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Evaluation of the Teaching Funding Method

Report to HEFCE by SQW Ltd

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Executive summary

Introduction

1. This is a summary of an evaluation of the Teaching (T) Funding Method, commissioned by HEFCE, and undertaken by SQW Limited. This evaluation is intended to contribute to an evidence base to inform the proposed consultation on possible changes in the funding methodology. The main fieldwork task was consultations with 28 Higher Education Institutions (HEIs) and Further Education Colleges (FECs) most of which were undertaken during January and February 2005.

Key findings

2. The majority of the T grant is awarded as a block grant and institutions have, in principle, considerable control over how the grant is spent. This provides institutions with some, welcomed, flexibility. However, they tend to see the Teaching Funding Method (TFM) as a budget constraint which they need to reflect in their internal budget allocations.
3. The TFM generally facilitates prediction of teaching grant allocations by HEIs provided they are able to predict student numbers with some accuracy. Some institutions, however, have experienced difficulties recently because of changes in various characteristics and parameters of the TFM.
4. The changes from initial projections have been, in most cases, a relatively small percentage of an institution's total T grant. However, for most HEIs, with limited reserves, marginal changes in grant can force quite significant departures from plans.
5. The tolerance band introduces an important, and widely welcomed, element of stability to the funding system. However, a minority of those consulted felt the band should be narrower.
6. The concept of supporting growth through Additional Student Numbers (ASNs) is acceptable to most HEIs. However, some of those consulted identified difficulties with the way the system is implemented in practice. In part, these reflect the recent focus on Foundation Degrees since many HEIs have decided not to offer Foundation Degrees. But concerns were also raised in relation to: the management burden imposed by competitive bidding (separate bids in some cases) for capital funds; the timing of announcement of awards.

7. The last HEFCE consultation on the TFM elicited views on the price groups and many of these points were reiterated during our consultations.
8. There is a general preference for the special initiative funding to be minimised in order to: increase predictability; reduce bidding costs; and to give institutions greater flexibility over the allocation of T grant.
9. Both the Part-time (PT) premium and Widening Participation (WP) funding are welcomed by almost all institutions. However, institutions for which these modes were important were universally of the view that the funds did not meet the additional costs incurred. It is, however, difficult to assess whether changes in WP funding would materially influence behaviour. Many of the institutions which felt funding was inadequate are committed to WP and this is a major market for them. Changes in funding are, therefore, unlikely to influence recruitment strategies. However, the increases in funding have led to greater investment and are therefore likely to increase both the quality of student experience and assist in keeping retention rates high.
10. The treatment of non-completion is probably the most controversial aspect of the TFM, at least amongst those institutions which are intensively involved in WP. The problems which institutions identified include: the TFM provides no funding for students who, say, complete all but one module during the year; the institution may have added significant value which is ignored by the current TFM; the completion measure may be inconsistent with academic regulations which permit a student to progress to the next year even though they may have not completed a module. One effect is that students with a higher than average propensity to not complete are viewed as high risk and, as a result, some institutions have become increasingly careful over the types of students they are seeking to recruit.
11. For some institutions compiling statistical returns, and reconciling HESES and HESA returns, can be burdensome. There was, however, little enthusiasm for basing T grant allocations on (earlier) HESA returns alone.
12. Many of the issues already discussed apply to *directly* funded FECs. There are also specific issues relating to these institutions, which in part derive from their relatively small scale. In particular: limited scope to manage T grant as a block grant; no, or restricted access to, special initiative and capital funding.

13. Those FECs with *indirect* funding arrangements have a different relationship to the TFM but it is an important consideration in negotiations with their Higher Education (HE) partner(s). Franchise arrangements have been a key factor in WP and Foundation Degree developments, and we encountered quite diverse experiences during consultations. There are examples of such arrangements working very well but also cases where the FEC believes it is gaining little, if anything from the arrangement. The two key problems appear to be: a very wide range of payments from the HEI to the FEC, which have been documented elsewhere; and a lack of any real partnership in some cases.

Conclusions

Best use of public money

14. A key principle of the TFM is that T grant is allocated as a block grant for institutions to decide on how it is spent. The obligation is therefore placed on institutions to decide on the best use of public money and how learning experiences can be enhanced. This flexibility is welcomed, and exploited, by institutions, but is also restricted by competition between institutions and the need to ensure that subject areas receive adequate investment.

Diversity of provision

15. The standard Unit of Resource (UoR) is the same for each institution within each cost band. In this sense, the TFM permits diversity but it does not explicitly recognise the different costs of different provision. The TFM does, however, directly reward diversity through some special funding elements and premiums. Those for WP (and PT) provision have assisted HEIs for whom WP is an important part of their mission. There is a widespread view within the sector that funding does not reflect the true costs of WP but they do represent an addition to resources for those engaged in WP.
16. The premium for specialist institutions explicitly recognises, and sustains, institutions that have distinctive approaches to teaching. However, this is restricted to a relatively small number of institutions. Many other HEIs would also claim distinctiveness, and higher costs, which are not reflected in the TFM.

Interests of employers and the Government

17. Employers' interests are not directly reflected in the TFM, although the most recent round of bidding for ASNs was mainly restricted to Foundation Degrees which require employer involvement and reflect their needs more directly.

18. The TFM offers more scope to reflect government needs. The TFM offers considerable scope to influence behaviour through changes in the price groups and the introduction of premiums and special funding. However, any changes in these basic parameters reduce the predictability of funding which is one of the strengths of the TFM. The premiums are potentially a means for the Funding Council to have a direct impact on institutional behaviour, but any increase in their relative importance means a reduction in the flexibility institutions have to implement their own strategies.

To promote quality

19. The TFM does not reflect directly any assessment of quality, other than that Quality Assurance Agency for Higher Education (QAA) requirements should be met. Quality factors enter indirectly, but it is difficult to see these as having a pervasive impact on teaching quality. The TFM is thus largely reliant on the professionalism of the institutions.

Openness

20. It is difficult to see how the TFM could be more transparent and open. The method for calculating allocations is well documented and has been the subject of a recent consultation exercise.

Predictability

21. Provided there are no changes in the parameters of the TFM and as long as institutions are able to make accurate projections of student numbers then funding is highly predictable. There have, however, been recent changes in the TFM which have significantly reduced predictability.

Fairness

22. The key drivers in the TFM are student numbers and price groups, and these impose conformity in funding. Variations, to a large extent, reflect positions in the tolerance band. The main caveats concern premiums, but both small and specialist premiums account for a relatively small part of the total T grant.

Limited burden on institutions

23. We believe the TFM scores highly in this respect. The main burden relates to the provision of HESSES data, and later reconciliations with HESA returns, and most of those we consulted were comfortable with HEFCE requirements.

Overview

24. The current TFM is an attempt to resolve tensions, and sometimes conflicting objectives, in the system. The Funding Council is responsible for ensuring that public money is spent effectively while at the same time promoting quality (in all areas of HE) and reflecting government priorities. The Council has a limited statutory scope to act as a planning body, and the process for allocating T grant, therefore, permits institutions flexibility in how they spend the grant. For reasons given elsewhere in this report this flexibility is restricted in practice, and there is also a tension between seeking to reflect government priorities and the scope for discretionary actions which institutions have.
25. There are also important administrative considerations. Many of the issues which HEIs identified during this study could only be resolved by a much more finely grained TFM which would, we believe, increase the burden on both the sector and the Funding Council of implementing the TFM. In addition, more detail in the TFM implies less flexibility for institutions to manage their T grants.
26. Our overall conclusion is that the current TFM has achieved a good balance of these various tensions and objectives with two main qualifications. The first is mainly concerned with the way in which the TFM has been implemented rather than the parameters and structures of the method. Specifically, changes in premiums and price groups have reduced predictability and created difficulties for some HEIs. We note, however, that most of the problems identified in this respect relate to the most recent changes only; comparatively few consultations identified this as a systemic problem.
27. The second qualification concerns detailed aspects, in particular the levels of WP funding and PT premium and the treatment of non-completion. These were widely thought to be inadequate and/or problematic. These issues are relatively more important to those HEIs which are recruiting non-traditional students.

1 Introduction

1.1 SQW was commissioned in December 2004 by the Higher Education Funding Council for England (HEFCE) to undertake an evaluation of the Teaching Funding Method (TFM). This evaluation is intended to contribute to an evidence base to inform the proposed consultation on possible changes in the funding. The objectives of the evaluation were to:

- evaluate the extent to which the current HEFCE Teaching Funding Method has met HEFCE's stated intentions
- identify and evaluate the extent to which the current method has produced any unintended and/or undesirable effects on the sector
- comment on any other issues arising in relation to the operation of the method that may be relevant to the development of the Council's future policy on its teaching funding method.

1.2 The evaluation was managed by a Steering Group of HEFCE staff as part of the more general review of the TFM which HEFCE is undertaking. The steering group was advised by Jim Port of JM Consulting.

1.3 Initial work involved a review of previous HEFCE literature, studies, consultations and evaluations and analyses of the statistics relevant to HEFCE's funding for teaching. The main field work began in mid January 2005. Interviews were undertaken over the period up to the beginning of March with a sample of institutions and other stakeholders including:

- HEIs with differing levels of research intensity
- HEIs of different sizes
- HEIs with differing levels of activity in relation to widening participation
- pre and post 1992 institutions
- specialist and non-specialist institutions

- institutions that have been subject to rapid changes in teaching funding
- Further Education Colleges delivering higher education funded directly by HEFCE
- Further Education Colleges delivering higher education franchised through one or more universities
- HEIs delivering Further Education
- a range of stakeholder bodies such as the Association of Heads of University Administration , Association of Colleges, British Universities Finance Directors Group, Department for Education and Skills, Standing Conference of Principals and Universities UK
- HEFCE staff.

1.4 Consultations were undertaken with 28 institutions and, typically, involved face to face interviews with several different functions within each organisation including:

- the Vice Chancellor/Principal
- deputy Vice Chancellor/deputy Principal
- registrar
- finance director
- director of learning
- director of planning
- deans of faculties/heads of departments
- director of quality/information/statistics.

1.5 These interviews with institutions were structured using a standard aide-memoire, sent to interviewees in advance, with an accompanying introductory letter from the Chief Executive of HEFCE. Interviews with other stakeholders and HEFCE regional staff were structured using a separate aide-memoire. We are most grateful to all those who gave their time, at short notice, in order to enable us to complete the work within the specified time frame.

- 1.6 During the course of the evaluation meetings were held with the Steering Group and with the client group. The interim results and initial conclusions were discussed at a workshop organised by HEFCE in March 2005 which was attended by some fifty staff from the institutions visited during the fieldwork phase. A short paper was prepared for this workshop and presentations were given by SQW on the initial findings and conclusions. The break out groups and plenary discussions provided an opportunity to test whether there were any other issues related to the TFM that had not been addressed and to validate the emerging findings and conclusions. A draft report was submitted to HEFCE in the middle of March and this final report incorporates feedback from HEFCE.
- 1.7 This report is an interpretation and analysis, by SQW Limited, of the views expressed by institutions during the evaluation. These institutions have not had an opportunity to review the report prior to publication and the views expressed are not necessarily those of HEFCE.

2 Outline of the Teaching Funding Method

Introduction

2.1 The majority of readers of this report will be familiar with the methods used for funding higher education teaching in England. For those who are unfamiliar with the Teaching Funding Method (TFM) or who would like to check their understanding of it, we have set out a brief, simplified outline of the key features in this Chapter¹.

2.2 Funds are distributed by HEFCE to meet four broad aims:

- to make the best possible use of public money
- to recognise and encourage diversity in provision and in the range of students
- to respond to the interests of employers and the Government
- to promote quality in teaching and learning.

2.3 The key features of the TFM are intended to incorporate:

- openness
- predictability
- flexibility
- fairness
- efficiency. Efficiency in this context refers to the burden imposed on Higher Education Institutions (HEIs) which should be as small as possible.

Important elements of principle

2.4 The TFM is used to allocate funds from a sum which is fixed in any given year by the Government. The TFM does not therefore have any role to play in determining the total amount of funds available.

¹ A full account can be found in documents available on the HEFCE web site www.hefce.ac.uk. See in particular, *Funding higher education in England: How HEFCE allocates its funds*, May 2004/23.

- 2.5 Funds are provided to institutions in a block grant which they are able to distribute internally at their discretion.
- 2.6 Grants are calculated largely on the basis of the *number* of students studying at any given institution.
- 2.7 Other features of institutions, of the subjects they teach, and of the students themselves are introduced into the calculation in an attempt to make the final allocations meet the aims set out above.
- 2.8 Special initiative budgets are set up from time to time. These are also drawn from the fixed sum determined by the Government and are top-sliced before institutional grants are calculated. A range of methods is used for the allocation of special initiative budgets to institutions.
- 2.9 The block grant principle is intended to make it possible for individual institutions to meet their own missions and objectives, constrained, of course, by the total budget they receive. Institutions do not always find that as straightforward in practice as the principle might imply.

The grant calculation

- 2.10 There are four stages to the grant calculation:
- (1) A '*standard resource*' is calculated for each institution. This is based on the number of students in the institution plus subject related factors, student related factors and institution related factors.
 - (2) An '*assumed resource*' is calculated for each institution. This is the sum the institution was paid by HEFCE in the previous year, adjusted for inflation, assumptions about fee income and similar factors.
 - (3) The standard and assumed resources are compared and the percentage difference between them is calculated.
 - (4) If the percentage difference is less than plus or minus 5%, i.e. the assumed resource is within a 10% *tolerance band* of the standard resource, the institution's grant is carried forward from one year to the next. If the assumed resource falls outside this tolerance band HEFCE will take some action.
- 2.11 In principle, the standard resource calculation takes into account the size of the institution and any factors it faces which have implications for its grant. The assumed resource is

largely derived from the income the institution has received in the past and, unless the assumed and standard resources are significantly different from each other, the institution can work on the principle that there is stability in its grant. The grant will flow forward from one year to the next.

The devil is in the detail

- 2.12 At stage one, calculating the standard resource, student numbers are weighted according to four broad subject groups, referred to by HEFCE as *price groups*. The price groups reflect broad differences in cost between subject areas. Medical students, for example are weighted four times as heavily as Economics students. The price groups ensure that institutions with heavy laboratory-based costs, or other subject-related costs, have, in principle, extra funding to take that into account.
- 2.13 *Student factors* are also taken into account at stage one to reflect the extra costs incurred in recruiting, retaining and teaching students with different characteristics. These include premiums for part-time students, for students on Foundation Degrees and for students studying courses which extend beyond the conventional academic year.
- 2.14 Stage one also includes a calculation based on *institutional factors*. Premiums are given to reflect additional costs incurred by small HE institutions (defined as institutions with 1,000 full-time equivalent (FTE) students or fewer), by those HE institutions responsible for historic buildings, and by institutions located in London. Specialist HE institutions (with 60% or more of their courses in one or two subjects only) are also given extra support through additional premiums.

- 2.15 Stability or predictability in the grant is a major intended feature of the TFM. The relationship between the assumed resource and the standard resource is the key factor. Where the two are close in size the grant carries forward. When assumed resource is more than 5% greater than standard resource, HEFCE will adjust the grant so that it comes back into the tolerance band. When the assumed resource falls below minus 5% of standard resource, the institution may be asked to adjust its student numbers. Institutions therefore focus on remaining within the tolerance band. If they are near the bottom of the band, their 'unit of resource' (income per student) is low for their level of activity; if they find themselves near the top of the band their unit of resource is high for their level of activity. All other things being equal, a high unit of resource is desirable for the institution, although some may want to increase total income by recruiting more 'fees-only' students. But, HEIs are anxious to avoid cuts in grant which occur when they move out of the top of the band. The band is asymmetrical in that sense. The penalties for moving out of the top of the band are more severe for the institution than those for falling out of the bottom.

Other features

- 2.16 In addition to the basic grant arrangements set out above, there are a number of other features through which grants are adjusted or allocated.

Special initiatives

- 2.17 HEFCE reflects changing government priorities by establishing special initiative budgets, which are top-sliced from the fixed sum determined by Government. They reduce the amount of grant available for distribution by the formula described earlier.
- 2.18 Special initiative funds are allocated differently depending on the particular project, for example, the recent initiative to establish Centres for Excellence in Teaching and Learning (CETLs) was allocated through a bidding process (and were additional, not top sliced from core funds), but widening participation funds are allocated according to measures of educational deprivation (which have changed during the life of the initiative).

Additional Student Numbers

- 2.19 The formula funding forming the core of the TFM is essentially retrospective. It provides stability and is based on student numbers already in the HE system.

- 2.20 Prospective funding is provided through awarding Additional Student Numbers (ASNs) to HEIs which bid successfully for them. ASNs tend to be relatively small scale, and only around 35% of HEIs bidding are typically awarded additional numbers. The additional numbers are sometimes restricted to particular subject areas or areas which are favoured for development such as Foundation Degrees.
- 2.21 The significance of ASNs is that they add to the numbers which go into calculations of the institutions' standard resource and provide real cash increases in grant income. HEIs are able to take extra students at any time but will not receive extra funding for them (except for the fees paid by the students themselves) unless the extra numbers form part of an ASN allocation. Such fees-only (home/EU) students therefore reduce the institution's unit of resource – its average income per student – and may result in the institution moving out of the bottom of the tolerance band. ASNs, conversely, allow for funded growth.
- 2.22 Institutions which fail to deliver, over a defined period, additional student FTEs in line with bids will have the funding for shortfalls in students withdrawn. However, institutions are not required to recruit additional FTEs to the same programme areas for which ASNs have been awarded and funds will not be withdrawn provided total FTEs increase in line with bids for ASNs.

Completion

- 2.23 Student numbers are clearly a key factor in the scale of an institution's grant. Institutions wish to stay within the tolerance band and to achieve a unit of resource which enables them to carry out their work effectively. Expansion in the system is largely driven by Additional Student Numbers.
- 2.24 Public accountability responsibilities require careful assessment of whether or not agreed student numbers are delivered (for which institutions send in an aggregate data return to HEFCE and an individualised student record to HESA/LSC each year). However, this is not as straightforward as it sounds. Students may drop out of a course in one year and complete it the next, for example, or they may move from full-time to part-time study during the year. As the characteristics of the student body become more diverse, and economic demands upon them change, it is difficult to define a typical student. At the same time course provision and mode of study is becoming increasingly flexible to meet the needs of students. Nevertheless clear definitions of students are required for grant allocation purposes.

2.25 Currently institutions are funded for each student who completes the 'contract' s/he has entered into with the institution. Students register for a course or programme of study. If they complete their year of study they count as fundable students. The definition of completion is that the student has either attempted (but not necessarily passed) the final piece of assessed work for each module on the course, or passed the modules in some other way. Students who study during the year but fail to attempt the last assessment are not funded, unless they have already passed the modules for the course.

Moderation

2.26 HEFCE phases in changes in grant to institutions that would otherwise be affected by large fluctuations in income.

Summary

- teaching funds are provided in a block grant for each institution taken from a fixed sum determined by Government
- funds are calculated on the basis of weighted student numbers plus specific institutional features
- institutions aim to achieve an average unit of resource within a 10% tolerance band
- special initiatives and additional student numbers provide opportunities for growth and work in new areas which reflect government policy priorities.

3 The impact of the TFM on institutions: Overview

Introduction

- 3.1 As discussed in Chapter 2, the details of the TFM, and the way it has been implemented, have been major influences on its impacts. However, it is important to understand how HEIs relate to the TFM at a more general level and this is discussed in the current Chapter.

Block grant and internal allocations

- 3.2 A key element of the TFM is that the majority of the T grant is awarded as a block grant and institutions have, in principle, considerable control over how the grant is spent. There is no requirement to allocate to subjects in the same proportion as the grant is calculated nor, indeed, to spend T grant on teaching and learning activities. This does provide institutions with some flexibility to determine their own missions and strategies and this is universally welcomed, at least amongst the institutions we consulted. Nevertheless, all the HEIs we consulted reflect, to varying degrees, the TFM in their internal allocation models. Few replicate the TFM exactly², but most reflect closely student numbers³ and/or movement of subjects between price groups are likely to have a direct impact on schools⁴.
- 3.3 Some elements are typically not replicated internally, in particular:
- the tolerance band is not applied automatically, so that changes in student numbers generally feed into schools' revenues. However, as is discussed further below, institutions sometimes moderate the impact of unexpected changes in recruitment on individual schools

² All institutions, of course, retain some element of T grant centrally to cover institutional overheads. Those we consulted either top-slice T grant prior to internal allocation or 'tax' schools/faculties after internal allocation.

³ Central management will impose controls on recruitment of 'fees only students'.

⁴ 'Schools' is used generally to refer to whatever level budgets are devolved to: faculties; departments; and schools. Schools will often have discretion over how they allocate T (and other HEFCE grants) internally so that even if internal allocation models mirror the TFM, the final allocation of resources may still differ.

- premiums, and other special funds, are not always passed on to schools as separate allocations, but instead consolidated into funding per student. This is often the case with the WP funding, and sometimes also the PT premium. The rationale is usually that WP is part of the institution’s mission across all programmes and would therefore apply equally to all schools. In addition, the complexity of calculating WP funding on a schools basis is not considered worthwhile.

3.4 Institutions can, and do, depart from the TFM and we encountered three main ways in which this happens

- as mentioned above, temporary assistance to schools following changes in the TFM. Some HEIs consulted, for example, did not implement the recent changes in price groups immediately even though internal allocations would normally dictate this. Some will postpone, or reduce, funding reductions if student recruitment targets are not met. In both cases the aim is to assist transition
- subsidy for teaching programmes which are above average cost for the price group. Several HEIs consulted claimed their teaching methods were distinctive and higher cost in comparison with similarly titled degrees at other HEIs. In some cases there may be cross-subsidisation between subjects in the same price group, but in others the claim was more general, for example greater emphasis on lab-based as opposed to classroom-based teaching across all “Science Engineering and Technology” (SET) subjects
- in part, related to the last point, provision of programmes which are ‘loss-making’ on the basis of the TFM across the sector as a whole.

3.5 We think it is fair to say that the Funding Council and individual institutions tend to see the issue of block grant and institutional flexibility in different ways. The Council views the block grant mechanism as giving institutions considerable flexibility to provide subjects, and modes of delivery, in line with their missions and strategies. Institutions tend to see the TFM as a budget constraint which they need to reflect in their internal allocations. As is discussed further below, the real flexibility which institutions have depends on several factors, notably alternative income sources, but there are in practice quite powerful pressures on institutions to reflect the TFM.

- 3.6 First, they operate in competitive markets for students. A decision to allocate more than the TFM calculation to a given subject means, all other things being equal, allocating less to another. If an institution continues to allocate less than its competitors to a given subject area it will become less competitive, probably first through a reduction in staff and facilities and eventually through student and other stakeholder perceptions of the quality of the programme.
- 3.7 Second, the TFM is extensively documented and transparent and, while not universally understood, academic managers perceive a clear link between their school activities and the institution's T grant. This inevitably creates pressures within an institution to reward schools on a basis which reflects the TFM. Central management's role is to define and implement institutional strategies, but in large and complex organisations one element of this is to provide clear incentives to academic managers which are aligned with the constraints and opportunities which the institution as a whole faces. There are, therefore, sound management reasons, as well as internal pressures, to reflect the TFM in internal allocations.
- 3.8 These points illustrate some capacity for HEIs to invest in strategic priorities within the constraints of the TFM. Their ability to do so is limited by competitive and other pressures described above but, obviously, also by alternative income sources. Many consulted drew attention to the importance of research income, or more accurately research intensity, in relation to teaching. Two points in particular emerged:
- the ability to share resources, both staff and equipment, between teaching and research activities⁵. This also enables research intensive universities to provide a distinctive type of education
 - access to substantial capital funding, most notably through HEFCE's Science Research Investment Fund.
- 3.9 History, however, is also important and those HEIs which have significant endowment income, and/or have comfortable levels of financial reserves have been better placed to implement their own strategies.

⁵ It should be noted that some of the recent closures of science departments have been attributed to a failure to achieve a RAE 5 grade together with high teaching costs, rather than student recruitment difficulties.

Predicting TFM

- 3.10 One of the strengths, in principle, of a formula-based funding method is the predictability it enables. No funding method can be entirely predictable because institutional outcomes will depend on the total HE grant and its distribution between teaching, research and other activities. In addition, since the total T grant is fixed in any year, the allocation to one institution will depend on the activities of all others to at least some extent.
- 3.11 The current TFM provides for predictable outcomes because:
- provided the assumed resource is within +/-5% of the standard resource, institutions will receive the previous year's T grant together with any change to reflect real increases or decreases in the overall grant. Institutions generally have a good idea of what the latter will be by the end of the previous calendar year to which the T grant relates
 - clawbacks in grant relate mainly to any failure to recruit target ASNs for institutions which remain within the tolerance band
 - the outcomes of the TFM are moderated by HEFCE to ensure that institutions do not experience radical decreases in grant on a year to year basis. No institutions, for example, received a decrease in real T grant following the most recent changes to the TFM.
- 3.12 Given this framework, and provided the TFM is stable, predictability in funding is largely a question of accurate prediction of student numbers. Several of the HEIs we consulted had little difficulty in predicting their T grant, and some of those which did, acknowledged that this reflected weaknesses in predicting, and tracking, student numbers. However, there are three points to make in this respect.
- 3.13 First, predicting student numbers is far simpler for those HEIs with excess demand for student places – so-called 'selecting universities'. The main issue for these institutions is to ensure that they do not over recruit. Admissions tutors have become quite expert in this respect, and it is relatively easy for these institutions to set and adjust offers in the light of applications so that targets are met. Those institutions which are not facing excess demand find it more difficult to predict recruitment. They are often seeking to recruit non-traditional students whose decision on whether or not to enter HE is subject to a wider range of influences than those entering straight from school, and their (non-HE) options are also wider.

3.14 Second, the TFM has not been entirely stable, and various characteristics and parameters have been altered to reflect policy decisions. Many of our consultations with HEI staff reflected the most recent changes and two of these in particular. First, the recent changes in WP funding were widely expected, but there appears to have been a general assumption that this would be funded by an increase in total T grant. The top slicing of 'core funding', and the level of funding were not expected and led to a redistribution of shares in total T funding between institutions heavily engaged in WP and others. To oversimplify, research intensive HEIs lost share and others gained. The change coincided with a substantial increase in QR funding, with the benefits heavily concentrated amongst research intensive HEIs. However:

- while in aggregate, the increased QR was larger than WP funding, the increased QR was far from evenly distributed and some HEIs were disadvantaged by both the WP funding and failure to score highly in the Research Assessment Exercise (RAE)
- the increased QR funding was widely expected, and predictable, and had been built into planning assumptions. Even those institutions, for which the QR increase outweighed the notional reduction in T grant, had been planning on the basis of a larger total HEFCE grant than they received. For this reason, unpredictability caused problems, even though total T grant may have increased
- similarly, some of those institutions which gained from the introduction of the WP funding could have planned its use more effectively with more prior warning.

3.15 The third point was, we believe, less important in practice and concerns the introduction of the new price groups and changes in price group weightings. Some HEIs complained that insufficient notice was given of the changes. As was discussed above, since most HEIs reflect these groups in internal allocations the movement of subjects led to unplanned surpluses and deficits within schools.

3.16 The changes in funding which resulted from changes in the TFM were, in most cases, a relatively small percentage of an institution's total T grant. However, for most HEIs, with limited reserves, marginal changes in grant can force quite significant departures from plans.

Similar treatment of similar activities

- 3.17 One of the stated characteristics of the TFM is that it seeks to fund similar activities at similar rates. This does not mean the same rate for the same subject and effective units of resource can vary, in the main, because of⁶:
- similar institutions at different points in the tolerance band
 - the specialist institutional premium, intended to reflect the different circumstances and cost structures of specialist institutions, and also that they have less flexibility than multi-faculty institutions to redistribute block grant between faculties/departments
 - small institutional premium, which reflects the higher overhead (per student) of small institutions.
- 3.18 This is a complex area involving underlying policy rationales as well as considerations of equity between institutions. The simplest issue to deal with is varying positions within the tolerance band. In principle, two institutions with the same student intake could be receiving up to 10% difference in funding per student, and many of those we consulted could see no logic in such a wide variation. At the same time, as is discussed elsewhere, the tolerance band is generally viewed positively, as a means of cushioning institutions from annual variations and introducing an important degree of stability into the system. We believe that the majority of institutions would prefer stability to 'equal' funding, although there are differences in opinion as to how wide the tolerance band should be.
- 3.19 The other issues are more complex. The Funding Council has recognised that some institutions are delivering a distinctive, and higher cost, form of teaching and have different institutional cost structures that could not be adequately reflected by applying the standard price groups and instead pays these institutions additional premiums. These include: the conservatoires with their emphasis on one-to-one tuition and the costs of maintaining orchestras and performance spaces; some specialist engineering provision dependent on industry-standard equipment and facilities; and the additional costs of the college system and facilities at Oxford and Cambridge. It is important to note what is not at issue here: that such provision does incur higher costs; and that it is high quality in the sense of fit-for-purpose.

⁶ Other components of the TFM, such as WP funding and PT premium also lead to different effective UoRs. However, these are student-based and the same student would attract the same funding wherever they are studying.

3.20 However, unsurprisingly, these premiums have been questioned by other HEIs and while it is beyond the remit of this evaluation to make a judgement on these issues we think it is important to record the arguments. They can be essentially classified in two groups. First, while many HEIs accept the principle of the additional funding they do not believe it has been applied equitably:

- there is a specific issue in relation to conservatoires. We understand that conservatoires attached to other HEIs do not receive the specialist premium, even though they face similar additional costs
- other HEIs believe they could also offer higher quality and a more distinctive learning programme if they had access to similar resources.

3.21 The second argument is a questioning of the underlying policy rationale, and more specifically the justification for public money supporting such provision. The argument is that students, or their employers, rather than HEFCE should meet the additional costs although some would acknowledge that this would imply reductions in provision, and possible cessation, in some cases.

Impacts on quality

3.22 One of the TFM aims is to enhance teaching quality, but quality assessment does not enter directly into the calculation of T grant. Indeed, it is difficult to see how it could, given the demise of subject review and absence of an overall metric for institutional quality. The fundamental issue is that the TFM does not seek to define what constitutes high quality but instead leaves this to individual institutions to determine. For some, high quality teaching is inextricably linked with research, and many in this group believe the TFM does not recognise the cost implications. For others, quality is adding value to students who enter HE with non-traditional qualifications, and again many would argue this is not adequately reflected in the TFM.

3.23 In practice, quality considerations enter the TFM, at best, indirectly in five main ways. First, the Funding Council can withhold grant if institutions fail to meet QAA requirements. The system therefore seeks to ensure that minimum standards are met throughout the sector.

- 3.24 Second, there may be indirect impacts through student demand. The TFM is driven by student recruitment and perceptions of the quality of a course influence student choice. However, potential students do not, in general, have robust information⁷ on quality, and choice of information is heavily influenced by many other factors such as institutional reputation (which is not necessarily correlated with quality) and costs.
- 3.25 Third, quality of provision is one criterion used in the allocation of Additional Student Numbers. However, it is only one, and other factors have weighed heavily in recent bidding rounds. In addition, ASNs represent only a marginal addition to capacity and many HEIs have not entered the recent competition because of the focus on Foundation Degrees.
- 3.26 Fourth, the lower end of the tolerance band implies a minimum unit of resource, and corrective measures are taken if an institution moves outside the band. To the extent that the UoR is correlated with quality, this represents an additional means of maintaining minimum standards.
- 3.27 Fifth, through special initiatives, such as Rewarding and Developing Staff⁸ and the CETL. These provide a means for the Funding Council to promote quality enhancements outside the core funding elements of the TFM.
- 3.28 We also note that several HEIs consulted questioned the way the TFM dealt with institutions which had underperformed (there are elements of their arguments which are more general than quality alone). Under the current arrangements, HEIs which under recruit significantly will move outside the upper limit of the tolerance band and will be forced to take corrective measures by the Funding Council. However, the reductions in funding will be moderated, giving the institution some opportunity to recover its position and take remedial action. Some of those we consulted felt that there were two problems with this approach: first, the institution was able to escape the full impacts of the consequences of its actions; second, moderation of the T grant means a diversion of resources from other HEIs. They would have preferred an approach which led to the redistribution of funds from underperforming HEIs to those which had met their recruitment and other targets. There is undoubtedly some logic to this argument. The absence of, or reduction in, moderation would result in a redistribution of funds to

⁷ The National Student Survey and Teaching Quality Information data may lead to better information in this respect.

⁸ The potential benefits of the RDS initiative are not restricted to teaching and learning.

strongly performing institutions and, some would argue, an increase in quality over the sector as a whole.

3.29 However, there are two difficulties with this approach:

- failure to meet recruitment targets, which is the main reason for exceeding the tolerance band, does not necessarily reflect poor quality. It may indicate weaknesses in predicting student numbers but demand may fall short of expectation for many other reasons
- perhaps more important, the Funding Council must consider the interests of students attending underperforming institutions. Reductions in T grant could reduce the quality of their HE experience, whatever the impact on the sector as a whole.

3.30 We note that the view of moderation described above was not universally held. Some HEIs, including some which had not benefited from the safety net of moderation funding, felt that it was important to protect institutions in difficulties and that they should be given the opportunity to address any underlying difficulties.

3.31 Our general conclusion is that the TFM is neutral so far as quality of teaching is concerned. There is little in the method which gives a powerful incentive to enhance quality, which depends mainly on the professionalism of staff. Equally, we have not been able to identify evidence which suggests the TFM provides incentives to drive down quality.

4 Structure of the TFM

Introduction

4.1 As was discussed in Chapter 2, the detailed characteristics of the TFM are important and these are explored in the next Chapter. These detailed characteristics, however, operate within a general framework which is discussed in this Chapter. By structural aspects we refer to:

- tolerance band
- Additional Student Numbers
- price groups
- the balance between formula funding and special initiatives.

Tolerance band

4.2 HEFCE calculates a standard resource for each institution. This is a notional calculation based on number, and type, of student and institution-specific factors. It also calculates an assumed resource for the institution based on the teaching grant paid to the institution for the previous year, adjusted for various factors such as inflation, plus the TFM's assumptions of student tuition fee income. If the difference between the standard resource and the assumed resource is no more than +/-5 % then the previous year's grant is carried forward.

4.3 The tolerance band introduces an important, and widely welcomed, element of stability to the funding system. ASNs, and changes in TFM parameters and premiums, complicate the picture, but leaving these to one side, if recruitment is within +/-5% of the previous year's outcome then institutions will receive a constant grant apart from changes reflecting the overall grant from Government. In this sense the tolerance band is a major strength of the current TFM and has enabled institutions to plan more effectively than would otherwise be the case.

- 4.4 Management devotes substantial effort to ensuring that institutions remain within the tolerance band, although impacts, in terms of HEFCE interventions, are not symmetrical. Moving below -5% may lead to additional funding and/or a requirement to reduce student numbers. The latter is obviously relatively easy to achieve, and institutions which are close to the lower limit are less likely to be in a position where they need to expand in order to cover overheads or otherwise exploit economies of scale. Institutions which exceed the upper limit are subject to close scrutiny by HEFCE, and since rectifying the position invariably entails additional recruitment, face greater management challenges.
- 4.5 Three main issues were identified during the consultations. First, it would seem that the operation of the tolerance band is not always understood fully by all academic managers (as opposed to central management). Several HEIs reported that schools sometimes believed that increases or decreases in recruitment would automatically lead to changes in institutional T grant. In part this reflected internal allocation models, which do not replicate fully the tolerance band, and is more an issue for internal communication than a comment on the TFM. However, we encountered one instance where there appears to have been a misunderstanding between central management and HEFCE. The institution was awarded extra T grant because it had moved outside the lower limit of the tolerance band and it believed that these funds would be available on a continuing basis. Subsequent changes to the TFM meant that institution was brought back within the tolerance band without the need for additional funding leading to some short-term difficulties because the institution had been planning on the basis of a higher T grant. This example highlights the importance of clear communication between HEFCE and institutions over the basis on which funds are awarded.
- 4.6 Second, several of those consulted felt that the 10% variation allowed at present was not appropriate, and the majority of these felt the band should be narrowed. These were all institutions towards, and sometimes at the limit, of the lower end of the band. Their view is that they are more efficient than institutions in the positive range of the band and that this efficiency should be rewarded by extra funding. At the system level, they perceive a wide tolerance band as protecting HEIs which are failing to recruit to target and that public money would be better spent if resources were transferred to institutions with lower units of resource. This argument can, however, be questioned on two grounds:

- an institution's position in the tolerance band only reflects relative efficiency if the parameters in the TFM are accepted as the actual costs of educating a student. In reality the TFM makes no pretence that this is the case and, for example, each price group applies to a wide range of subjects each with different costs of teaching. In addition, even within the same subject, different institutions may teach in different ways to achieve different outcomes, so that unit of resource comparisons may not be helpful. Nevertheless, for institutions teaching similar subjects in similar ways the unit of resource is a useful indicator of cost-effectiveness
- as was mentioned in the previous Chapter, redistribution from those at the top of the tolerance band could have an immediate impact on current students in these institutions, and the Funding Council needs to balance these impacts against seeking to maximise efficiency across the sector as a whole.

4.7 We note that any narrowing of the tolerance band would inevitably lead to less stability in funding. In particular, more institutions would exceed the upper limit which would trigger grant reductions and, if the band is to be meaningful, more frequent interventions by HEFCE.

4.8 Third, a small number of institutions argued that the band should be widened. In all cases these were institutions which had undergone structural changes in the sense of merger or expansion into, or retrenchment from, specific areas. The issue appears to be that the structural change, even though there had been prior discussion with HEFCE, immediately placed the institutions above the upper limit and this triggered a HEFCE response as if the institutions had not changed but simply failed to meet recruitment targets. We do not believe this is a reason for widening the band but it does raise the question as to whether sufficient consideration is given to recalculation of the standard resource (and therefore actual position in the tolerance band) and requirements for transitional funding following structural changes.

Additional Student Numbers

4.9 Funded growth is provided for through ASNs, which are awarded in response to competitive bids from individual or consortia of HEIs⁹. ASNs are intended to reflect national priorities:

- increasing the numbers of students from disadvantaged backgrounds
- increasing opportunities for students
- increasing vocationally-oriented provision
- supporting the expansion of high quality in learning and teaching.

4.10 The last round of ASN bidding was in 2003. Bids were mainly restricted to Foundation Degrees, although some additional places in Social Work were also provided. The concept of supporting growth through ASNs is acceptable to most HEIs, and it is recognised that it provides the Funding Council with a means of steering growth to areas which reflect national priorities. However, some of those we consulted identified difficulties with the way the system is implemented in practice. In part, these reflect the recent focus on Foundation Degrees. Many HEIs have decided not to offer Foundation Degrees and, as a consequence, have had no opportunity to grow through funded numbers, but two other issues were also raised.

4.11 The first concerns the process itself and encompasses a number of issues:

- the competitive bidding process imposes a burden on the institutions and HEFCE's figures indicate that, since 1997, only around 35% of bids have been successful. Some institutions claim that it is difficult for them to judge their chances of success in advance
- bids need to be made to separate funds for capital costs. This further increases the burden on institutions, but also the risk since success in one bid does not guarantee success in another

⁹ The framework for allocating ASNs is currently under consideration by HEFCE.

- the results of ASN bids are announced in February, with recruitment scheduled for the next academic year. Failure to meet FTE targets will trigger clawback arrangements under the TFM¹⁰. Most HEIs consider this insufficient notice. Publicity material needs to be prepared and the course marketed, yet by February many school leavers will already have made their decision on what and where to study. For this reason, some HEIs consider they, effectively, have only one year to deliver on ASN allocations. One HEI visited also made the point that it is difficult to motivate staff to go through the process of course validation when there is no certainty that ASNs will be awarded, although it could be argued that this is a development cost which institutions should be expected to bear.
- 4.12 The second point arises because of the way in which failure to meet ASN plans is treated by the TFM. The clawback mechanism is triggered by total student numbers, i.e. previous numbers plus any ASNs awarded, rather than simply recruitment to the ASN programmes. This means that an institution can be penalised if it delivers the ASN programme bid but experiences a fall in demand for other courses. Conversely, it would not be penalised if it failed to meet ASN targets but recruited additional students to other courses. The rationale is that ASNs are intended to support expansion, in line with national priorities, in the sector rather than a diversion from one subject area to another.
- 4.13 However, from the perspective of individual institutions this increases the risk of ASNs. The risk is further increased where HEIs enter into franchise arrangements with FECs. Typically, the FEC will require payment up-front, and the HEI may lose this payment if there is under recruitment. The incentive may in fact be to reduce total FTEs prior to bidding for ASNs, although we doubt whether this would be logical, or feasible, in practice. Some also made the point that ASNs are an opportunity for them to introduce new and innovative approaches to learning, since the tendency with established courses is to recruit to where there is a demonstrable demand for, rather than introduce innovation. As a result, some argued that funding for ASNs should be ‘ring fenced’ – institutions should be rewarded or penalised on the basis of delivering numbers in the ASN programmes bid for, and other changes in recruitment dealt with separately, subject to movement in or out of the tolerance band.

¹⁰ Although institutions have the chance to make good any shortfall in the following academic year.

The price groups

- 4.14 The last HEFCE consultation on the TFM, HEFCE 2003/42, elicited views on the price groups. Many of these points were reiterated during our interviews and we have not attempted to repeat them all here. The concept of a small number of price groups was universally welcomed, and only one institution felt that there should be more than four¹¹. This reflects the reduction in reporting demands that a small number of groups enables, but also a view that, in general, the relativities between groups and the placing of subjects within groups is broadly appropriate¹². Despite this, most institutions would prefer that the relativities were based on an explicit assessment of relative costs, although it was recognised that more progress would need to be made with the implementation of the Transparent Approach to Costing (TRAC) methodology to teaching for this to be feasible.
- 4.15 The concern on the part of some institutions that the most recent changes to the price groups were introduced with insufficient warning was mentioned in the previous Chapter. The other main issue related to the classification of programmes, and was raised by a minority of those we consulted. The issue essentially concerns different approaches to teaching programmes with a similar title, and more specifically the relative balance between equipment/lab-based and classroom-based approaches. Some institutions have adopted approaches which differ significantly from the sector average in this respect. They believed that their approach implied that the programme, or more accurately part of the programme, should be placed in a different price group to the rest of the sector in recognition of the higher costs involved. There is scope within the TFM to discuss these issues with HEFCE, but we were told that the Funding Council had become less willing to consider partial regrouping with the result that the TFM tended to impose conformity on curricula. It is worth mentioning, however, that this was not a widespread complaint and did not relate to more than a few programmes in those institutions which did identify it as an issue.

¹¹ There is an issue concerning price groups and specialist institution premiums which is discussed in the next Chapter.

¹² This is not to suggest that institutions consider the absolute levels of funding to be adequate.

- 4.16 We also note a specific issue which was raised during the consultations and that concerns the division of medical programmes between pre-clinical and clinical subjects. The former being group B and the latter group A. The norm has been to allocate students in the first two years of their programme to pre-clinical studies, and clinical studies thereafter. However, our understanding is that pre-clinical and clinical training is, for professional reasons, becoming increasingly integrated and that the distinction is becoming meaningless in practice. For those HEIs which train a cohort of students through pre-clinical and clinical studies this is not important, but some institutions transfer large numbers of students to other universities when they enter teaching hospitals. This means that the university where the students first studied is incurring some clinical costs but only being funded at pre-clinical levels. They are, however, forced to integrate both stages; otherwise their students would not be capable of transferring after the initial years of training.

The balance between formula funding and special initiatives

- 4.17 Alongside formula funding, HEFCE has made funds available for specific activities via a competitive bidding process. These special initiatives are significant since they are one of the main means by which the Funding Council seeks to influence institutional behaviour in line with national priorities. They are also potentially a way of addressing directly desirable characteristics of the TFM which formula funding does not; notably the quality issue where HEFCE has recently made significant funding available through the Centres for Excellence in Teaching and Learning initiative.
- 4.18 These points are recognised, in principle, by HEIs, but there is a general preference for the special initiative funding to be minimised for a number of reasons. First, the special initiatives create more unpredictability in funding for two reasons:
- the funding is diverted from core formula allocations so it is more difficult for institutions to predict the total T grant and their likely share, should they remain within the tolerance band
 - the results of a bidding process are inherently unpredictable.
- 4.19 Second, the bidding process imposes costs on the institutions. This is especially the case in relation to smaller institutions which face high fixed costs of bidding, sometimes in relation to relatively small grants. Some of the smaller institutions also perceive themselves to be disadvantaged in bidding since they cannot make available dedicated resources to prepare bids in the same way that larger organisations can. The reporting

- requirements associated with special initiatives are also considered onerous and further add to costs.
- 4.20 Third, special initiatives are seen to conflict with the general principle of a block grant which institutions decide how to spend. As mentioned above, special initiatives are a diversion from ‘core funding’ but they are also seen to encourage mission drift. There is a widespread view in the sector that teaching is under funded and individual academics feel under pressure to bid for resources even though they may not be closely related to key strengths and strategies.
- 4.21 Finally, and in part related to the previous point, some institutions expressed reservations over the ways in which bidding processes had been conducted. Specific reference was made to the CETL initiative which some institutions believed had been used to spread good practice rather than to reward and support excellence.
- 4.22 Several institutions also expressed concern over the way in which special initiatives can be consolidated into the core grant. Most comments were in relation to the Rewarding and Developing Staff (RDS) initiative and may, in part, reflect the way in which this was presented by Government as a real increase in resources for teaching. The substantive point is that, because internal allocation models reflect the TFM, it is difficult for institutions to ring-fence funding for particular activities if the funding is consolidated into the formulaic core allocation. Institutions have the authority to decide on internal allocations, but we reiterate the point that they may also wish to incentivise schools and establish clear links between T grant and school activities.
- 4.23 The problems associated with special initiatives are recognised by HEFCE. There is a general intention, not just in relation to teaching funds, to reduce the relative importance of special initiatives. In addition, special funding programmes have moved increasingly away from bidding exercises towards formula based provisional allocations which allow HEIs to set their own priorities. The aim is, in part, to reduce the burden of administration on HEIs.

5 Detailed aspects of the TFM

Introduction

5.1 This Chapter considers some of the detailed aspects of the TFM under the headings:

- timing
- special funds
 - WP funding and part-time premium
 - specialist institutions
- non-completion
- statistical returns
- Further Education

Timing: notice and grant period

5.2 The timing of funding announcements is, generally, as follows:

- November, total funding for HE is announced
- December, institutions provide information on current student numbers (HESES) which is used to calculate T grant for the next academic year
- January, HEFCE decides the total T grant
- March, T (and other) grant announced to institutions.

5.3 The result is that institutions do not know with certainty what their T grant will be until around seven months before students are admitted. Some considered this period of notice too short for effective planning, but the majority felt able to predict T grant, with sufficient confidence, further in advance. To some extent, different views reflected whether the institution was experiencing excess demand for places or whether there were difficulties in recruiting. But some institutions with no recruitment problems also felt that advance notice was insufficient.

- 5.4 A more general concern was the annual T grant cycle combined with an academic planning cycle of two or, more usually, three years. Almost all institutions would prefer a longer planning cycle but also recognise the constraints which government expenditure cycles place on HEFCE. There were some exceptions, and a few institutions preferred an annual cycle, provided this responded to changes in recruitment between institutions.

Special funds

Part-time premium and WP funding

- 5.5 These two funding elements are considered together because for many, but not all, institutions PT provision is an important component of the WP strategy. The first point to make is that both sources of funds are welcomed by almost all institutions, as recognition of the additional costs which WP, and PT, provision generate. Institutions for which these modes were important were, however, universally of the view that the funds did not meet the additional costs incurred. Specifically:

- the PT premium of 10% does not recognise the fixed costs of dealing with individual students such as student registration, tracking and support. It is perceived as being based on the notion of an FTE comprising two PT students when, in reality, the headcount may be much higher
- similarly, the WP funding substantially underestimates the additional costs of recruiting and retaining students¹³
 - institutions need to devote significant resources to marketing their courses and attracting non-traditional students
 - students require intensive support after entering HE
 - relationships with FECs are sometimes a key element of WP and these are costly to maintain, especially in relation to quality assurance. Some HEIs consulted also drew attention to the high unit costs of maintaining FE networks in geographically dispersed areas with some FECs having small numbers of HE students.

¹³ A recent study commissioned by HEFCE and others came to similar conclusions – The Costs of Widening Participation in Higher Education, Report to HEFCE, Universities UK and SCOP by JM Consulting Ltd. (HEFCE R&D report)

5.6 It is, however, difficult to assess whether changes in WP funding would materially influence behaviour. Many of the institutions which felt funding was inadequate are committed to WP and this is a major market for them. Changes in funding are, therefore, unlikely to influence recruitment strategies. However, the increases in funding have led to greater investment and are therefore likely to increase both the quality of student experience and assist in keeping retention rates high.

Specialist institutions

5.7 Specialist institutions are defined as those for which at least 60% of (FTE) provision is in one or two subject areas. These institutions are recognised as offering a distinctive form of HE which would not be adequately compensated for by funding at the standard price group levels. Specialist institution premiums range from 0 to 240%. The highest rates are, in general, applied to institutions focused on performing arts although some others also receive substantial premiums.

5.8 The 60% cut-off is, of course, arbitrary but it does enable HEFCE to identify a relatively small group of institutions which are most likely to be offering distinctive programmes and to have different cost structures. Those specialist institutions we visited are able to provide convincing arguments as to why higher rates of funding are required, but some non-specialist institutions questioned the rationale for, and other aspects of, the premium as was discussed in Chapter 3:

- the premium reflects an implicit judgement that the higher costs of provision are justified by higher quality or meeting national requirements in some sense. Some other institutions would claim that they also provide high quality or strategic programmes without special funding, and/or they would be able to do so given access to similar funding levels
- unlike most other elements of the TFM, the specialist premium is negotiated and not transparent
- as mentioned above, the stand-alone conservatoires receive the premium but similar schools within other institutions do not. The rationale is, presumably, that such institutions have flexibility from the block grant to support the higher costs if they wish to. However, as was argued elsewhere, institutional flexibility is restricted and the current system is also seen as inequitable. But it is worth noting that this issue of comparability was not raised in relation to other subjects and may therefore be relatively unimportant across the sector as a whole.

- 5.9 We believe there is logic to these arguments, but would note that an alternative approach would almost certainly require HEFCE to enter into negotiations with many institutions and to make judgements over cost, quality and national need. Apart from the administrative burdens this would impose, it would imply a different relationship between the Funding Council and institutions than currently exists.
- 5.10 There is some nervousness amongst, at least some, specialist institutions over the robustness of the specialist premium. The current situation, for many, reflects negotiations over a long period during which they have demonstrated a case for special funding. The nervousness arises because premiums are seen as vulnerable to changes in the TFM. For this reason, some of those consulted would prefer to see specialist premium reflected in the core formulaic allocation. However, it is difficult to see how this could be achieved without additional price groups, which would not be generally popular and could also increase the number of institutions eligible for the additional funding.

Non-completion

- 5.11 If students fail to complete¹⁴ the year of programme for which they are registered then they do not count in the TFM calculations. If the result is to move the institution above the tolerance band, or a failure to meet student numbers when ASNs have been awarded, then there will be a clawback of T grant. The definition of completion is that the student is assessed on the year's programme or a specified number of modules. The treatment of non-completion is probably the most controversial aspect of the TFM, at least amongst those institutions which are intensively involved in WP. The problems which institutions identified include:
- a student either completes or does not, so the TFM provides no funding for students who, say, complete all but one module during the year. Institutions feel that this does not recognise the resources which they will have committed over the year
 - even though students may not complete the programme, the institution may have added significant value which is ignored by the current TFM

¹⁴ See paragraph 2.25 for the definition of completion.

- the completion measure may be inconsistent with academic regulations which permit a student to progress to the next year even though they may have not completed a module. This may be because aggregate performance on other modules is sufficient, or because some modules can be deferred.
- 5.12 The TFM does, indirectly, reflect the problems institutions face with non-completion through the allocation of WP funding. Since non-completion rates are, generally, higher for WP students it could be argued that WP funding recognises the increased costs associated with non-completion. However, as was discussed above, most institutions we visited consider WP funding inadequate in relation to the extra costs they incur and, in addition, non-completion is not restricted solely to WP students.
- 5.13 One effect is that students with a higher than average propensity to not complete are viewed as high risk and, as a result, some institutions have become increasingly careful over the types of students they are seeking to recruit. This is seen as running counter to the WP agenda. It has also been suggested that institutions have changed their assessment procedures to avoid penalties for non-completion.
- 5.14 Several of those we consulted also pointed out that the incentive is to retain students on their initial programmes, even if it might be in the student's best interests to enter another programme, or indeed to leave HE. However, we saw no evidence that this was occurring in practice.
- 5.15 As was mentioned above, the treatment of non-completion was a key issue for several of the HEIs consulted and all felt the TFM needed modification in this respect. The main suggestions were:
- more than one 'census' point so that a share of funding would be allocated on the basis of registration and additional amount on the basis of numbers completing¹⁵. Most HEIs recognised that completion per se was important, but objected to this being the sole criterion. This approach was the most commonly advocated
 - funding by credits gained, although the administrative burden this would imply was acknowledged
 - define completion to be consistent with the institution's academic regulations.

¹⁵ There are similarities with the LSC approach where funding depends on registration, completion and gaining an award.

Statistical returns

- 5.16 At present, the T grant is calculated on the basis of Higher Education Students Early Statistics (HESES) survey for HEIs and the Higher Education in Further Education: Students (HEIFES) survey for FECs from the previous December. The returns cover both existing students and projections of expected students and completion rates. These figures are later compared with HESA returns data, when those figures become available at the end of the academic year. Divergence in the two data sets, for example because of failure to recruit against expectations or different completion rates, can lead to adjustments in funding. For some institutions, projections and later reconciliations can be burdensome, especially if there are large numbers of students beginning programmes after December, or a high proportion of students not enrolled full-time on three year programmes¹⁶.
- 5.17 Institutions need to collect HESES data for their own internal management purposes, but we did explore whether there would be interest in moving to a system where T grant was allocated on the basis of HESA data. This would lessen the reporting burden on institutions since, although they would still collect HESES data, reporting this in the HEFCE format, the high levels of accuracy required and the later need to reconcile with HESA data, all impose additional costs. The obvious drawback is that T grant would be based on student numbers two years in the past. There was, however, little enthusiasm for such a change for two main reasons:
- most institutions have well developed procedures for HESES collection and projecting student numbers from this data; several spoke highly of the utility of the HEFCE software in this respect
 - funding would be increasingly disconnected from student numbers and, for example, improved completion rates would not be reflected quickly enough in T grant¹⁷. More generally, the implications of moving in or out of the tolerance band would be delayed.

¹⁶ The shorter the average programme length the greater the proportion of students moving in and out of the institution in a given year.

¹⁷ The same point emerged from the last consultation on the TFM.

5.18 Some institutions did, however, question the level of detail HEFCE required in the HESES returns. Specifically, institutions are required to report on students funded by other agencies, for example NHS and TTA, in a different format to that required by the other funding agencies. This added to reporting requirements and the rationale was unclear.

FECs

5.19 Visits were made to a small number of both directly funded FECs and those with franchise arrangements with HEIs. The ways in which the TFM impacts on these FECs is quite different. In both cases, however, the T grant, or revenue derived from grant, is usually a relatively small proportion of total funding. As a result, the operation of the TFM is less important to the institution as a whole than is the case with HEIs.

5.20 Many of the issues already discussed in this report apply to directly funded colleges. In particular, reflecting the student markets they are serving, the adequacy of the WP funding and PT premiums was cited as a problem by many. There are also specific issues relating to these institutions, which in part derive from their relatively small scale:

- there is limited, if any, scope to manage T grant as a block grant
- the FECs have no, or restricted access to, special initiative and capital funding. There is a concern that development activities are not undertaken to a satisfactory extent because responsibility for their support falls between HEFCE and the Learning and Skills Council (LSC), and sometimes other funders.

5.21 Those FECs with indirect funding arrangements have a different relationship to the TFM. In one sense the TFM is not of direct relevance since its impacts are mediated through the financial relationship with an HEI. However, the TFM is an important consideration in negotiations, although not always understood fully within FE. Franchise arrangements have been a key factor in WP and Foundation Degree developments and we encountered quite diverse experiences during consultations. There are examples of such arrangements working very well but also cases where the FEC believes it is gaining little, if anything from the arrangement. The two key problems appear to be:

- a very wide range of payments from the HEI to the FEC, which have been documented elsewhere. There appears to be little logic to some of the variation which often reflects historical factors rather than varying inputs to development and delivery

- a lack of any real partnership in some cases. We encountered some cases where the HE partner, in response to its own recruitment difficulties, reduced the offers it was making to potential students in competition with the FEC and withdrew student numbers from the FEC at very short notice.

6 Conclusions

General aims for the TFM

- 6.1 HEFCE has articulated four general aims for the current TFM¹⁸.

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

- 6.2 A key principle of the TFM is that T grant is allocated as a block grant for institutions to decide on how it is spent. The obligation is therefore placed on institutions to decide on the best use of public money and how learning experiences can be enhanced. This flexibility is welcomed, and exploited, by institutions, but is also restricted by competition between institutions and the need to ensure that subject areas receive adequate investment.

- 6.3 There are important aspects of the TFM, and the way in which it is implemented by the Funding Council, which help to ensure that money allocated to institutions is properly spent. Institutions which move above the +5% tolerance band, and would therefore receive relatively high levels of resources compared with similar institutions, are subject to clawback of funds and particularly close scrutiny. Institutions which move below the tolerance band may receive additional funding to remedy their position.

To recognise and encourage diversity in the provision and delivery of higher education, and in the range of students

- 6.4 The standard UoR is the same for each institution within each cost band (ignoring premiums and WP funding) irrespective of curricula and type of student, but institutions decide how and what to teach. In this sense, the TFM permits diversity but it does not explicitly recognise the different costs of different provision. In addition, a number of HEIs consulted felt that there was increasing pressure to place similarly titled programmes in the same cost band even when there were differences between institutions in the balance between lab- and classroom-based teaching. This was felt to be reducing diversity in provision.

¹⁸ As listed in HEFCE 21/96, Funding method for teaching from 1998-99

- 6.5 The TFM does, however, directly reward diversity through some special funding elements. Those for WP (and PT) provision have assisted HEIs for whom WP is an important part of their mission. There is a widespread view within the sector that funding does not reflect the true costs of WP, but they do represent an addition to resources for those engaged in WP. It is, however, doubtful whether these funds have led these universities to recruit more non-traditional students because this is their core market. The way in which non-completion is treated is, however, widely perceived to increase the risks of recruiting non-traditional students and to work against the WP agenda.
- 6.6 The consultations suggested that WP funding had encouraged some HEIs, which have not previously engaged with the WP agenda, to be more proactive. The main impact, in this respect, has almost certainly been on the recruitment of well qualified and able students from non-traditional backgrounds rather than admitting students who may be less well prepared for HE.
- 6.7 The premium for specialist institutions explicitly recognises, and sustains, institutions that have distinctive approaches to teaching. However, these are restricted to a relatively small number of institutions. Many other HEIs would also claim distinctiveness, and higher costs, which are not reflected in the TFM.
- 6.8 Several of the comments above are also relevant to the question as to whether the TFM has encouraged diversity of programmes. Students on Foundation Degrees attract a 10% premium, but there is a widespread view that this does not compensate for the extra costs of developing programmes in partnership with employers. Some institutions also felt that ASNs should be awarded for progression after the two-year Foundation Degree. As with WP, however, institutions have bid for Foundation Degree numbers because of their strategic fit, and the premium has increased investment in their development.
- 6.9 We believe that the TFM may have inhibited the provision of innovative programmes incorporating features such as PT (and mixed mode) attendance, work-based learning and Accreditation of Prior Experiential Learning. These modes are often, but not always, associated with WP, and the comments made elsewhere in relation to WP funding, PT premiums and the treatment of non-completion, are therefore relevant. While some institutions are, nevertheless, engaged fully in WP the TFM encourages conventional delivery modes in relation to these students. The main exception to this is e-learning which, in blended mode, has been developed by some institutions as a cost-effective method of delivery in some circumstances.

To respond to the interests of employers and the Government

- 6.10 Employers' interests are not directly reflected in the TFM. If the method has an impact in this respect it is through higher student demand for courses which generate high employment rates, and is therefore an indirect impact. There is also the potential to reflect employers' needs in ASNs, but these can have only a marginal effect unless numbers are concentrated on a specific profession. The most recent round of bidding for ASNs was, however, mainly restricted to Foundation Degrees which require employer involvement and reflect their needs more directly.
- 6.11 The TFM offers more scope to reflect government needs: it can influence behaviour through changes in the price groups and the introduction of premiums. However, any changes in these basic parameters reduce the predictability of funding which is one of the strengths of the TFM. The premiums are potentially a means for the Funding Council to have a direct impact on institutional behaviour, but any increase in their relative importance means a reduction in the flexibility institutions have to implement their own strategies.

To promote quality in teaching and learning

- 6.12 The notional UoR does not include any assessment of quality, other than that QAA requirements should be met. Quality factors enter indirectly through student demand, to the extent that students have useful information on teaching quality and act on it. The more direct levers are consideration of quality in the award of ASNs and the availability of funding through special initiatives such as CETL. However, it is difficult to see these as having a pervasive impact on teaching quality. The TFM is thus largely reliant on the professionalism of the institutions. Given the absence of a metric for teaching quality there would appear to be little alternative, nor is there a demand for an alternative from institutions or stakeholders.

Features of the TFM

- 6.13 HEFCE has defined five key features for the TFM which are discussed in this section.

Openness

- 6.14 It is difficult to see how the TFM could be more transparent and open. The method for calculating allocations is well documented and has also been the subject of a recent consultation exercise (HEFCE 2003/42). This does not mean that it is always understood fully. Our interviews indicated that central management and services had, in general, an excellent understanding of TFM mechanics and the implications for their institution, but that academic managers were not always so well informed. This is not necessarily a problem; the internal allocation/attribution models are of more importance to academic managers and the issue often concerns communication within an institution rather than openness of the TFM.
- 6.15 The one caveat we would make concerns the calculation of specialist institution premiums. These relate to only a small number of institutions, but they entail negotiations between the institutions and the Funding Council rather than a formulaic allocation. The outcomes are, however, published.

Predictability, so that an institution knows how decisions it might take, and changes in its circumstances, will affect its funding

- 6.16 Provided there are no changes in the parameters of the TFM, funding is highly predictable so long as institutions are able to make accurate projections of student numbers. However, there have been recent changes in the TFM which have significantly reduced predictability:
- most important, the recent increase in WP funding which was achieved through a transfer from the 'core' teaching allocation. This was not anticipated by institutions and created real difficulties in some cases
 - some institutions complained that the changes in price groups were introduced with insufficient notice.
- 6.17 Both of the above led to relatively small changes in T grant for most institutions, and changes were moderated by HEFCE to ensure that real funding was maintained. However, marginal changes in funding can require significant changes in plans for many HEIs that do not have large reserves.

Flexible enough to respond to external policy changes, particularly to developments in the Council's own policies

- 6.18 The comments made in paragraphs 6.10 and 6.11 are relevant here. We would, however, reiterate the point that reflecting policy imperatives in the TFM carries the danger of less predictability in T grants and reduced flexibility for institutions.

Fairness. Differences in funding between institutions will be for good and justifiable reasons

- 6.19 The key drivers in the TFM are student numbers and price groups, and these impose conformity in funding. Variations between institutions do exist but, to a large extent, these reflect positions in the tolerance band, and many of those we consulted felt that the benefits of stability in funding enabled by the tolerance band outweighed any drawbacks arising from differences in units of resource.

- 6.20 The main caveats concern premiums, as discussed above in relation to specialist institutions, but there is also a very specific issue in relation to small institutions. Oxford and Cambridge are allocated small institution premiums to compensate for the costs of the college system. The arguments against this are similar to those in relation to specialist premiums – there may be higher costs but this is not a sufficient condition for higher grants. However, both small and specialist premiums account for a relatively small part of the total T grant.

The funding method will impose as small a burden as possible on institutions

- 6.21 We believe the TFM scores highly in this respect. The main burden relates to the provision of HESES data, and later reconciliations with HESA returns. Most of those we consulted were comfortable with HEFCE requirements.

Summary conclusions

- 6.22 The current TFM is an attempt to resolve tensions, and sometimes conflicting objectives, in the system. The Funding Council is responsible for ensuring that public money is spent effectively while promoting quality (in all areas of HE) and reflecting government priorities. The Council has a limited statutory scope to act as a planning body, and the process for allocating T grant, therefore, permits institutions flexibility in how they spend the grant. For the reasons given elsewhere in this report this flexibility is restricted in practice, and there is also a tension between seeking to reflect government priorities and the scope for discretionary actions which institutions have.

- 6.23 There are also important administrative considerations. Many issues which HEIs identified during this study could be resolved only by a much more finely grained TFM which would, we believe increase the burden, on both the sector and the Funding Council, of implementing the TFM. In addition, more detail in the TFM implies less flexibility for institutions to manage their T grants.
- 6.24 Our overall conclusion is that the current TFM has achieved a good balance of these various tensions and objectives with two main qualifications. The first is mainly concerned with the way in which the TFM has been implemented rather than the parameters and structures of the method. Specifically, changes in premiums and price groups have reduced predictability and created difficulties for some HEIs. However, most of the problems identified in this respect relate to the most recent changes only; comparatively few consultations identified this as a systemic problem.
- 6.25 The second concerns detailed aspects and in particular the levels of WP funding and PT premium and the treatment of non-completion. These were widely thought to be inadequate and/or problematic. These issues are relatively more important to those HEIs which are recruiting non-traditional students. It could also be argued that other aspects of the TFM impact differentially on this part of the sector. They are, for example, more dependent on the T grant and thus less able to cushion the effects of changes, or to exploit the flexibility of the block grant. It is, of course, the case that any changes in the TFM which favoured this group of institutions would be at the expense of others.

Glossary and acronyms

ASN	Additional Student Numbers
Assumed resource	HEFCE grant for teaching plus assumed income from tuition fees.
CETL	Centre for Excellence in Teaching and Learning
EU	European Union
FE	Further Education
FEC	Further Education College
FTE	Full-time equivalent
HE	Higher Education
HEFCE	Higher Education Funding Council for England
HEI	Higher Education Institution
HEIFES	Higher Education in Further Education: Students survey. The annual aggregate recruitment survey completed by FECs, which informs HEFCE's funding for teaching.
HESA	Higher Education Statistics Agency
HESES	Higher Education Students Early Statistics survey. The annual aggregate recruitment survey completed by HEIs, which informs HEFCE's funding for teaching.
LSC	Learning and Skills Council
NHS	National Health Service
PT	Part-time
QAA	Quality Assurance Agency for Higher Education
QR	Quality-related research - the component of HEFCE research grant related to RAE performance and the number of active researchers
RAE	Research Assessment Exercise
RDS	Rewarding and Developing Staff

Standard resource	A notional calculation of what an institution would get if teaching grant was calculated afresh each year. It is proportional to each institution's FTEs weighted both by price group and by any student and institutional premiums which may apply.
T grant	Teaching grant allocated through the TFM
TFM	Teaching Funding Method
Tolerance band	+5 per cent to -5 per cent of the standard resource.
UoR	Unit of Resource (teaching funding divided by FTEs)
WP	Widening Participation