultural industries) supply and demand are in reasonable balance.
- **Information about the expected salary in a certain sector** – this would to some extent also signal potential employment opportunities. As 24+ loans become more prevalent, information about the returns to education (the expected salary) are likely to become increasingly important to learners. Some Colleges do provide information about labour market projections and expected salaries to their prospective learners as part of an initial screening and induction process. Currently, learner responsiveness to expected salary signals is quite low. This is illustrated by a 2013 study by the Education and Employers Taskforce, UKCES and b-live⁹⁸ who found that seven out of the ten least popular student choices (including locksmith, surveyor and speech therapist) pay more than the UK median salary.
- **Information on the quality of the providers** – there are likely to be various metrics that could be useful to learners to indicate the quality of providers. However, although such metrics can add significant value in allowing learners to compare providers – such as the proportion of learners that go on to employment or higher education; or the quality rating of the teaching – defining a list of ‘quality’ metrics is likely to be highly challenging for further education. Data on the outcomes for learners is likely to be useful, but may not tell the whole story. For example, the local nature of FE markets could mean that employment rates could be lower for some providers than others, not because the quality of the teaching is low or the links with industry are poor, but because local labour markets are tight. Therefore simply comparing providers on this metric could lead to misinterpretations about the

⁹⁷ http://cesi.org.uk/sites/default/files/publications/CESI_Hidden_Talents_Skills_Mismatch.pdf

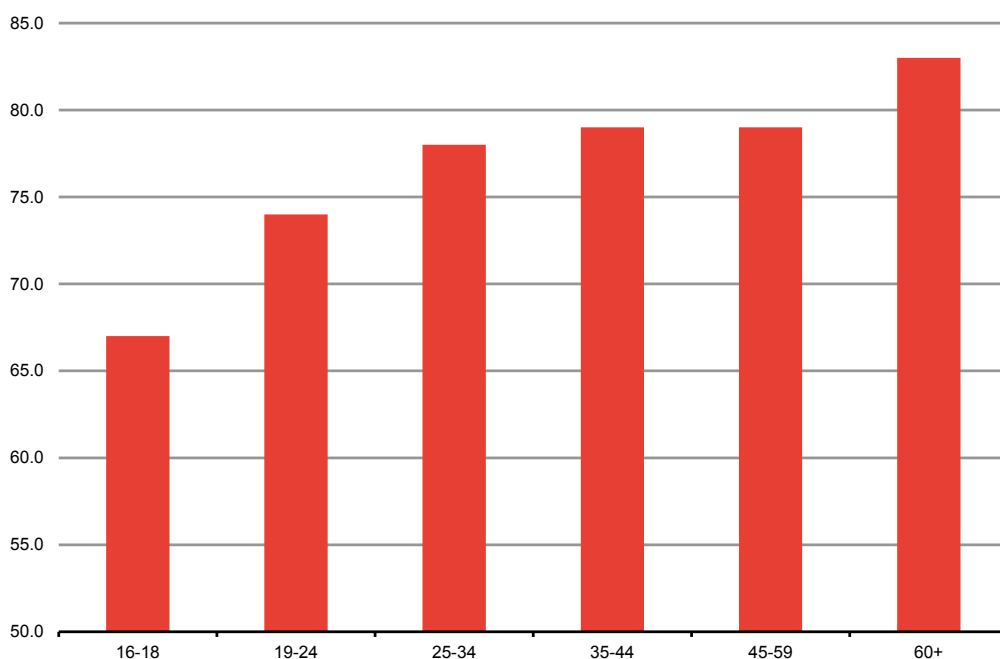
⁹⁸ http://www.educationandemployers.org/wp-content/uploads/2014/06/nothing_in_common_final.pdf

quality of the provider. It is likely that a suite of indicators would be needed on each provider to allow a suitable picture to be built of quality – but this requires a lot of data to be made available by providers and a central co-ordinator and then processed by learners.

Availability of information also varies across different areas of the FE market. For example, learners tend to be less aware of certain types of education such as traineeships. One reason for this might be that information intermediaries are sometimes not impartial. An area where this seems to be prevalent is schools with 6th forms. Schools are incentivised by the funding mechanism to keep learners in their own 6th forms. In practice this means that they do not have an incentive to encourage learners to consider other forms of FE.

A recent survey of Learner Satisfaction by the SFA found that 16-18 years olds were least satisfied with the information they were given when choosing their course. This is shown in Figure 36. The far left column relates to 16-18 year olds and this shows that just two-thirds rated the information they were given more than 8 out of 10. This compares with the far right column that shows 83% of learners over 60 years of age rated the information more than 8 out of 10.

Figure 36. Percentage of learners rating the information they were given when choosing their course 8 or more out of 10



Source: SFA Learner Satisfaction Survey 2014

The currently available information sources about what to study and where are plentiful and may guide learner decisions to some extent. However, young learners have only limited information about what the labour market and their future employers really demand. In the absence of market signals indicating which skills are needed, decision-making may be misguided and the skills gap in the UK economy could potentially widen.

A study conducted by the Education and Employers Taskforce⁹⁹ suggests that higher levels of employer contact while at school lead to a lower likelihood that students will be not in education, employment or training (NEET) and to higher salaries if in full-time employment. This can be linked to young learners building social, cultural and human capital whilst interacting with their employers. First-hand information gathered on the job is often perceived to be more authentic and therefore more trusted than information published elsewhere.

Exposing young people more to employers may therefore be a start to giving them more authentic information and the necessary skills and motivation to gather and interpret labour market signals in order to facilitate their decision-making process.

Confidence and ability to make decisions

Learners may not have the confidence to make decisions about their further education (even if they are aware of their choices and have access to information). This may be for a number of reasons including a lack of experience in the further education market, the fact that someone else is making the decision on their behalf (such as JobCentre Plus mentors, or if the learner has particular disabilities which mean decisions are taken by their families or guardians), or because they are unsure about what their skills are. These are explained below:

- **Lack of confidence** – Vulnerable or hard to reach groups (some of whom belong to the 5.2 million people in low paid jobs in the UK¹⁰⁰) may lack the confidence to actively seek opportunities to learn. This group of learners may comprise:
 - individuals who have not been in contact with the education system for a long time because of other commitments such as family or work; and
 - individuals coming from ethnic minorities, disabled learners, older individuals and other underrepresented groups.

These individuals may need encouragement to participate in learning. For some, the choice of course is less important as the value of the learning derives not particularly from the subject matter, but from their participation which can increase the confidence and enthusiasm to learn. In doing so, this can lead to further education or a desire to up-skill in readiness for employment.

- **Others deciding on behalf of learners** – some groups may receive training without choosing the provider themselves. Examples may include employers choosing where their employees should participate in FE; or unemployed individuals who are referred to a provider to participate in a training course by their Job Centre Plus mentor. They may also be required to take training courses by the Department for Work and Pensions as

⁹⁹ <http://quarterly.demos.co.uk/article/issue-3/great-expectations/>

¹⁰⁰ <http://www.niace.org.uk/our-thinking/blog/our-agenda-new-secretary-state-bis>

part of the Work Programme if they are in receipt of Jobseeker's Allowance or Employment Support Allowance.

- **Lack of guidance** – younger learners at school may not be clear about what their skills are or how they make the most out of them in a complex and evolving labour market. As a result, they would often need advice about where their skills fit best. Stakeholders in the FE market noted that there might actually be too much information out there for young learners to make sense of it. Or there might be a mismatch of messages between advertising/media and reality of opportunities for example in relation to the availability of apprenticeships. Learners may be unclear about which source can be trusted and may need an adviser. In general, the quality of providers can be hard to assess for individual learners, but this may be easier for employers as they interact with providers repeatedly.

6. Responsive providers

Key findings

For the FE market to function well in terms of meeting the interests and needs of learners, employers and the government (i.e. those we defined as ‘consumers’ in the chapter above), providers need to be **responsive**. They need to be incentivised to improve the quality and suitability of their offer to learners and employers as well as the efficiency of their offer to ensure they remain profitable at the prevailing funding rates.

The incentives faced by providers are likely to vary according to the degree of competition they face from alternative providers and the extent to which the funding arrangements for their provision are a clear threat to their profitability.

In this chapter we consider whether providers are constrained in some way from responding to those incentives. As with any diverse market, there are elements of good practice in terms of responsiveness such as providers that undertake studies of demand, engage actively with employers and sector bodies and keep an active track of what their competitors are doing. But, there are also instances where providers appear not to be responsive, either because they lack the incentive to or because they face barriers in so doing.

Although there is evidence to suggest that many providers are responsive to learners, employers, competitors and policy, there are also some clear barriers that have limited responsiveness for some providers in some markets. We have identified a number of clear barriers to provider responsiveness:

- **Limited scope of operation** – providers offering a limited range of courses may find it harder to respond to changes in learner and employer demands, competition or policy. They are unable to benefit from economies of scope in their operations.
- **Cost of switching awarding bodies** - providers must adhere to the awarding body requirements to be eligible for funding. Although awarding bodies allow some flexibility, this may be insufficient and there appear to be high costs associated with changing awarding bodies, further hindering their ability to respond quickly.
- **Achieving awarding body status** - few providers of FE are awarding bodies themselves, despite several providers commenting that they would like to be.
- **Short lead times of funding allocations and only a single year allocation** - these short lead times can hinder longer term planning and space for innovation and can make it difficult to invest in line demand.

- **Funding limits for independent providers** – independent providers face a cap on the level of provision they are able to deliver. This can constrain them amending their provision to meet higher than expected levels of learner demand.
- **Policy instability & uncertainty** - reduces the ability of providers to plan ahead and release resources for innovation. Specialised providers are arguably at greater risk of changes in policy priorities and funding because they have centred their business model on a certain type of provision.
- **Staff shortages** - there are staff shortages for many subjects for both teaching and assessment (e.g. maths) as FE providers compete with schools, Higher Education and with their associated occupations for skilled staff. Further education providers find it hard to attract skilled teachers away from other organisations that are able to pay more, including their trade or industry¹⁰¹.
- **Local employment markets** - the employment and economic composition of a provider's catchment area can make a significant difference to their ability to respond to policy incentives. This is particularly true in the case of apprenticeships.
- **Inadequate provider governance** - weak governance and a lack of expertise and management skills are likely to be among the causes of provider difficulties in terms of responsiveness to market conditions. In some cases FE College leaders were not trained in how to manage such large 'businesses' as FE Colleges. In a minority of cases there are also problems around the length of board tenures.

Introduction

In conventional markets, providers face incentives to improve their offer because of the ability of consumers to switch away to alternative providers or the ability of new providers to enter the market if they spot a gap in terms of efficiency or quality.

For the FE market to function well in terms of meeting the interests and needs of learners, employers and the government (i.e. those we defined as 'consumers' in the chapter above), providers need to be **responsive**. They need to be incentivised to improve the quality and suitability of their offer to learners and employers as well as the efficiency of their offer to ensure they remain profitable at the going market rates.

The incentives faced by providers are likely to vary according to the degree of competition they face from alternative providers in different parts of the FE market and the extent to which the funding arrangements for their provision are a clear threat to their profitability. In Chapter 0 and Chapters 0 and 8 we discuss the extent to which structural and policy conditions create the incentives for competition across different parts of the FE market. In

¹⁰¹ The Teach Too initiative seeks to address this

this Chapter we restrict ourselves to thinking about whether providers are constrained in some way from responding to these incentives i.e. whether there are barriers that prevent an effective response.

A few points about incentives are worthy of note:

- Some providers face only a few competitors because of low demand in their market, geographical location or the specialised or resource intensive nature of their courses or barriers created by policy (e.g. inability to enter or lack of a threat of failure). In these markets, providers may have a reduced incentive to be responsive.
- There are clear parts of the market where incentives for quality and efficiency are strong. Our stakeholder interviews suggest that incentives are particularly strong in the case of apprenticeships. Providers often have to compete directly for contracts with employers to deliver FE for their employees and when employers are not satisfied with the quality or relevance of training they tend to either quickly change to a different provider or start to provide training in-house (and several have done so).
- In markets where providers do not face an active competitive threat from other providers, government (as the gatekeeper to funding for learners) still plays an important role in terms of incentivising efficiency and responsiveness to key policy areas through funding policy. The funding mechanism provides a clear incentive for providers to deliver in line with their funding allocations or they may have to repay some of their funding, or in the worst case, risk having their contract terminated. Layered on top of that are the incentives created by the regulating body Ofsted to ensure that quality is maintained. Providers whose Ofsted rating falls to 4 risk losing their contract or intervention from the FE Commissioner.

This means that, our findings need to be considered in the context of the wide range of competitive situations that providers may be faced with. As with any diverse market, there are elements of good practice in terms of responsiveness, likely driven by the highly competitive nature of the market the provider has entered. However, there are also instances where providers appear not to be responsive, either because they lack the incentive to or because they face barriers in so doing.

This Chapter is divided into two main parts. The first part of the chapter describes the evidence of provider responsiveness that we have gathered as part of this study. The second part of the chapter sets out the barriers to responsiveness faced by providers and covering their response to demand, competition and policy.

Evidence of responsiveness

There are numerous examples of where providers demonstrate clear responsiveness to learners, employers, competitors and policy.

Responsiveness to learners

Providers generally take a range of actions to understand learners' needs such as demand studies and analyses of trends in demand for their courses. Providers also actively make changes to respond to learners needs. For example, some providers choose awarding bodies to help the onward careers of their learners (by choosing employer-recognised awarding bodies or selecting courses that are a good fit with HE courses). The desire to remain true to a strong core mission in terms of provision for particular learners can provide incentives for providers to be more efficient in back office functions rather than cut back their FE offer.

Responsiveness to employers and sector bodies

Many providers regularly engage with employers through a range of channels. Some have their own networks of local employers whom they regularly engage with. Other important channels include LEPs, direct relationships with individual employers, having business relationship development teams and some have forged close relationships by, for example, hosting the Chambers of Commerce on campus. In some instances for example, College representatives sit in LEP board meetings thus giving them better information about current and future local demands.¹⁰²

Employer engagement with providers and the FE market overall is further strengthened through Sector Skills Councils (SSCs) and Trailblazers. These allow the industry an increasingly bigger say in what skills are needed and how qualifications should be designed.

Responsiveness to competitors

Some providers gather market intelligence through various channels such as demand studies carried out by themselves or from bodies such as the Association of Colleges. Many providers report monitoring competitors' offerings (including 'secret shoppers'). Especially business-minded providers assess opportunities for expansion based on their commercial merit and longevity and taking account of whether particular market segments are already well served by competitors.

Responsiveness to policy

Providers are well incentivised to respond to policy – funding has a particularly important impact on their behaviour and decision-making. Stakeholders tell us that many providers are adept at “following the money” and that they will adapt their training offer to ensure they remain profitable and can draw down as much funding as possible. Clearly this isn't true for all providers and those that fail to respond now face the intervention of the FE Commissioner or have had their contracts terminated or have exited the market for subcontracting.

¹⁰² BIS “An Assessment of the impact of governance reform in FE colleges” March 2015

Providers are responsive to funding because clearly they need to be viable entities for them to continue in the market. Funding rates for courses therefore play an important role in providers' decisions about what to offer. However, in many cases, providers make decisions about portfolios of courses such that as a whole the courses on offer are viable, but at the course-level may not be. This may be for a number of reasons such as the wider objectives of the provider or the complementary nature of some courses that allow them to attract a broader learner-base. As funding constraints increasingly bite, the focus on financial viability could be expected to become increasingly acute. This could potentially risk providers leaning more towards courses for which there is greater financial viability as opposed to meeting social objectives.

It should be noted that the basis on which funding is delivered to the sector, which is currently qualifications-based, is currently being reviewed.

The focus of this study is publicly funded further education, so the funding system and the incentives it provides play a critical role in driving provider behaviour. To examine the extent to which providers are responsive to policy changes, we have undertaken some indicative analysis of two policy shifts: the introduction of 24+ advanced learner loans¹⁰³ and the shift towards delivery of apprenticeships.

The response of providers to the introduction of 24+ Advanced Learning Loans

Until April 2013, learners aged 24 and above had their further education funded by the SFA, and therefore the provider would receive the funding level associated with the delivery of qualifications to those learners. Since April 2013, providers are allocated a loan facility by the SFA and they only have access to that funding if they recruit the learners who would like to take out the 24+ Advanced Learning Loan to help with the costs of their course. Where providers recruit learners who wish to take out a loan with the Students Loan Company, the provider can then 'draw down' the corresponding loan value for each learner from their allocated loan facility. If they do not recruit eligible learners who want to take out the loan, then they are not able to draw down those funds. Providers therefore face clear incentives to attempt to recruit 24+ learners who will take out loans.

To understand the extent to which providers have been able to recruit learners to study courses that are eligible for the 24+ Advanced Learning Loan (all are level 3 or 4 and last for at least 2 weeks), we have analysed loan allocations and the percentage of those allocations that providers have delivered (or 'drawn down').

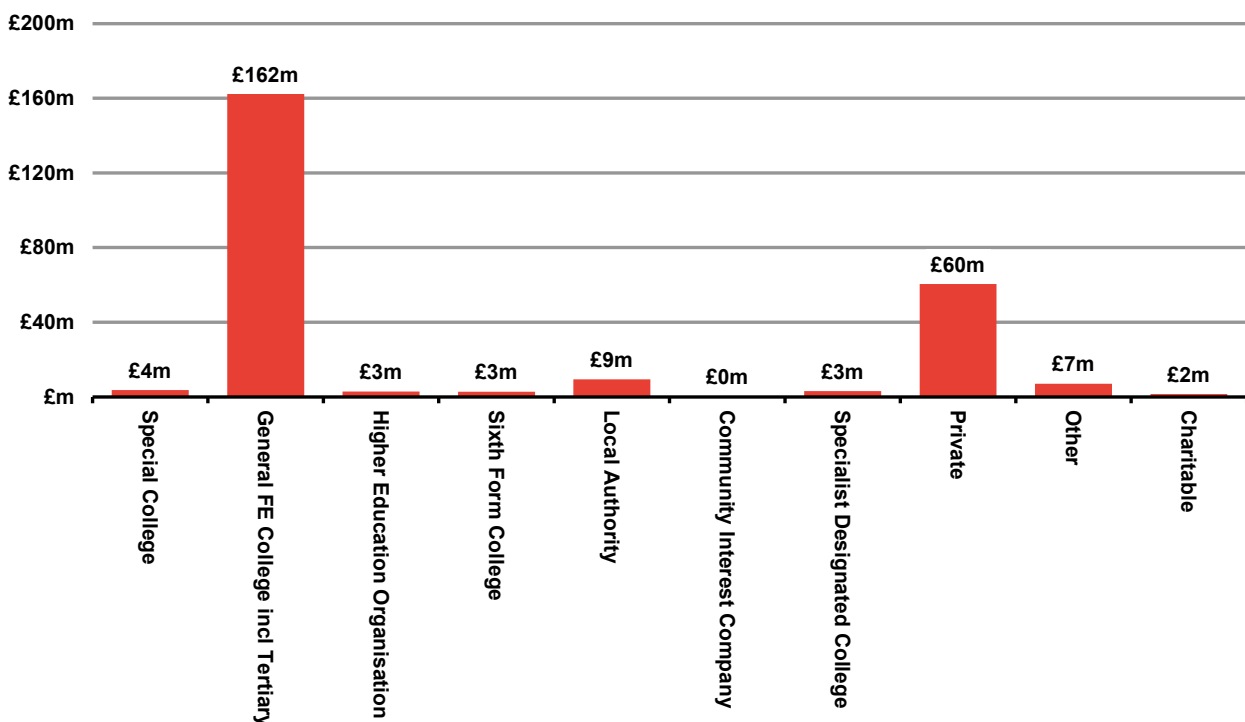
Using data from the Student Loans Company and the SFA, we can see that:

¹⁰³ From April 2013, learners aged over 24 years of age studying eligible qualifications at levels 3 and 4 generally no longer had their courses fully funded by the SFA (though there are some exceptions). Instead, those learners were able to take out a loan (the 24+ Advanced Learner Loan) to fund the cost of their further education course. The loan is intended to cover the cost of the course itself though not travel to the place of learning or subsistence to live in another location to access learning. There are about 150,000 learners on courses eligible for the loan.

- The value of the loan facility available for providers in 2013/14 was £253.6 million
- The value of loans actually delivered by providers in 2013/14 was £137 million

Loan facility allocations for 2013/14 by provider type are shown in Figure 37. This shows that FE Colleges account for 64% of the loan facility allocation (£162.3 million) and private providers account for 24% (£60.5 million). The remaining 12% is accounted for by other provider types including local authorities, charitable providers, community interest companies, specialist designated colleges, special colleges (such as agricultural or arts) or others.

Figure 37. The value of 24+ Advanced Learning Loan facility in 2013/14 by provider type



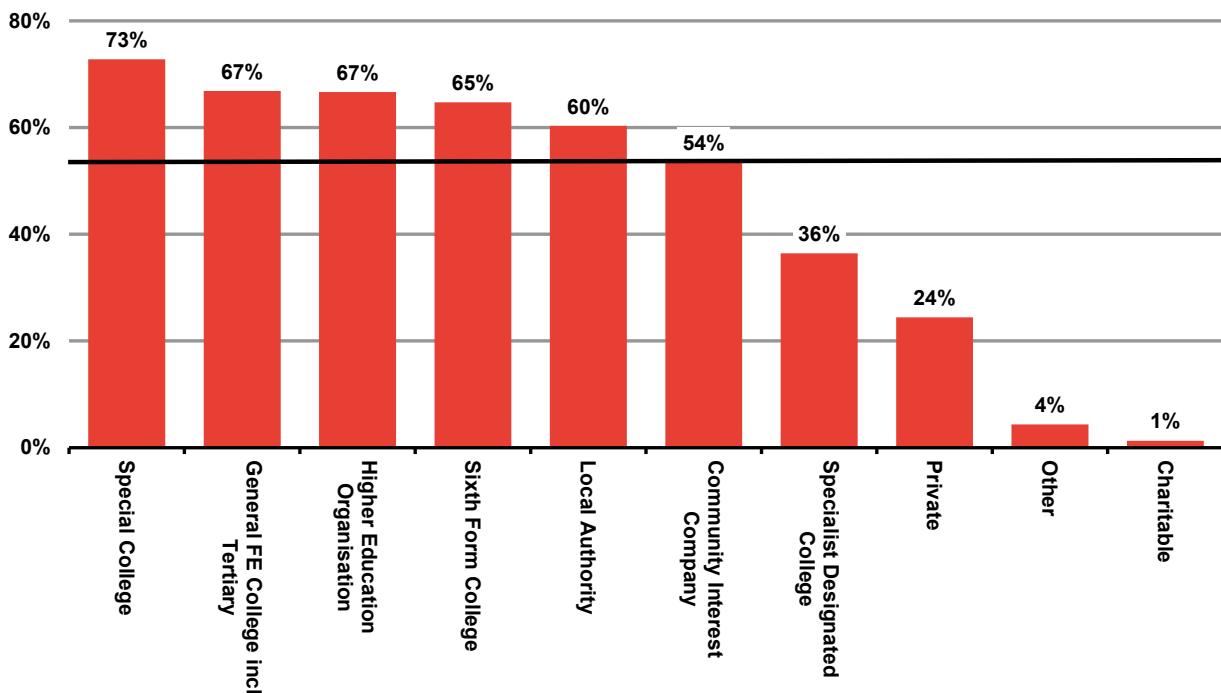
Source: Frontier analysis of data from SF and Student Loans Company

Figure 38 shows that on average, 54% of the available loan facility for providers was delivered. The percentage delivered varies across providers. Key observations are:

- Special colleges, which are defined here to be agricultural or arts and drama colleges, were able to deliver the highest proportion of their loan facility: 73%. This means they were able to attract a higher relative proportion of 24+ learners who were willing to take out the loan than other provider types.

- Large multi-disciplinary providers were also able to deliver a relatively high proportion of their loan facility, on average. This includes FE Colleges, HE institutions that deliver FE, local authorities and sixth form colleges.
- Community interest companies (which accounted for £348 million or 0.14% of the available loan facility) were able to deliver just over half of their allocation (54%).
- The providers least able to deliver their available loan facility were specialist designated colleges (36%); private providers (24%); and charitable providers at just 1%.

Figure 38. Percentage of 24+ Advanced Learning Loan facility delivered, by provider type



Source: Frontier analysis of data from SFA and the Student Loan Company

It is important to understand the context to this analysis:

- The extent to which a provider is able to draw down the loan facility available will be dependent on a range of factors. These include the efforts of providers to recruit learners eligible for the loans; the extent to which learners in the local area are prepared to take out a loan to fund their FE when they have never had to do this before (this alone can be influenced by a wide range of factors); and the extent to which the provider has changed its activity in other areas to enhance revenue streams.

- The level of loan facility available in this first year of operation may not reflect the 'optimal' allocation of the loan facility. This will become clearer over time as providers and learners adjust to this new approach to funding level 3 and 4 learning for those aged 24 and above.
- This analysis is for one year only so it will be important to monitor the delivery of Advanced Learning Loans over time. At this stage, the analysis suggests that multi-disciplinary learning environments have been able to deliver a greater proportion of their loan facility than other providers.

This analysis suggests that some providers face challenges in recruiting 24+ learners more than others. This could be for a number of reasons but there is a particularly striking difference between the ability of Colleges to deliver the 24+ loans (67% delivered on average) and private providers (24% delivered on average). This in turn has potential implications for their funding.

The response of providers to the policy shift towards apprenticeship funding

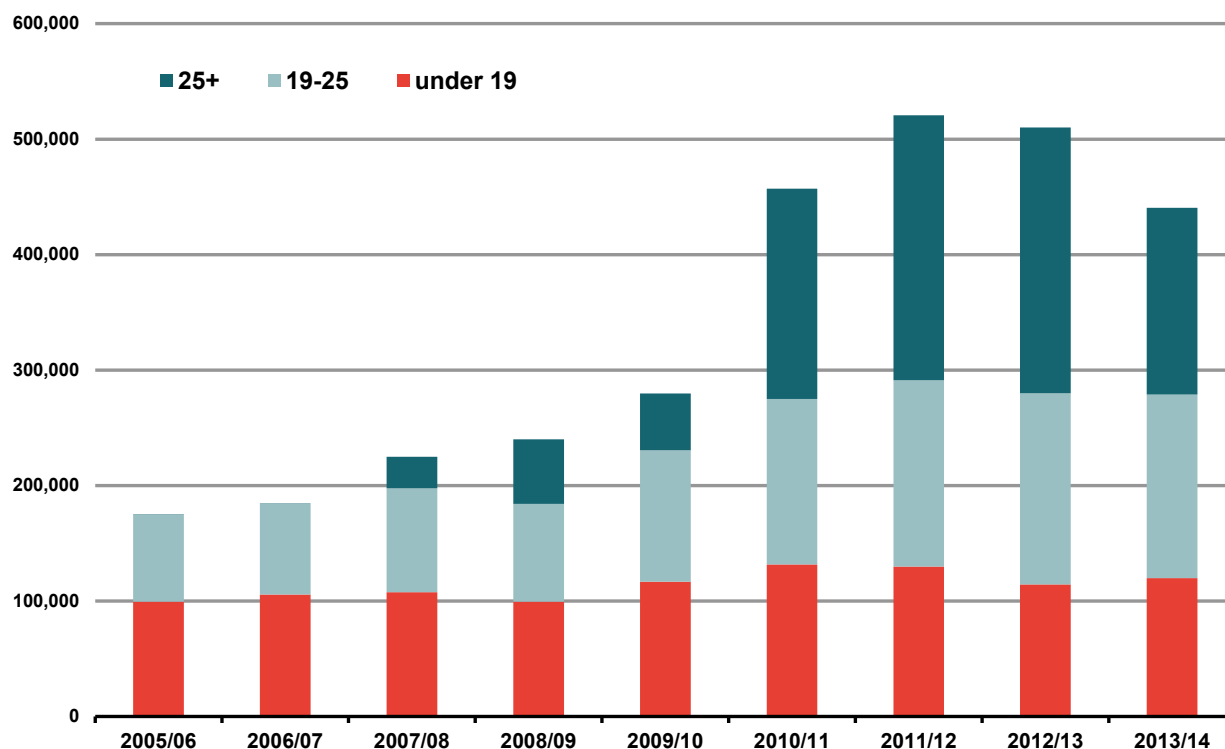
A current clear priority of government is to increase the number of apprenticeship starts in England, with a target of 3 million new apprenticeship starts between 2015 and 2020. Funding has been providing the incentive to providers to boost their delivery of apprenticeships for several years, with the current SFA funding allocation ring-fencing £770 million for the delivery of apprenticeships, while the adult skills budget for non-apprenticeships is set to fall 24%¹⁰⁴. Apprenticeships are fully funded by the Department for Education for 16-19 year olds, half funded by the SFA for 19-24 year olds and up to half funded for those over 24 years of age.

Apprenticeship starts over the period 2002/03 to 2013/14 are shown in Figure 39.

¹⁰⁴ Source: SFA 2015

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407468/Allocations_for_the_Funding_Year_2015_to_2016.pdf

Figure 39. Apprenticeship starts 2002/03 to 2013/14



Source: Frontier analysis of FE data library statistics

Figure 39 shows that there was a significant jump of 63% in the number of apprentices between 2009/10 and 2010/11. This was largely driven by the growth in apprentices over 25 years of age. Our analysis also suggests that the growth was largely driven by a rise in advanced apprenticeships (level 3) which grew 75% between 2009/10 and 2010/11, though in intermediate apprenticeships (level 2) grew notably at 58%.

The significant rise in adult apprenticeships reflects a range of factors. For example, the removal of the upper age limit of 25 in 2004, the launch of the National Apprenticeship Service in 2009, and in 2009 the Skills Funding Agency increased the flexibility of direct contractors by allowing them to deliver apprenticeships in any area of England. In addition, Government allocated additional funds to deliver 50,000 more apprenticeships in 2010¹⁰⁵. The significant increase in apprenticeships demonstrates the responsiveness of providers to policy change and policy incentives.

The fall in apprenticeships between 2011/12 and 2012/13 reflects the introduction of a 24+ Advanced Learning Loan such that apprentices were expected to contribute towards their learning, but this was subsequently removed due to poor take up¹⁰⁶.

¹⁰⁵ *Adult Apprenticeships*, National Audit Office 2012 <http://www.nao.org.uk/wp-content/uploads/2012/02/10121787.pdf>

¹⁰⁶ *Apprenticeship statistics: England, Briefing Paper 06113*, James Mirza-Davies, 2015 <http://researchbriefings.files.parliament.uk/documents/SN06113/SN06113.pdf>

Barriers to provider responsiveness are explored in the next section.

Barriers to responsiveness

Although there is evidence to suggest that many providers are responsive to learners, employers, competitors and policy, there are also some clear barriers to provider responsiveness in some markets.

Limited scope of operation (size of provider)

Small providers tend to be less diversified and may find it more difficult to respond to demand changes (which may result from demographic change, a change in preferences or just cultural trends for example) because of the smaller scope of their operations. This means that a provider who is providing a wide range of courses such as a FE College may find it easier to respond to changes in demand and adapt their course offer, because its teaching staff may have capacity and capability to teach multiple courses (or they may have access to a wider pool of teaching staff) and the costs of the additional offer to meet new demand is lower the larger the scope of existing provision. This type of effect is often called 'economies of scope'.

Cost of switching awarding bodies

A recent assessment of competition in the market for the provision of qualifications in secondary education carried out by Frontier Economics for Ofqual¹⁰⁷ found that schools switched awarding organisations infrequently, facing apparent switching barriers in the form of acquisition of new training material or teacher training required for a new qualification. The assessment also found that schools did switch following a relatively large change in the quality of assessment. This occurred in two key circumstances: (i) when an awarding organisation made, or was perceived to have made, a mistake such as marking error, or (ii) when specifications changed. This assessment found that, even though switching was infrequent, switching was at a considerable scale when it occurred as schools switched in large numbers from the awarding organisation that was perceived to have made a significant error, in particular with respect to marking. The report concluded that this ability to switch helped keep the market competitive.

In this study, we have found that that the FE market has some of the same features as secondary education. FE appears to have high switching costs caused by the need to acquire new training materials and retrain teachers and instructors. It also has other features further increasing the switching costs compared to secondary education such as the need to run two systems in parallel in order to cater for 'legacy' qualifications (i.e. those that are, for example, 2 academic years) associated with changing awarding bodies. In addition, most adult skills funding is currently linked to accredited qualifications (though this is expected to change) so providers also must keep to the awarding body requirements to be eligible for funding. Although awarding bodies allow some flexibility,

¹⁰⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407337/2015-02-26-frontier-report-understanding-ao-commercial-behaviour-before-and-after-the-gcse-and-a-level-reforms.pdf

sometimes providers cannot tailor their courses enough to meet local learners' or employers' specific needs or preferences, further hindering their ability to respond quickly.

There may also be costs associated with losing the benefit of using the same awarding body for several qualifications, and the associated bulk discounts that can in some cases be negotiated.

A further barrier to switching awarding body as noted by stakeholders is the reputation of some awarding body qualifications with employers. Several providers noted how a key factor in their choice of awarding body is the extent to which the qualification is recognised by employers in a particular occupation because learners have a clear preference for those that give them a better chance of employment after their FE course. For example is the recognition of City & Guilds for hospitality and catering.

A recent survey for Ofqual of schools and colleges and their purchasing behaviour¹⁰⁸ found that relative to schools “Colleges were the most proactive institution type as far as taking steps to reduce their expenditure was concerned. They also paid closest attention to their examination expenditure. In addition, to reducing the number of late entries, colleges were the institution type most likely to have negotiated collaborative purchasing agreements with other colleges, with almost one-third of colleges reporting having done this” (Ofqual, 2015).

However awarding bodies were felt by Colleges not to provide information on fees in a timely basis as fewer than half of the colleges surveyed by Ofqual said that awarding organisations provided information on fees in sufficient time. Overall however, the report concludes that the qualification purchasing market is price-insensitive and decision makers are primarily subject heads of department who are uninformed about fees.

Funding contracts with the SFA

Where independent providers have direct contracts with the SFA, they are capped at a particular financial level. Any provision that is delivered by a provider in excess of the value of the contract may not be funded without applying for additional funding. Therefore, if local demand for a particular form of provision increases, the provider may not be in a position to increase its provision to meet that demand.

Achieving awarding body status

There are many awarding bodies that are voluntarily regulated by Ofqual and have developed thousands of qualifications that are eligible for public funding if they are offered by providers. Very few providers of FE are awarding bodies themselves, despite several providers commenting that they would like to become awarding bodies. Reasons stakeholders noted for wanting to become an awarding body were generally around the ability to develop qualifications that meet specific unique and local labour market

¹⁰⁸ *School and College Purchasing Behaviour*, Ofqual, 2015
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407336/2015-02-26-school-and-college-purchasing-behaviours.pdf [accessed August 2015]

requirements, and to capitalise on the location of large employers nearby that need particular tailored qualifications (such as air cabin crew). Stakeholders interviewed for this study described in some cases how they had developed a new academy with associated courses and qualifications in response to local employment demand (in particular for railway engineering) but they had to partner with an awarding body to do this because it was too difficult for them to achieve awarding body status themselves (despite being an HE awarding body).

Short lead times of funding allocations and only a single year allocation

Funding allocations for Colleges are only for one year and are announced in March for the academic year commencing September that year. These short lead times can hinder longer term planning and space for innovation and can create very big challenges, especially where changes to staff numbers are required as a result of the funding shifts. A lack of ability to plan far ahead means that where providers have carried out studies of local learner and employer needs and interests, it may be more difficult to respond and invest in line with those if future funding streams are likely to be aligned with different incentives.

Policy instability & uncertainty

Policy instability reduces the ability of providers to plan ahead and release resources for innovation. The FE market has been subject to continuous and sometimes contradictory policy or institutional changes over the last years (such as the introduction of, among others, the Individual Learning Accounts in 2000, the Learning and Skills Council in 2001, Train2Gain in 2006 and the Young People's Learning Agency in 2010 and their subsequent dissolutions a few years later). Specialised providers are arguably at greater risk of changes in policy priorities and funding. This is because small specialised providers might have centred their business model on a certain type of provision. Large providers on the other hand may have greater opportunity to adjust their offering (though there are barriers for some larger providers too such as stranded assets resulting from a policy and funding shift towards work-based provision such as apprenticeships). These shifts in business model take time and mean that the need to respond to other (funding) incentives means it is not viable for providers to be as responsive as they would like to local employers or learners.

Staff shortages

There are staff shortages for many subjects for both teaching and assessment (e.g. maths) as FE providers compete with schools, Higher Education and with their associated occupations for skilled staff. Further education colleges are bound by public sector employment terms and conditions, including pension schemes such as the Teacher Pension Scheme and the Local Government Pension Scheme. This means they are not able to set their own levels of pay which are more competitive with other organisations that are able to pay more. Meeting employer or learner needs in areas where there are teaching staff shortages can therefore be difficult.

Local employment markets

The employment and economic makeup of a provider's catchment area can make a significant difference to their ability to respond to policy incentives. This is particularly true in the case of apprenticeships. The extent to which local employers want to employ apprentices varies greatly. Providers within local economies with a large proportion of small firms and sectors that are not amenable to apprenticeships for example, are likely to face significant challenges. The UKCES Employer Perspectives Survey (2014) found that around 45% of employers with over 100 employees employed (formal) apprentices and they are planning to continue doing so. This contrasts with just 7% of smaller businesses (2-4 employees) who currently employ (formal) apprentices. The sectors in which employers are most likely to take on apprentices are construction (16% of employers currently employ apprentices); non-market services (such as health and social care) (19% of employers); and manufacturing (17% of employers). The composition of the local economy is therefore important.

It is important to note that there is also clearly more that providers can do in this space. There is an important distinction between actual barriers to employers being willing to employ apprenticeships and perceived barriers. The UK Commission on Employment and Skills for example found in its Employer Perspectives Survey (2014) that 21% of employers thought that their business was not the appropriate size to take on apprentices; and 8% perceived that apprenticeships were not offered for their industry. Around 10% of employers demonstrated a lack of awareness of apprenticeships.

Inadequate provider governance

There is variability in the governance of colleges with some colleges being less adept than others, many of whom have found themselves in financial difficulty. To some extent this reflects the challenging balance some providers (particularly colleges and large, multi-faceted providers) must strike: on the one hand, course provision is influenced by the qualifications that are eligible for funding (from the SFA) and the way in which funding rates are calculated. But on the other hand this may not align fully with the local demand and needs of learners and employers.

However, weak governance and a lack of expertise and management skills are likely to be among the causes of provider difficulties in terms of responsiveness to market conditions. In some cases College leaders were not trained in how to manage such large 'businesses' as FE Colleges – although this seems to be changing now. In a minority of cases there are also problems around the length of board tenures. Evidence is emerging that a majority of colleges (55%) are imposing maximum terms of office for governors. In two thirds of colleges the Chair has been in the job for less than 4 years. But for a significant minority this is not the case¹⁰⁹.

¹⁰⁹ AoC "The Composition of English Further Education Corporations and College Government Frameworks", May 2014

7. Conditions for entry

Key findings

- Overall, there has been limited entry across the FE market in recent years, other than for subcontractors and school sixth forms. In the last 3 years, 172 new providers accessed government funding within the FE market, but most of this change cannot be considered true entry. It is the result of new provider identities created following consolidations or mergers and the creation of new bodies to overcome SFA changes in funding rules.
- Some entry has however been observed. Within the SFA funded part of the market, this has largely come from existing training providers expanding into the funded part of the market. Existing providers have expanded into new geographies and course offerings.
- One reason we may not have seen much entry in some parts of the FE market is because of market saturation due to previous high levels of entry. Also, our analysis suggests clear evidence of economies of scale in college provision. This means that entry is likely to be difficult in smaller markets where there is a pre-existing provider operating at scale. It also indicates that there are many providers likely to be operating far below the minimum efficient scale for provision, perhaps because of small learner volumes or saturation of their market by other providers.
- There are two barriers to entry likely to be most relevant for the FE market. The first barrier relates to large, predominantly sunk, initial investment costs. This means that entry needs to be on a large scale to prove profitable. The second barrier relates to the historic absence of College closures (though there have been many mergers) which sends a signal to the rest of the market about the real potential for profitable entry.
- These barriers to entry are likely to vary by market and we have identified two markets where they are likely to constitute particularly high barriers to entry:
 - **Local “core” mixed environment training for 19+ year olds** – this is due to reputation effects associated with established colleges and the scale of entry required. Entry may be particularly problematic in geographical areas where this is low demand as there are likely to be economies of scale in this type of training.
 - **Capital intensive training courses** - where assets are very specific and may have low resale value. Again, there may be low demand and economies of scale in this type of training.

Introduction

In most markets, the ideal scenario is the presence of a range of alternative providers who compete fiercely for consumers. In markets where there are few or no alternatives, providers may still face incentives to improve and innovate if there is a credible threat of an alternative provider being able to set up in the market relatively easily and quickly if incumbents do not perform well. If there are significant barriers to entry to a market then the threat of such entry, and the incentives that come with it, will be much reduced.

As shown in Chapter 0, there has been little observed entry into the publicly funded FE market in recent years. This Chapter explores in more detail the extent to which entry by new providers or expansion into new FE markets by existing providers is a feature of the market, and in turn, what impact this has. As part of this assessment, we explore the extent to which there are barriers to entry which may hinder the entry or expansion that otherwise could happen.

It should be noted that the extent of entry observed in the FE market will reflect both the underlying structural conditions, as well as the dynamics of the market. For example, a market where no recent entry has been observed might be one in which there are clear structural barriers, meaning that entry can only occur if high levels of irrecoverable investment are made. The observation could also be made in a 'saturated' market where entry has occurred but there is now no more room in the market, given the level of demand from learners and employers. Likewise, in a rapidly growing market, there may be scope for entry, even in spite of entry barriers.

In general, a combination of little existing competition and limited entry is likely to be of concern. In these circumstances, it is sensible to explore the factors that limit entry into the market and whether those factors (or barriers) are structural (and hence difficult to address) or whether there are barriers that policy could overcome.

To explore these issues, this chapter provides:

- *An assessment of market entry* – we review recent entry events in the market building on the description in Chapter 0. This includes detail on the nature of entry into FE provision by large employers and training organisations, and case study examples to illustrate geographical expansion and entry into new areas of provision.
- *A discussion of market saturation leading to a lack of entry* - we explore the relationship between scale and cost using college accounts and activity data and consider those markets where demand may be small relative to the minimum efficient size of a provider, meaning that a limited number of competitors can be sustained. This is an important area, as if these markets have limited existing competitive threat and there is unlikely to be entry in the future, there could be a role for policy in ensuring that a competitive threat is replicated by other incentives within the market.
- *A description of the barriers to entry that may be faced by providers* – we set out the various costs that an entrant is likely to have to incur in order to successfully enter the

market and whether these investments constitute a barrier. We also consider any other barriers entrants might face and how this might vary from FE market to market.

An assessment of market entry

In Chapter 0 we reviewed entry and exit in the market between 2010/11 and 2013/14. Over this period, 172 new providers appeared to have entered the funded FE market and 572 had ceased to exist. This net outflow of providers is driven in part by consolidation and college mergers, and also by changes in contracting arrangements (no longer operating) that caused providers below a certain minimum threshold to cease drawing down SFA funds directly. Analysing the largest 50 entrants, we found that these providers were either new entities resulting from merger or consolidation of existing providers, or were existing training organisations expanding into FE provision called “partial new entrants”. These “partial new entrants” are the closest thing there has been to large-scale entry into the market, so warrant further investigation. We have placed these providers into some groupings below¹¹⁰ to provide a richer description of the entry observed¹¹¹.

- **Established training providers entering the FE market** (e.g. Exemphas and QA Limited) - these providers were active in the wider training market, but not previously involved directly in FE provision. The group includes commercial private providers as well as third sector organisations.
- **Large employers developing in-house training** - these are organisations whose main activity is not training, but who have moved into FE provision. On closer inspection, we find that the vast majority of these providers use sub-contractors to deliver significant volumes of their training, but a small number have developed in-house training arms.
- **Umbrella organisations** (e.g. Health Education North East) – these are bodies which act as an umbrella either for providers of training or organisations with training needs. In most cases these organisations are intermediaries that sub-contract to other providers. In this regard, the entry of many umbrella organisations could reflect changes in SFA contractual arrangements causing smaller sub-contractors to sub-contract through an umbrella organisation, rather than through other channels.
- **Councils** – these include both metropolitan and borough councils. Many councils are already active in the FE market, mainly delivering training directly, but also sub-contracting delivery to other providers in some cases. These new providers have tended to access community learning funding and Adult Basic Skills funding.

Whilst, new entrants to SFA direct contracts have been limited, there have been other forms of entry worthy of note in the FE market. Firstly, there has been a large **increase in the number of School Sixth Forms**, generating extra provision in the 16-18 part of the market. A network of new employer-led “National Colleges” is planned to be operational by 2017. Furthermore, there appears to be **considerable activity within the subcontractor**

¹¹⁰ Based on a qualitative assessment of provider characteristics and detailed desk research

¹¹¹ This uses data from the PIMS database which identifies the funding streams each provider accesses.

market for training which is much more difficult to observe directly using available data. Finally, our analysis in Chapter 0 shows that established providers have been active at entering new parts of provision and hence new FE markets. All of these factors signal that entry, whilst limited, is possible in some areas of the market.

Market saturation resulting in a lack of entry

As noted earlier, one reason why we may not see much entry in the FE market is because of saturation. The larger the efficient scale for provision relative to the total demand in the market, the fewer providers can be sustained. If there are economies of scale in provision, the situation in which the cost per unit – such as per learner – decreases with the scale of activity of the FE provider, and the total number of learners is low then only a small number of providers can profitably be sustained in that market.

Our analysis, using FE College account data for 2012-13¹¹², suggests clear evidence of economies of scale in college provision. We have explored a number of dimensions through which economies of scale could be observed, and we have used the number of learners as a proxy for the size (or scale) of the College. The analysis is restricted to General Further Education Colleges (GFEC) and Tertiary Colleges (TC) in order to allow comparison across similar providers (other providers may have different cost structures).

Given we are using the number of learners to represent the scale of the College, it is important to acknowledge that learners may be studying courses of different lengths, therefore a learner on a 6-week part time course should not be considered equivalent to a learners on a 2-year full time course. Therefore, we have adjusted the number of learners to account for this¹¹³.

Figure 40 shows the results when looking at the relationship between total expenditure¹¹⁴ and the (adjusted) number of learners¹¹⁵. This shows that there do appear to be economies of scale for these providers, as indicated by the fact that the cluster of dots in the chart demonstrates a downward sloping trend from top-left to bottom-right i.e. that the greater the scale of the provider (the more learners it has), the lower are the costs per learner. The analysis indicates a 'co-efficient' of -0.51, meaning that if a college increases its scale by 10% then its total expenditure per learner would fall by 5.1%.

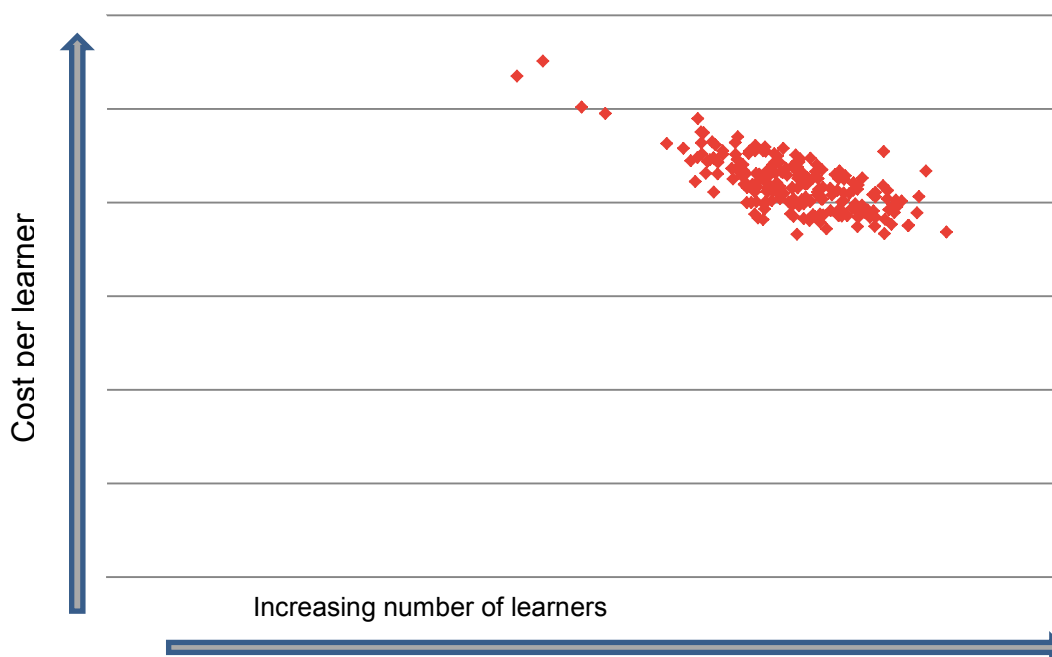
¹¹² SFA website: <https://www.gov.uk/government/publications/sfa-financial-management-college-accounts>

¹¹³ We choose a logarithmic specification; therefore the relationship between the two variables needs to be interpreted in percentage terms.

¹¹⁴ This refers to FE College costs only, of which around 50% of expenditure relates to 16-18 provision.

¹¹⁵ We conducted analysis also on more disaggregated cost variables like teaching staff costs, administrative costs, and running costs. All results were consistent with the one presented.

Figure 40. Economies of Scale for FE Colleges



Source: Frontier analysis of SFA college account data and the ILR

Generally, for areas with relatively small number of learners or employers and an established college operating at scale, entry is likely to be difficult. However, what this analysis also shows is that there are many colleges that are likely to operating well below minimum efficient scale which could mean the cost of provision is higher than it needs to be, in part because there learner base has been spread across a number of different providers.

Barriers to entry

There are many possible barriers to entry that can exist within markets. In the context of the FE market, there are two barriers we consider to be most relevant. The first barrier most likely to be applicable for some parts of the market relates to large initial investment costs, predominantly sunk, that mean that entry needs to be on a large scale to prove profitable. This barrier is, however, only likely to exist within certain parts of the FE market, in other parts the barrier to entry it poses may be low. The second barrier relates to the historic reluctance of FE Colleges to close and to merge instead. This sends signals to the rest of the market about the real potential for profitable entry that act as a barrier to entry.

Large, predominantly irrecoverable investment costs

Setting up a new FE provider can in some cases entail incurring relatively high up-front expenditures. When deciding whether to enter the market, providers will take into account what form and scale of investment is likely to be required, and whether this is likely to be recoverable at some point in the future. Where investments are not possible to recover, they are considered to be *sunk costs*. The higher the sunk costs, the higher are the likely

barriers to entry. We have identified a number of potential sunk costs that are likely to be present for providers entering the funded FE market. These are:

- Capital investment in buildings and equipment;
- Up front administrative costs (e.g. registering with the SFA and other bodies);
- Recruitment and staff training costs;
- Costs of gathering market intelligence; and
- Cost associated with building a reputation.

What is critical, in terms of assessing whether these sunk costs constitute a barrier to entry, is understanding the size of the costs and the extent to which they are fixed (and do not vary with learner numbers) and the chances of recovering them post-entry.

Starting with the latter point, the chances of recovering these costs is likely to depend on the extent to which the funding rate paid by government is reflective of the full costs of provision (including depreciation on investment). Where the funding rate is generous relative to the cost of provision for an individual learner, the chances of recovering the investment will be increased. Thus we are likely to observe more entry in those areas where funding rates are generous as they act as a vehicle for overcoming the potential barrier to entry. To the extent that funding rates reflect operating costs rather than costs of investment, the barrier to entry created by these sunk investments will represent will be higher.

Given the increasing pressures on government funding we would expect that the chances of recovering these investment costs through the funding rate is only likely to diminish with time.

In the context of investment in assets such as buildings and equipment, the extent to which these costs are sunk and constitute a barrier to entry depends on the market value of the assets if the provider were to exit. If assets can be easily sold at a price reflecting their market value, they are not truly sunk and would therefore not constitute a barrier to entry. However, assets that are highly specific and are not of value to others are unlikely to be saleable and will be sunk and cause a barrier to entry. We would therefore expect to see little entry in areas of provision where assets are very expensive and highly specific.

These issues are also important in the context of access to capital for large-scale investment. Investors will wish to examine the potential return on any assets and the associated risk of lending money for the particular venture. New entrants may find it harder to access capital if they have not previously demonstrated their skill of operation in the market and would therefore be considered a greater risk (and it may be more costly for them to borrow the required funds).

In terms of the scale of investment required, several points are worthy of note. Where entry costs are fixed (do not vary with learner numbers) and large, barriers to entry will be higher. So, for example, the cost of registering with the SFA is a fixed cost. In addition, it is likely to be of a reasonable size for completely new entrants (who may need to invest resources to meet certain conditions) as opposed to existing providers who may already meet these requirements (because they are already providing some training) and for whom registering becomes more straightforward.

Recruitment and staff training costs are likely to be notable in scale but they are also likely to vary with the anticipated number of learners. A provider is unlikely to train ten staff if it only expects to recruit a handful of learners in the first instance. These costs can therefore be ramped up as provision becomes established. A similar argument is likely to be true of market intelligence gathering costs as a provider can explore a small number of markets in the first instance and test out provision in those before expanding further. These costs are unlikely therefore to present a significant barrier to entry.

Finally, the scale of the fixed costs associated with building a reputation is likely to depend on several factors including:

- how easy it is for consumers (learners, employers) to objectively judge quality; and
- how large is the risk associated with a bad choice.

It is likely to be relatively difficult for consumers to objectively judge the quality of a training provider, so investment in reputation is likely to be important for all providers entering the publically-funded FE market. Most learners will not tend to make a choice about their FE provider very often and so for them the risk of selecting a poor provider could lead to significant consequences for their learning. This means that reputation building costs are likely to be greater for providers entering markets where learners (rather than employers are government) are the key decision makers.

This is likely to be particularly true for learners doing longer courses and thus committing to much greater investment in terms of time and (sometimes) money. It is also likely to be true for providers serving a largely static population where generation after generation have used the same provider and behaviour becomes ingrained. Thus we would expect barriers to entry to be higher for long and expensive courses where learners are the primary customer and for static populations.

Conversely, employers are more likely to engage with training providers on a more frequent basis which means that they may be better able to judge quality and may be prepared to give a new provider a chance but then switch to an alternative if the provider fails to deliver what they want. This means that the costs associated with building a reputation outside of your ability to deliver is likely to be limited. We would expect barriers to entry to be lower for short courses for learners and for courses “purchased” by employers on behalf of their employees.

1992 Further and Higher Education Act: pension liabilities

The 1992 Act¹¹⁶ removed Further Education Colleges from the control of local authorities and instead set them up as independent statutory corporations. The governing body is either a further education corporation or a sixth form college corporation. Some of the key characteristics of FE Colleges that are relevant when considering the ease with which a new College can enter the market are:

- **Colleges have a charitable status:** they are subject to the Charities Act but have their own regulator (not the Charities Commission as they are classified as exempt). This means that the property and income of the college can only be used for the purpose of the charity.
- **As of 1st April 2012, Further Education Corporations (FECs) and Sixth Form College Corporations (SFCCs) were re-classified outside of the public sector¹¹⁷.** This was largely because the Education Act 2011 removed many of the public sector powers over FECs and SFCCs, for example, the right of the Secretary of State to dissolve a FE College was removed (unless it is mismanaged or performing poorly) and FECs and SFCCs no longer need the consent of the relevant governing body for any borrowing¹¹⁸.

However, although Colleges are outside of the public sector for the purposes of borrowing, the ability to purchase private training providers and the ability to recruit outside of public pay and conditions, they remain subject to particular regulations.

For example, teachers in FE Colleges and Sixth Form Colleges are able to join the Teachers' Pension Scheme and non-teaching staff are eligible to join the Local Government Pension Scheme. These pension liabilities can be very substantial and can be an additional cost burden acting as a barrier to both entry and exit.

A further issue relating to FE Colleges is that there is no specific administration or insolvency procedure¹¹⁹. This lack of clarity about the process for orderly exit could be seen as a barrier to exit of Colleges from the market.

Historic reluctance of government to close a college

As described in Chapter 0, there has not, to date, been an example of a college being closed outright as a result of failure. The tendency has been for Colleges to merge and therefore Colleges have dissolved and transferred to other Colleges. As a result of

¹¹⁶ The Further and Higher Education Act 1992:

http://www.legislation.gov.uk/ukpga/1992/13/pdfs/ukpga_19920013_en.pdf

¹¹⁷ Reclassification of Further Education Corporations and Sixth Form Colleges in England, May 2012

http://www.ons.gov.uk/ons/dcp171766_266962.pdf

¹¹⁸ Further Education Colleges were classified as outside public sector before 2010. The decision to reclassify as within the public sector was taken in 2010 and reversed in 2012 following the Education Act 2011 changes. Therefore, pre 2010, FECs were not public sector.

¹¹⁹ This is noted in "Summary of statutory and regulatory requirements relevant to College governing bodies, Association of Colleges (2013)

<http://www.aoc.co.uk/sites/default/files/Summary%20of%20Statutory%20Regulatory%20Requirements%20Relevant%20to%20College%20Governing%20Bodies.pdf>

Colleges' charitable status, their assets are required (except in exceptional circumstances) to be used for educational purposes only¹²⁰. The combination of these two effects means that, even where a college is failing there is little chance at present of that college failing to exist in some shape or form, particularly when significant amounts of funding are routed via colleges on rolling contracts. This is likely to constitute a barrier to entry to providers who might otherwise consider entry into the FE market.

There has however been some closure of some provision. For example, several Colleges have backed out of the A levels market.

Summary of barriers to entry by market

The table below applies the above descriptions of barriers to entry to each of the market segments to provide a view as to where the barriers are likely to be the greatest.

Table 8. Summary of barriers to entry by market

Market grouping	Description
1. Local, "core" mixed environment training	16-18 year olds - Barriers to entry appear to be low due to specific government policy to encourage new School Sixth Form provision.
	19+ year olds - Barriers to entry likely to be high because of reputation effects associated with established colleges and scale of entry required. May be particularly problematic in sectors where there is low demand as there are likely to be economies of scale in this type of training. Pension legislation and regulations require that all employees of FE Corporations as defined by the 1992 Further and Higher Education Act are automatically enrolled into either the Teachers' Pension Scheme (TPS) or the Local Government Pension Scheme (LGPS) for non-teaching staff. These are high cost liabilities that can act as a barrier to entry (and exit) for Colleges.
2. Local, "basic" community-based training	Barriers to entry are likely to be low as entry can be on a small scale and courses tend to be shorter and thus risk to consumer of a poor choice is lower, meaning reputational effects may have lesser effect.
3. Capital intensive training courses	Barriers to entry from the need to invest in high cost equipment, land or other capital assets. Large and stable learner base is often needed to make them viable owing to the scale of investment needed and the skilled staff to teach the courses

¹²⁰ The documents below set out which bodies FE colleges can transfer their assets to. In any case, assets can only be used for educational purposes
<http://www.aoc.co.uk/sites/default/files/Dissolution%20of%20a%20Corporation%20Property%20Rights%20and%20Liabilities.pdf>
<http://www.legislation.gov.uk/uksi/2012/1167/contents/made>

Market grouping	Description
4. Regional “advanced” sector-focused training	<p>Barriers to entry from the capital investment needed for capital equipment needed. Often requires skilled staff that may be in shortage owing to the competition for such skilled teachers with HE and the occupations themselves.</p> <p>Reputation of providers with learners and employers also likely to be important so difficult for new entrants to compete</p> <p>Relatively large and stable learner base likely to be needed to make the courses viable, given the required investment.</p>
5. Sector focused training in the workplace	<p>Barriers to entry are likely to be low as training is delivered in the workplace so the upfront and sunk costs are lower. But relationships between providers and employers are important given the role of providers in matching learners to apprenticeships. Entry likely to be easier for established training providers compared to completely new providers.</p>
6. Specialist classroom learning	<p>Barriers to entry may be high as highly trained staff and specialist equipment are likely to be needed.</p> <p>Capital investment in residential provision is often likely to be needed.</p> <p>Catchment areas are likely to be larger given specialist focus – stable demand is likely to be needed to remain viable.</p>
7. Prison based learning	<p>Barriers to entry likely to be lower given education is provided within the prison setting so less capital investment is likely to be needed.</p>

Barriers to expansion

There are also a range of barriers that hinder the ability of providers to expand into new areas of provision. Particular barriers are below:

- **SFA direct contracts are not typically re-tendered and contracts are subject to funding limits for independent providers:** providers holding direct SFA contracts have an advantage in the market because those contracts provide the holders greater stability and security for as long as they meet minimum standards. This is likely to be a significant barrier to entry because there is no space for new entry. In addition, contracts are subject to a funding limit for independent providers which again could limit the potential for expansion.
- **No new SFA direct adult skills budget contracts:** contracts for the Adult Skills Budget are very rarely procured. In part this links with the point above, but it also indicates that when funds are clawed back from providers that have under-performed, the associated activity is not offered to the open market, but instead is open only for other direct contractors.
- **Funding allocations are made on the basis of retrospective activity.** Therefore, where a provider does want to expand into new sub-markets, it can generally only do so if it has reserves to fund that expansion until the next year when the expanded activity can be accounted for in funding allocations.

8. Threat of failure

Key findings

- For a market to be dynamic, innovative and sustainable, organisations that are inefficient or do not deliver the desired quality must face a credible threat of failure, or exit from the market. Unless the threat of failure is credible, providers will not face an appropriate incentive to improve their performance.
- The threat of failure must be credible for all providers not just some. For those providers on government contracts, it must also largely mimic the circumstances in which providers would fail in a more conventional market. Finally, it must be accompanied by a clear and workable plan to look after learners.
- There has been exit of providers from the FE market but this has been largely subcontractors and independent providers with SFA contracts. There has been no full exit of a college to date, although there has been significant merger and consolidation activity. Beneath the surface, providers regularly exit from particular elements of provision, but remain active in others. Our analysis suggests that 35% of providers withdrew from at least one subject area and 6% withdrew from at least 3 new subject areas. Our stakeholder analysis suggests that an important element of this has been FE colleges withdrawing from A-level provision in response to Sixth-form schools and colleges saturating the market.
- The threat of failure is not equal across providers. Subcontractors may be more exposed than many firms in a traditional market as they are unable to access government funding directly and must rely on drawing down funds from other funded providers. Independent providers with SFA contracts are also exposed to failure criteria that largely mimic those on a traditional market. In some cases the risk of failure is perhaps more biting than in some traditional markets as providers are given very little time to get provision back on track and may suffer if there are fluctuations in the demand for their courses over time.
- In contrast, grant funded providers such as FE Colleges have historically had a less biting threat of failure. The introduction of the FE Commissioner appears to have increased the exposure of colleges to this threat but to generate a real change in the FE market this threat needs to be seen to bite where providers are failing to deliver.
- This may be about to change due to further shrinking budgets and a number of providers at the point of financial crisis. Much will depend on how these cases are handled over coming months as to whether a binding threat of failure begins to take effect in the market.

Introduction

For a market to be dynamic, innovative and sustainable, organisations that are inefficient or do not deliver the desired quality must face a credible threat of failure, or exit from the market or sub-markets. Unless the threat of failure is credible, providers will not face an appropriate market incentive to improve their performance. For example, if providers were to believe that in the event that they get into financial difficulties because of poor management or if they deliver poor quality, they would receive help and be propped up and not be allowed to fail, then this reduces their incentive to push for better performance and efficiency. This would be to the detriment of learners and employers.

The threat of failure is therefore important. But, for the market to be resilient and efficient, the threat of failure on its own is not sufficient because it must be a credible threat for all providers and not just some. Also, given the threat of failure in the funded FE market is the withdrawal of government funding, for this threat to be credible and proportionate, it must be that the circumstances in which that funding is withdrawn largely mimic the circumstances in which a market would withdraw demand.

Finally, given the nature of FE, it must be recognised that there are consequences for others from any exit or closure. The nature of FE is that learners are recruited and remain with their provider for the duration of their course, which can in some cases be several years. In the event of exit, there is a role for policy to minimise disruption for the learners. In addition, there could be contractual implications for employers as they will need to find an alternative provider to meet their training needs. These issues are considered further in Chapter 9.

In this chapter, we explore three issues:

- the extent of recent exit from the market;
- the extent to which failure criteria mimic those that might be found in conventional markets; and
- relevant institutional factors that may restrict exit or cause it to disproportionately affect some types of providers.

Recent exit activity

As indicated in Chapter 0, there has been a recent trend towards consolidation in the FE market, with colleges merging or re-organising. Between 2010/11 and 2013/14, 572 providers appeared to exit their SFA direct contracts. Similar to our analysis of entry, much of this actually reflects merger and consolidation activity (with one or more of the merging parties renamed) or institutional changes forcing small sub-contractors to cease dealing directly with the SFA. These providers may not have exited (or even reduced) activity, but may simply have ceased direct contact with the SFA and be acting as subcontractors instead.

To delve underneath this aggregate picture we therefore examined in detail the apparent exits of the 50 largest providers over this three year period. We identified 12 cases of

sizeable firms exiting the market and ceasing activity altogether over the 3 years since 2010/11. The largest provider in this group, Pearson, made an orderly withdrawal from the funded FE market, having attempted entry at a large scale, but finding it unprofitable.

Other cases of exit have involved firms entering administration or ceasing trading following termination of SFA contracts. By and large these have been providers of apprenticeships or other work-based training. There have also been examples of what we call “partial” exit, where providers no longer remain part of the funded sector but continue to provide training in other markets and some examples of providers, such as Sainsbury’s and A4E who are still involved in apprenticeships, but on an arms’ length basis, and so are no longer identified as distinct providers in the ILR.

Our stakeholder analysis is consistent with the statistics above and suggests that there has been reasonable exit from the market in recent years but that this exit has not included any colleges. Private training providers are the largest group to have exited the market.

Beneath the surface, there is also significant scope for providers to exit from particular elements of provision, but remaining active in others. In terms of subjects, our analysis suggests that 35% of providers withdrew from at least one subject area and 6% withdrew from at least 3 new subject areas.

Our stakeholder analysis suggests that an important element of this has been FE colleges withdrawing from A-level provision in response to schools with 6th forms saturating the market.

Failure criteria

The criteria by which providers are deemed to fail can largely be divided into three categories:

- failure criteria for subcontractors;
- failure criteria for private, independent and voluntary providers on SFA contracts; and
- failure criteria for grant funded providers including colleges and schools with 6th forms.

Threat of failure for subcontractors

Those providers who are active in the FE funded market but who do not have direct contracts with the SFA are hidden from the direct sight of government as their contracts are with a funded provider rather than government directly. From what we understand from our stakeholder analysis, these providers are largely exposed to the traditional dynamics of a market whereby their funding is withdrawn if they fail to deliver adequate quality for learners or if demand for their provision reduces.

In fact, these providers may be more exposed than firms in many markets to the threat of failure as their financial contracts are with a small number of funded providers rather than with customers directly and providers may choose to withdraw funding for reasons other than performance. Subcontractors appear to protect themselves against this by dealing with multiple lead providers but this can create many interdependencies within the market that are below the lens of government but could come to light in the event of the exit of a lead provider with many subcontracting relationships or a large subcontractor. This is considered further within Chapter 9.

Threat of failure for independent providers with SFA contracts

Where an independent provider who has a direct contract with the SFA fails to meet minimum standards, receives a grade 4 rating from Ofsted (i.e. is rated as inadequate) or fails to deliver in line with its contract value (reviews take place quarterly), the provider will be likely to be given a 3-month notice of contract termination. It will also be banned from any further recruitment of learners. At the same time, the SFA will try to manage the process of exit of the provider by looking for alternative providers who would be willing to take on the learners. It is often FE Colleges that are approached to take on those learners because the SFA would prefer to minimise the number of providers to which learners are transferred to keep the process as efficient as possible.

The threat of failure for these providers appears broadly in line with what one might expect in a market. Providers are exposed to the risk of exit if they fail to deliver relevant quality or recruit sufficient learners (demand falls). In some cases the risk of failure is perhaps more biting than in some traditional markets as providers are given very little time to get provision back on track and may suffer if there are fluctuations in the demand for their courses over time. This is particularly true of the threat of failure associated with a failure to deliver in line with contract value. A more proportionate response in these circumstances might be to reduce funding in line with the reduced demand for a longer period of time before terminating the contract.

Our stakeholder analysis has also highlighted some examples of where providers may have their contracts withdrawn for administrative reasons that were easily rectifiable and result in the loss of otherwise high quality providers, potentially leaving a gap in some markets. This threat may also be more biting than in many conventional markets where consumers might withdraw demand for a period of time whilst an issue is rectified before begin to purchase from that provider again.

Threat of failure for grant funded providers (including FE Colleges)

When a grant funded provider fails to meet minimum standards, the threat of failure is much slower to bite than for independent providers. There has, to date, not been a full exit of a FE College, for example, though many have merged or consolidated in response to underperformance.

Since August 2013, there is a strengthened intervention process in place to ensure rapid and robust action is taken in the case of underperforming FE Colleges, designated institutions and local authority maintained FE institutions. A Further Education

Commissioner has been introduced¹²¹. The FE Commissioner is independent and his¹²² assessment of a provider's situation is used to make recommendations to Ministers about an appropriate course of action for struggling providers. Recommendations could include simple measures to bring the provider back on track; mergers; or even closures in more severe cases (this has never happened so far). The Commissioner's remit includes Colleges and Local authorities with SFA funding, including tertiary colleges but it does not include 6th form colleges or independent providers.

There are three events that would trigger the involvement of the FE commissioner in the affairs of a provider. Two of these are similar to the threat of contract withdrawal for independent providers – failure to meet national minimum standards of performance set by BIS or DfE or a grade 4 (inadequate) Ofsted rating. The third, an inadequate assessment by the SFA or EFA for financial health and/or financial management and control, is additional but largely mimics the financial constraints an independent provider would naturally face.

The involvement by the FE Commissioner in a provider's affairs is quite onerous. The initial on-site assessment lasting three days¹²³ and is followed by the Commissioner preparing a written report¹²⁴ containing recommendations about potential interventions to the Minister. There are many forms such interventions can take. The intervention might involve just implementing recommendations set out by the Commissioner's report, aimed to bring the college back on track. In more severe cases the Commissioner may recommend he undertakes a Structure and Prospects Appraisal¹²⁵ with a view to

¹²¹ As set out in 'Rigour and Responsiveness in Skills'

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/186830/13-960-rigour-and-responsiveness-in-skills-amended.pdf

¹²² At the time of writing the FE Commissioner is Dr David Collins CBE.

¹²³ A typical on-site assessment usually lasts for three days. On the first day there are meetings with the Chief Executive/ Principal, Chair of the governing body and separately with senior managers. On the second day, the three-person team (the Commissioner and two colleagues) splits up. One colleague investigates the quality of tutorials and classes. The other colleague would visit the finance department and assess the accounts and financial forecasts. The Commissioner himself would engage with teachers, unions, students and mid-level managers. On the third day the classroom and financial assessments continue while the Commissioner tries to get the views of wider stakeholders. The SFA would provide a list of stakeholders including for example the county and city councils, Chief Executive of the LEP, employers, HE providers and others depending on the context.

When assessing the management and governance of a College, the Commissioner's team consider the mix of skills in the senior management team and governors. Factors the Commissioner would consider include, for example an assessment of longevity of the board, the Principal's role in the downturn and their experience, whether there is a mentoring process in place for new principals; whether the College has been adequately responsive to changes (including financial cuts) in the funding system; and whether the College has been quick enough in adapting to new technologies.

¹²⁴ This report is shared with SFA, EFA, BIS and Ofsted, who are given the chance to comment on it. These comments need not be taken into account necessarily as the Commissioner's report is meant to be independent and not a consensus view.

¹²⁵ Where a Structure and Prospects Appraisal is suggested, this looks at whether the present arrangements best meet the needs of employers and learners and what the impacts of alternatives might be. It involves a detailed assessment of the local, sub-regional and regional demographics, economic issues and LEP priorities; a detailed competitor analysis; a detailed review of its own performance over recent years in terms of learner numbers; quality; financial; measures; responsiveness to change; an assessment of a wide range of options to address the objectives of achieving a change in mission or better meeting the needs of interests of local learners and employers. The assessment would need to consider impacts on

determining appropriate changes that need to be made to the college's structure, governance or delivery model. In any case, the overall goal is to minimise the impact of any intervention on the learner/employer experience and to ensure best value for money.

In deciding upon the appropriate course of action, the Commissioner would explore a number of options including internally focused changes, mergers, re-location and closure (with transfer of assets to another educational organisation and action to settle all outstanding liabilities). Closure would need to be a decision for the governing body of the College to make. There are intervention powers which would allow the Secretary of State to direct a board to dissolve a college but these only apply in cases of significant underperformance or mismanagement and have not been used to date. Where closure or a reduction in provision is considered to be necessary the transfer of programmes to the most suitable provider (including independent providers) would be considered. That is, it may not be a college-based solution that is recommended. It might lead to a merger or even exit of colleges although the latter has not occurred to date.

Grant funded providers are typically far less exposed to the threat of failure compared with independent providers in the same market and as compared with other more conventional markets. The introduction of the FE Commissioner appears to have increased the exposure of colleges to this threat but to generate a real change in the FE market this threat needs to be seen to bite where providers are failing to deliver. As for all providers, given the public interest in provision of this type, failure must also be managed in a way that is satisfactory for learners but without allowing these concerns to prevent failure in the first place. This is unlikely to be in the interests of learners in the medium term and will dilute provision across the rest of the market.

Barriers to exit

As noted above, to date there have been no examples of outright college exit from the market (there are many examples of mergers and consolidations). In contrast, there have been many examples of independent provider exit covering both small and large providers. This, in itself, constitutes a barrier to exit for colleges in the market as they are aware that failure to deliver does not result in the termination of their contract with government and this will disproportionately affect those parts of the market where colleges are present, particularly the "core" learning market. This may be about to change with the introduction of the FE Commissioner, further shrinking budgets and a number of providers at the point of financial crisis. Much will depend on how these cases are handled over coming months as to whether a binding threat of failure begins to take effect in the market.

Clearly, one of the reasons why government has been reluctant to allow college failure relates to ensuring that learners are not unduly disadvantaged by becoming 'stranded' and left without an alternative provider to continue their learning. If well managed, providers failing can have a direct impact on learners' welfare because of the disruption to their learning activities. If failure of a provider is seen as excessively troublesome for learners, especially if they are a large provider with few alternatives then this may reduce the

learners, employers, the community, quality, value for money, staff, and financial position and how any changes could be implemented; and, a comparison of options and selection of the most preferred.

willingness of policy-makers to allow such failure to occur. In particular, government may need to pay particular attention to learners who have special education needs (of which there are currently around 18,000 studying at FE Colleges, and cannot simply be transferred to the next nearest provider) or learners on two-year programmes for whom even a grace period to close a College may not be long enough.

The consequence of a need to ensure continuity for learners means the threat of failure may no longer be credible so the competitive pressure to perform well is therefore dampened. This means that any enhanced threat of failure must go hand in hand with suitable policies to protect learners (discussed further in Chapter 9).

A further issue is the 'ease' with which providers are able to exit the market. Exit of the market could be considered more straightforward for independent providers in that some of them have fewer capital assets such as premises – often they rent or lease. This contrasts with Colleges which generally own buildings and land and because their assets are in a special class and must be used for educational purposes in the event of failure, this can affect the value of those assets in the event of a failure.

9. Policy and regulation

Key findings

In the context of facilitating a dynamic FE market, policy and regulation have a specific role to ensure three main things:

- that competitive pressures are enabled (and not distorted or reduced), where they are appropriate;
- that competitive pressures are supplemented with policy and regulation where there are structural market failures; and
- that appropriate safeguards for consumers are available in the event of provider failure or for vulnerable groups.

In the context of enabling competitive pressures, we find there is a role for policy to enable effective consumer decision making, ensure a level playing field and stable policy environment for providers and ensure that providers have sufficient flexibility and incentives to respond to consumer needs.

There are a number of areas within the FE market where there appear to be structural or natural market failures that mean that the competitive process is likely to be impeded. There is a role for policy in recognising and regulating any true natural monopolies (created by a combination of economies of scale in provision coupled with small catchments). There is also a role for policy to ensure that there is a coordination of provision across larger geographical areas where individual providers are incentivised to focus on local demand, which could lead to gaps.

Introduction

The policy context for further education is complex with multiple streams of public funding, a range of regulatory bodies and a multitude of other specific policies related to various aspects of the market. Overall, the combination of these policies aims to ensure that the FE market is able to deliver the desired outcomes for learners, employers and the wider economy.

In the context of facilitating a dynamic FE market, policy and regulation have a specific role to ensure three main things:

- that competitive pressures are enabled (and not distorted or reduced), where they are appropriate;
- that competitive pressures are supplemented with policy and regulation where there are structural market failures; and
- that appropriate safeguards for consumers are available in the event of provider failure or for vulnerable groups.

This chapter considers the extent to which policy and regulation are appropriate in this context and where there might be gaps. We stop short of saying whether and how policy and regulation could fill these gaps as this is beyond the scope of this work.

The rest of this chapter considers each of the three issues above in turn.

Enabling competitive pressures

Throughout this report we have identified a number of areas where policy may have a role to play in enabling (and not distorting or reducing without reason) competitive pressures. These include:

- enabling effective consumer decision making;
- ensuring a level playing field and stable policy environment for providers; and
- ensuring that providers have sufficient flexibility to respond to consumer needs.

Effective consumer decision-making

In Chapter 0, we identified a number of areas where there could be a role for government to ensure that consumers are able to make effective choices about the FE that they choose to participate in. These include ensuring that:

- information sources, and associated advice and guidance, are impartial and reflect the full range of options available to learners;
- information sources are aligned with what learners find useful and use to inform their decisions; and
- the way in which hard-to-reach groups are engaged within the FE market is recognised and incentives are appropriate for providers to engage with this group.

All of these actions may help to improve the ability of providers to exert a competitive constraint on providers but they will need to be supplemented by other actions to ensure that an effective provider response is possible to the signals sent by consumers.

Enabling a level-playing field and stable policy environment for providers

The funding system is one of the key aspects of policy that plays a role in ensuring a level playing field for providers. Whilst the funding rates paid per qualification (for adults) are the same for all providers, the table below provides a summary of how the funding system differs in other ways for different types of provider. Table 9 shows that there are important differences in the way in which providers that are grant funded providers, including General FE Colleges and Local Authority institutions, are funded compared to providers on a contract.

Table 9. Overview of the SFA funding system

Aspect of the system	Grant funded providers	Providers on direct contracts
How the annual funding allocation is determined	The mid-year funding claim from the current year is used as the baseline for the subsequent academic year. The ASB allocation will include the minimum amount of the ASB that the College is expected to use to fund adult apprenticeships	Baselines are equivalent to the current contract value (with any performance-related revisions). Contract states the minimum contract value and of this ASB allocation, the minimum amount that must be used for apprenticeship provision.
How payments are made	Payments made on a standard national monthly profile	Payments made monthly on the basis of actual delivery, as recorded in the ILR
Performance measurement	Funding claims are used to monitor actual delivery mid-year, at year end and a final funding claim	Performance is measured against a standard national profile, with performance-management points throughout the year
Process if low delivery	For any under-delivery, the SFA will make a year-end adjustment to funding allocations and unspent funds must be paid back.	The contract value is reduced where performance against the standard national profiles for the period in question is outside published tolerance levels. The reduction is in line with under-delivery.
Action if poor quality (Ofsted rating 4) or minimum standards not met	FE Commissioner is involved and begins a detailed assessment with recommendations to the Secretary of State	3 months' notice of contract termination and immediate ban on further learner recruitment

Source: Operational Performance Management Rules 2014 to 2015, SFA (2015) and Guidance Note: Allocations Methodology for 2015 to 2016, SFA (2015)

Table 9 highlights some important factors in terms of ensuring a level playing field between providers:

- Independent providers are paid on a monthly basis against their actual delivery. Colleges are paid according to a profile. This implies an un-level playing field in the extent to which fluctuations in demand would be managed with greater leniency afforded to FE Colleges than to independent providers.
- If an independent provider delivers poor quality or fails to meet minimum standards then there is a very different process in place. Colleges would be referred to the FE Commissioner who would carry out a detailed assessment of what has gone wrong and why, then make recommendations for how the situation can be improved. Independent providers are however likely to immediately be given 3 months' notice for termination of contract.

These differences are likely to mean that colleges are at a competitive advantage vis-à-vis their independent counterparts and may constitute a barrier to entry for independent providers and a barrier to exit for colleges. This could be an important issue for a key priority of government – apprenticeships – because the majority are currently delivered by independent providers.

In addition, government has a role to play in ensuring that there is a stable policy environment and a clear direction of travel for providers. The annual funding allocations and historic shifts in policy can hinder innovative thinking and the ability to be nimble to future opportunities because it points providers to being short-termism in their planning.

Ensuring that providers have sufficient flexibility to respond to consumer needs

One challenge for policy in the context of FE is ensuring that provision can be sufficiently responsive to changing learner and employer needs, whilst maintaining quality. Awarding Bodies have been identified as one factor that can act as a barrier in this respect. Funding is largely tied to qualifications and qualifications are the remit of the Awarding Bodies. Stakeholders have raised concerns that Awarding Bodies may not be as flexible as they might desire in terms of tailoring qualifications to learner and employer requirements.

Supplementing competitive pressures

Throughout our analysis, we have identified a number of areas within the FE market where there appear to be structural or natural market failures that mean that the competitive process is unlikely to be impeded.

There are two areas of particular note in this regard:

- **Possible natural monopolies:** areas where the combination of small catchments because of reluctance of learners to travel, low demand within catchment and economies of scale in provision lead to a position where a monopoly provider may be the most efficient market outcome.
- **Coordination issues where policy is devolved to local level:** providers make choices about what training to offer based, predominantly, on the demands of their local communities. This could lead to potential gaps in provision where demand is dispersed across wider geographical areas so no provider has the scale to make its offer sustainable.

Regulation of natural monopolies

There are clear economies of scale in college provision (this may also be true for other types of provision but we haven't been able to access data to test this) and catchment areas for providers tend to be small. These two observations coupled together can mean that in some markets, the level of demand is insufficient to sustain more than one efficient provider. For these areas, encouraging entry is unlikely to be in the best interests of learners, employers or government. However, government may need to consider ways of

ensuring the quality, range and efficiency of provision is maintained by these providers as the consumers they serve (learners and employers) will have few real alternatives.

Recognising minimum efficient scale

The existence of economies of scale in college provision also has the implication that some providers may not be able to achieve minimum efficient scale in provision because their catchment area is too small. This means that these providers are likely to be operating at a higher cost level and, to the extent they play an important role in providing access for learners, policy might need to recognise this.

Ensuring coordination of provision in core areas

Providers are encouraged to make choices about what training to offer based, predominantly, on the demands of their local communities. This could lead to potential gaps in provision where demand is dispersed across wider geographical areas so no provider has the scale to make its offer sustainable.

There is a potential role for government to ensure that for key areas of provision where this dynamic may be in existence, there could be a case for greater co-ordination across providers. There is evidence that some areas of the country recognise the effect of this issue. For example, the East Cambridge Learning Partnership has as its objective: “By working together the Learning Partnership hope to ensure a greater co-ordination of activities, to reduce duplication, enable easier access to external funding opportunities for learning and to widen participation in learning activities¹²⁶”.

Such partnerships, or variants of them exist across the country, but they are not systematically present. There may be a case for greater encouragement of similar efforts in areas where to ensure that allocations of provision are well co-ordinated and efficient. Government may therefore need a stronger voice in ensuring that coordination occurs in those markets where there are structural barriers to competition.

Safeguarding consumers

Policy and regulation have a clear role to play in safeguarding consumers in the FE market. There are two areas where this appears to be particularly important in the context of this report:

- ensuring the quality of provision; and
- protecting learners in the event of exit.

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http://www.eastcambs.gov.uk/sites/default/files/education/east_cambs_personal_community_development_learn_61164.pdf

Ensuring the quality of provision

There are clear information asymmetries in the market for training which mean that without regulation, learners and employers may find it difficult to observe the quality of the training they receive or the employees that they take on. Ofsted (responsible for assessing the quality of providers) and Ofqual (responsible for regulating awarding bodies who ensure that qualifications are consistently of the appropriate standard) are both active in this space and should continue to be so. In particular, policy should focus on ensuring that quality is consistently high, including from the training provided by subcontractors.

Protecting learners in the event of exit

Exit is a key requirement of the majority of markets to ensure a healthy and vibrant set of competitors. However, despite a policy of careful management of exit, our analysis suggests that there are examples where a significant proportion of learners were not successfully transferred to other providers, or were only transferred after a lengthy gap in learning. There may be a number of reasons for this. For example some learners elect not to transfer, perhaps because it may be early in their programme and they do not want to continue with that particular programme; or they believed they had “completed” their programme. Also in some cases employers can decide to use their local college or training provider so may not work with the SFA on transferring learners, or administrative issues can also cause delays if information is not shared with the SFA. However, it remains important the delays are avoided and learners are supported in their move to an appropriate alternative provider.

It should be noted that the feasibility of securing continued learning in the event of provider exit will depend on the availability of alternative providers at both a geographic and course level. It will be more difficult finding alternative provision for stranded learners if they are studying a very niche subject or are in an inaccessible location.

In addition, although the SFA has a policy of intervening to ensure that the best interests of learners are met, the SFA intervention is only for providers on its direct contracts. Therefore, where providers are on subcontracts, in the event that they fail, the lead provider would be responsible for finding an alternative provider. There is another issue worthy of note in relation to subcontractors. Subcontracting, by definition, creates a supply chain. This in itself poses risks to those in the supply chain because if any party in the chain were to fail then this could have implications for others’ ability to survive. Furthermore, as we saw above, providers can both act as subcontractors as well as lead providers who subcontract out to others. These arrangements lead to complex dependencies across organisations that are not transparent to learners, regulators and indeed to the providers themselves. Such complex relationships raise risks to others in the supply chains or networks in the event of failure of any one provider.

10. Conclusion: barriers to an effective FE market

Key findings

The purpose of this report has been to assess the extent to which the FE market demonstrates the features required to function well as a market. We have considered this from the perspective of the demand-side (learners and employers); the supply-side (providers' responsiveness and governance and the longer term observed entry and exit of providers); and the facilitation side (regulation and policy).

We have identified a range of areas where there are barriers to the effective functioning of the market, which we have classified into structural and policy related barriers.

Introduction

The purpose of this report has been to assess the extent to which the FE market demonstrates the features required to function well as a market. We have considered this from the perspective of the demand-side (active learners and employers); the supply-side (providers' responsiveness and governance and the longer term observed entry and exit of providers); and in the way the market is facilitated by policy and regulation.

Using these components as a foundation, we have carried out detailed analysis of the market and the extent to which these features are observed and identified points of divergence.

To deliver an assessment of where the market is working 'well' i.e. displaying the features that would be expected to be observed in a well-functioning market, ideally we would want to also consider a range of outcome measures. The measurable outcomes of FE that could be of interest are employment, length of time in employment, earnings, skills and labour market mobility, among others. However, although these outcomes could be investigated if the information were available in a consistent and comparable format, they would not be likely to tell the whole story. There are various other desirable outcomes that do not lend themselves to such quantified metrics – for example, the social value or community value of local FE provision; the sense of wellbeing for individuals engaged in FE that otherwise would not be learning at all; and, the motivation and opportunities offered to individuals that otherwise may not be employable. Outcome data would have value, but it would always need to be interpreted appropriately.

What would also be important would be what is driving the observed outcomes. For example, the quality of teaching may lead to higher 'success rates', but employment rates may be lower if a particular provider targets hard to reach groups or those who are long-term unemployed, for whom the value of FE is not to achieve a qualification but is rather to motivate the individual to engage in learning

This chapter focuses on those aspects of the market which do not appear to demonstrate the required features and why this is the case i.e. what the barriers are.

Within this assessment we identify:

- **Structural barriers:** those natural characteristics of the market, geographical context or local economic composition that prevent or limit competition; and
- **Policy barriers:** aspects of policy or the regulatory framework that hinder the competitive process.

It is worth being explicit that we recognise that policy and regulation exist for many reasons (such as to safeguard learners from poor quality provision) and that the primary objective in all cases may not be to bring about competition in some parts of the market. Indeed, promoting competition where it is not appropriate could actually lead to inefficiency (such as where the minimum efficient scale of operation means that there is only room for one or two providers). There are also social objectives which are unlikely to be met through a market-based solution, for example, in relation to the role the FE market plays in reaching out to disadvantaged groups who otherwise would not proactively participate in learning.

However, there are some parts of the market where competition and more competitive behaviour would be justified and could work well were it not for particular policy or regulatory barriers.

This chapter begins by introducing how we have classified barriers. It then identifies a set of barriers that are cross-cutting across all features and then goes through a feature by feature identification and analysis of specific barriers.





Classification of barriers

To help policy makers understand the key priorities for attention in the FE market, we have used a relative scale of traffic lights, as shown in

Figure 41 41. This shows four ratings: at the two extremes are red (priority for attention to address significant barriers to a well-functioning market) and green (evidence suggests little cause for concern in the particular geography or market groupings in question). In the middle we have amber/ green (potential for barriers to hinder the well-functioning of the market in some market groupings or geographies); and red/ amber (barriers are hindering the effective functioning of the market in several market groupings or geographies).




This chapter identifies some key areas that have been assessed as green or amber/green and then goes into detail for those areas identified as red or amber/red aspects.

Figure 41. Traffic light rating of barriers

	Amber/ green: potential for barriers to hinder the well-functioning of the market in some market groupings or geographies		Green: evidence suggests little cause for concern in the particular geography or market groupings in question
	Red: a top priority. Significant barriers hinder the effective functioning of the market on a wide-scale.		Red/ amber: barriers are hindering the effective functioning of the market in several market groupings or geographies

Aspects of the market that are working well

Our analysis identified various aspects of the FE system and its sub-markets that display characteristics associated with well-functioning markets. Examples include:

-  **Provider responsiveness:** our analysis suggests that providers are generally very responsive to learners, competitors and policy. Many actively monitor the market to understand learner and employer needs and adapt their FE offer accordingly. And, many providers seek to understand the FE offer of their local competitors.
-  **Learner choice:** in many areas and for many courses, learners have a good range of local choices for FE available for them. Even though the market considered by learners is typically very local, learners generally do appear to exercise some local choice. Typically only 20-30% of learners use their nearest provider..
-  **Ability to expand or change the FE offer:** evidence suggests that providers have adapted their FE offer in recent years. Some have expanded into new areas of provision in response to local demand and policy (such as apprenticeships), and others have actively chosen to withdraw from some forms of provision (such as A'levels) so that they can concentrate on providing other forms of FE.

There are, however, a number of barriers that cut across several of the features we have identified. We have looked into these barriers in more detail below.


Cross-cutting barriers



There are a number of barriers that cut across many of the features we have identified. Specifically, the availability of choice within the “active consumers” feature, the incentives to compete with the “responsive provider” feature and the ability to enter and threat of

failure are all interlinked. Observations of the number of providers within each market as well as the likelihood of new providers entering and failing providers exiting are all driven by a common set of structural and policy barriers. We consider these barriers in Table 10.

Our analysis suggests that there are some markets in which learners have a very limited choice of alternatives. In some cases, this can be entirely the ‘right’ market outcome because the nature of the investment involved, and the number of potential learners means that only a single provider can be supported by the market. However, in other cases this can be a cause for concern.

Table 10. Availability of alternative competing providers

		Structural barriers	Policy barriers
Barriers to entry		<ul style="list-style-type: none"> Natural monopolies or lack of alternative providers – economies of scale coupled with low market demand relative to the minimum efficient size of the provider can act as a barrier to entry. Large, predominantly sunk investment costs generate a barrier to entry in markets where they are fixed and difficult to recover post-entry (these include up front administrative costs, recruitment and staff training costs, market intelligence costs and reputation building costs). This is a particular issue for capital intensive parts of the FE market with very specific assets or college based provision where reputation and history can play a key role in learner recruitment. Pension regulations for Colleges as defined in the 1992 Further and Higher Education Act can also represent significant liabilities for Colleges, acting as both a barrier to entry and exit. Staff shortages in some areas (particularly those where providers must compete against other teaching professions and the trade/industry for staff) can limit entry into some parts of the market Local economy – the availability of apprenticeships as well as the demand for other types of vocational training is very dependent on the composition of the local economy. Cost of switching Awarding Body can limit entry into some parts of the market 	<ul style="list-style-type: none"> Lack of direct SFA contracts - access to direct contracts is limited because there are very few if any new direct contracts and current direct contracts roll on as long as providers meet minimum standards. Historic reluctance to close a college creating a barrier to entry as new entrants would not have confidence that they would be able to displace the incumbent.



	Structural barriers	Policy barriers
Level playing field	 <ul style="list-style-type: none"> Narrow focus of some providers: the risk of not being able to adequately respond to or manage policy changes can be greater for smaller providers. For example, if policy priorities shift funding away from their core areas of business. 	<ul style="list-style-type: none"> Historic reluctance to close a college with colleges receiving much greater support than independent providers to avoid closure. Ability of those with direct contracts to use subcontracting as a means of propping themselves up in the event of poor performance. Differential VAT regime – Schools 6th Forms benefit from preferential VAT regime compared to Sixth Form Colleges and General FE Colleges.
Barriers to exit	 <ul style="list-style-type: none"> Pension regulations for Colleges as defined in the 1992 Further and Higher Education Act can lead to significant pension liabilities for Colleges, acting as both a barrier to entry and exit. There are also no formal administration and insolvency procedures for Colleges – this lack of clarity over the process could be a barrier to exit 	<ul style="list-style-type: none"> Lack of formal requirement to secure continuity of provision for learners upon exit can increase reluctance to allow exit of large providers – this is a barrier to exit. College assets must only be used for educational purposes.

Barriers for active consumers

As we saw in Chapter 0, there are a number of aspects of the market that act as barriers facing learners and employers that prevent them from being ‘active’. This is in terms of their availability of choice (for example, whether they have a number of providers to choose from for the course they want to do); awareness of choice (the extent to which they are aware that they have choices); accessibility to information (in particular, whether they are able to access impartial, timely and accurate information of the form that will help them make choices in their own best interests); and, confidence and ability to make decisions. We have covered availability of choice in the cross-cutting issues above, so we do not consider it separately here.

A summary of the other barriers to active consumers is in Table 11.




Table 11. Barriers to active consumers

	Structural barriers	Policy barriers
Awareness of choice/ access to information 	<ul style="list-style-type: none"> Limited direct communication between employers and learners and lack of access to workplace meaning learners may not be aware of all their options or potential career paths. Too much information available on the internet can confuse learners about who to trust. Reliance on informal channels of advice (families, guardians, peers) so perceived choice may be lower. Lack of impartial advice from schools (they have the incentive to retain learners) which could restrict learners' awareness of choice Lack of information to certain groups, such as employees in low paid work, limiting awareness of choice e.g. National Careers Service focuses on disadvantaged groups. 	<ul style="list-style-type: none"> Poorly targeted information – available information needs to be better targeted to be appropriate for different learners (e.g. employment rates, salaries). Lack of awareness of some employers of options relating to apprenticeships.
Confidence and ability to make decisions 	<ul style="list-style-type: none"> Inability to judge quality or relevance of course can limit ability to make informed decisions. Individuals not actively seeking to participate: some disadvantaged groups are below the radar of the FE market. 	<ul style="list-style-type: none"> Lack of guidance and support to learners when making choices. Others decide on learners' behalf – e.g. JobCentre Plus mentors select the provider; some employers choose the provider for their employees.

Barriers for responsive providers

As we saw in Chapter 0, responsive providers play an important role in ensuring that the market functions well. In many areas of the FE market, we have observed that there are often strong incentives for providers to be responsive. These incentives are created by competitors as well as by government directly. However, our analysis has also highlighted a number of barriers to providers being responsive as shown in Table 12.

Table 12. Barriers to responsive providers




	Structural barriers	Policy barriers
Ability to respond to learners and employers 	<ul style="list-style-type: none"> • Size of provider – smaller providers could find it more difficult to make significant changes to FE offer • Staff shortages - can hinder the ability to provide those courses despite demand • High costs of changing awarding bodies – providers need to invest significant resources to re-train staff, purchase new teaching equipment 	<ul style="list-style-type: none"> • Difficulty in gaining awarding body status can hinder ability to respond to employer needs • One year funding allocations make it difficult to plan ahead and can deter investment to better respond to learner or employer demand. • SFA contracts for independent providers are capped and therefore it is difficult for providers to respond to changes in demand as they are not funded for any provision in excess of the cap.
Ability to respond to competitors 	<ul style="list-style-type: none"> • Natural monopolies and a minimum efficient scale can put some providers at a natural cost advantage • Large, predominantly sunk investment costs could hinder the responsiveness of providers to enter new segments of the market. Particularly an issue for capital intensive parts of the market with very specific assets or where reputation and history can play a key role in learner recruitment. 	<ul style="list-style-type: none"> • Funding allocations are based on the previous year's activity so where providers spot a market opportunity, in some cases it may not be straightforward to respond because funding will only change with a lag. • Multiple funding bodies - it may be difficult to change from focusing on one group of learners to another because of a required shift in funding streams e.g. EFA fund 16-19 year olds but SFA funds 19+
Ability to respond to policy 	<ul style="list-style-type: none"> • Local employment markets – composition of local employers may limit provider's ability to respond to policy incentives, such as a shift to apprenticeships or to deliver 24+ Advanced Learner Loans • Underutilised or stranded assets - it can be difficult for providers to respond to policy incentives to shift to, for example, apprenticeships, if it leaves under-utilised or stranded assets from previous capital investments 	<ul style="list-style-type: none"> • Apprenticeships are only available as full time jobs (30 hours or more) which may limit attractiveness for some learners, making it hard for providers to recruit them

Challenges for policy and regulation

As we saw in Chapter 9, policy plays an important role in ensuring that the market works effectively but also recognising where competition is not appropriate and providing alternative incentives for efficiency and quality. It also acts as a safeguard to learners.

Our analysis has also highlighted a number of challenges for policy and regulation in this context, as shown in Table 13.

Table 13. Policy and regulation challenges

Challenges for policy and regulation	
Ability to enable competitive pressures	 <ul style="list-style-type: none"> • Lack of requirement for schools to provide impartial advice and guidance on the full range of options open to learners • Lack of targeting of public information sources towards the needs of different learner groups – lots of information is available (e.g. FE Choices) but could be improved • Lack of rewards for activities to reach out to disadvantaged groups – the funding system and quality assessments do not reward out-reach work with learners who may have lower retention rates • Single year funding allocations and little advanced notice of the next year's funding hinder longer-term planning and innovation • Funding system hinders new entry and competition in the market as direct contracts roll-on (as long as minimum standards are met) • Difficulty for FE providers to become awarding bodies could hinder innovation and ability for providers to meet employers' needs
Supplementing competitive pressures	 <ul style="list-style-type: none"> • Lack of regulatory framework to address any natural monopolies (economies of scale in provision coupled with low demand) • Lack of recognition in funding for the role of minimum efficient scale • Absence of systematic promotion of coordination of provision where minimum efficient scale means multiple providers would not be efficient, and without co-ordination, may lead to gaps
Safeguarding consumers	 <ul style="list-style-type: none"> • Lack of transparency around mechanisms to ensure quality of sub-contractors and workplace based training • Lack of appropriate security of provision for learners in the event of exit of providers – many learners are currently left stranded. SFA only helps find alternative where direct contractors fail. • Lack of transparency and knowledge about interdependencies in the market caused by sub-contracting – this could lead to the impacts of a failure cascading widely to others in the market

Concluding remarks

The in-depth analysis undertaken for this study has found that in many areas of the FE market, we observe characteristics that are consistent with a well-functioning market. A key objective for policy is to therefore facilitate the continuation of what is working well and to identify those areas where there is a need for policy intervention. Some of the key policy implications are:

- **Recognising the limitations of competition in the FE market:** we have shown that in some cases, there is limited choice for learners and there are few competing providers. This could reduce the incentive for provision to be innovative and efficient. However, in some cases competition would not be likely to lead to the best outcomes for learners and employers because the market dynamics make competition (involving several providers) unviable. In such cases, alternative mechanisms for incentivising efficiency, quality and innovation are likely to be worthwhile.
- **Addressing barriers to active consumers:** Our work suggests that learner decision-making is extremely complex and localised and choices may not always lead to the best further education or labour market outcomes for learners. The decision as to whether to participate in FE at all poses a particular problem for some key groups. Key issues include ensuring young people at school have access to impartial advice; engaging groups who might not otherwise participate in FE (often considered 'hard to reach'); and strengthening the links between potential learners and employers.
- **Addressing barriers to responsive providers:** our analysis suggests variability in the extent to which providers are responsive to learners, employers, other providers with whom they compete and government (often a primary source of funding). This is often expected within a market as some providers will be subject to more pressures than others and some will be better able to respond, with poorer providers entering financial difficulties. The route to exit of poor providers must be clear but must also ensure that learners are not stranded without provision. The intervention process for all providers must be transparent, based on the same principles and create the incentive to deliver high quality FE efficiently. In addition, quality assessments must be appropriate and timely; and funding should not unduly inhibit flexibility to local market conditions or hinder changes to provision where there is local, regional or national demand.
- **Addressing wider policy and regulatory challenges:** policy has a significant impact on the way the market operates, whether through funding, quality assessments or procedures for contracting. Sub-contracting offers clear value to providers and learners but aspects of it are not currently well understood, such as the interdependencies this creates across the FE market. Issues identified in this study include a lack of appropriately targeted impartial information for different learner groups; impacts of the funding market on the responsiveness of providers (such as short lead times for funding allocations) and the impacts of local structural barriers on the ability of providers and employers to respond to national policy signals.

Annex 1: Stakeholders

We are very grateful to the following stakeholder for taking the time to be interviewed for this study (some more than once).

Table 14. List of stakeholders (Critical Friends highlighted)

Name	Organisation
Learners	
David Hughes	NIACE (Chief Exec)
Rosie Cantrell	Careers Yorkshire and Humber
John Endersby	Futures Advice
Professor Anthony Mann	Employment and Education Task Force
Helen Robinson	Prospects
Employers	
David Russell	Education and Training Foundation
Olivia Dorricott	Education and Training Foundation
Mark Froud	Federation for Industry Sector Skills & Standards (MD)
Adam Powell	Director of Skills West of England LEP
Steve Besley	Pearson - head of policy
Paul Turnbull	SEMTA
Gary Hewitt	Bosch Automotive Service Solutions
Susan McClean	Kimberley Clark
Jacqueline Kawczak	United Utilities
Simon Nokes	New Economy Manchester
Claire Bowie	Sheffield City Region
Providers	
Julian Gravatt	Association of Colleges (Chief Exec)
Stewart Segal	Association of Employers and Learning Providers (Chief Exec)
Lynsi Hayward-Smith	HOLEX and Local Education Authority Forum for the Education of Adults
David Mc Millan	Vice principal Burton and South Derbyshire College
John Callaghan	Principal and Chief Executive of Solihull College and Chair of the Funding External Technical Advisory Group
Sue Dare	Principal of Northbrook College and Chair of the Qualification Advisory Group
Debbie Gardiner	Chief Exec Qube Learning
Jo North	Chief Executive, IntouchCare, Sheffield
Roger Peace	CEO Learn Direct
Ruth Spellman	Workers Education Association
Andrew Cleaves	Principal Birmingham metropolitan college
Tim Ward	CEO The Learning Curve
Sue Rimmer	Principal, South Thames College
Carole Kitching	Principal Newcastle College
Brenda Mcleish	Managing Director: Learning Curve Group
Wider stakeholders	
Kirsty Evans	Skills Funding Agency
Una Bennett	Skills Funding Agency
Steve Robinson	BIS
Jon Howlin	BIS
Phil Lacey	BIS
Helen Kaczmarek	BIS
David Massey	UKCES
Susannah Constable	UKCES

Name	Organisation
Michael Davis	Chief Exec - UKCES
Dr David Collins	FE Commissioner
Prof Lorna Unwin	Institute of Education UCL (vocational education)
Jeremy Benson	Ofqual
Catherine Christie	Education Funding Agency
Mark Dawe	OCR (Chief Exec)
Prof Ewart Keep	Oxford University
Marina Gaze	Ofsted



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BIS/16/360