

14. THE FUTURE

- 14.1 This final chapter looks forward, and briefly considers some of the key financial challenges that governors might have to get to grips with in the next few years. It is necessarily speculative, and readers will need to put the general observations into the specific context of their own institution. Clearly, both the direct and indirect impact of the 'credit crunch' are crucial contextual factors.
- 14.2 The higher education sector seems poised between a recent period of relative plenty and a future of potential relative famine. The introduction of top up fees in England, Wales and Northern Ireland in 2006 and the recognition by government that capital funding was necessary produced a substantial element of new money for HEIs. These included a backlog of property maintenance and refurbishment as well as the need to tackle equal pay and other staff restructuring matters. Despite this improvement, many in the sector seem nervous about the prospects for the next few years. This is bound to affect the Treasury's ability to fund the sector, and capital funding will be the first casualty if history is any guide.

Pensions

- 14.3 A major challenge for many boards is likely to be the future funding of pensions³⁶. Higher education has not been immune from the turmoil in the pensions world of the last decade, and costs have increased and seem likely to continue doing so in all the various schemes operated by HEIs. Most academic and related staff in the pre-1992 institutions are members of the Universities Superannuation Scheme, which is the second largest pension fund in the UK. It is a funded scheme (ie it owns assets with which to pay pensions), but despite its size it seems likely to increase its contribution rates in response to life expectation changes and investment predictions. In the post-1992 HEIs, academic staff are usually members of the Teachers Pension Scheme, and this also may have to increase contribution rates. It is not funded and contributions go to the Exchequer, which accepts liability to pay pensions.
- 14.4 Pension arrangements for non-academic staff also vary, but the pattern is different. For historical reasons, many are members of local government superannuation schemes. These are funded schemes, but their investment performance has shown considerable variation. Employers' contribution rates have been rising steadily for some years and are now typically between 12% and 20%. The level of forecast assets compared to forecast liabilities varies from around 60% to almost 100%.
- 14.5 In many pre-1992 HEIs, non-academic staff are (or were, since some schemes have been closed) members of 'in house' schemes, operated by the institutions themselves (though governed by trustees in compliance with relevant legislation). These also have had varying investment experience, with a variety of funding positions and contribution rates similar to those for local government schemes. Funding deficits in several of these schemes have led to them being closed to new members and replaced with defined contribution schemes, where the risk is placed more on the employee.

³⁶ For a useful summary of the pensions position facing HEIs see 'Pensions Provision in Higher Education' published by UniversitiesUK at www.universitiesuk.ac.uk/bookshop

14.6 Pensions represent something of a 'ticking bomb' for HEIs. Contribution rates seem likely to keep going up, but advertised salaries rarely make reference to the fact that higher education pension schemes are among the most generous on offer. Unreformed final salary schemes are now the exception rather than the norm, but any attempt to carry out such a reform will be highly contentious. Even a move to a structure which bases pensions on average career salaries (rather than final salaries), now common in other not-for-profit sectors, will not be achieved easily.

Staff costs

14.7 In addition to pensions increasing, staff costs are also likely to give rise to challenges for governing bodies in the next few years. They are likely to continue rising well above the rate of general inflation. Competition for good staff will encourage institutions to stretch their resources in order to protect their position.

14.8 The problem for HEIs is unlikely to be staff costs alone, but the combination with other factors. The pensions challenge, the need for continuing infrastructure investment, and so on all raise cumulative issues.

PFI

14.9 The growing use of Private Finance Initiative (or Public Private Partnerships) in higher education has not yet led to any reported difficulties. These arrangements commonly provide facilities (eg student accommodation) without the institution having to provide the capital, either from its own funds or via borrowing. Given the heavy demands for capital, they can be a very attractive way of providing facilities, especially those which have a clear income stream associated with them; student accommodation is the classic example. What capital is available, it is argued, should be reserved for core academic developments, which no one else is likely to finance.

14.10 Yet these are never simple arrangements, since someone (a bank or other funder) will be careful to measure and protect their risk. Although 'off balance sheet', the agreements which underpin them may restrict an institution's ability to manage its affairs as it sees fit. For example, changes in rents and room allocation policies are likely to be restricted to avoid unfair competition with the PFI scheme. Other developments may also be subject to a 'first refusal' offer to the existing PFI contractor.

14.11 Whilst PFI arrangements may be 'off balance sheet' initially, it is not unknown for them to lose that status as a result of changes in accounting rules. If that happens, the borrowing capacity of the HEI might be severely affected - in the extreme, it may have breached the funding council's limit. Therefore, they should not be ignored in any future capital finance planning. Governor involvement in the supervision of PFI negotiations is essential. (For more details of PFI see the separate materials on estates in this series.)

Student numbers

- 14.12 Student numbers are likely to be affected by many factors. Demographic change will reduce numbers of UK students for some years' and for individual institutions the crowded UK higher education market may prove a challenge. In England, the cap on UK undergraduate tuition fees is due for review in 2010, and although there is strong pressure to increase it from some - not all - HEIs it will be extremely contentious politically. However, governing bodies cannot wait until 2010 to make strategic plans for future undergraduate provision, and so should be making their own planning assumptions about student funding.
- 14.13 Internationally the position is also likely to be challenging. Despite the huge growth in international recruitment in the past few years, there are some pressures that may limit demand. The global economic situation may well affect the numbers coming from overseas, and increased competition from other countries may have an impact (China and India are now starting to become substantial importers of students from other countries).
- 14.14 Of course, not all HEIs will be adversely affected by threats to student numbers, but sector wide most indications do not look encouraging.

The challenge for governors

- 14.15 In the whole panoply of higher education (at least since its post-war expansion) there have been remarkably few serious financial problems, so governors shouldn't lose too much sleep over the operation of financial processes. Moreover, improved controls and monitoring will probably prevent past problems recurring (although the Northern Rock episode might suggest otherwise!).
- 14.16 However, the basic problem may be a business model for funding higher education which is becoming exhausted. Most HEIs face a rate of cost increase which is twice the rate of inflation generally. But most sources of income are only rising by a lower rate. Seeking additional income is a constant challenge and can easily lead to management 'drift', taking the corporate eye off the main task of performing in teaching and research. The alternative is simply to cut staff numbers to balance the books, hopefully through increased efficiency, but more likely where posts become vacant through natural wastage. This is not a recipe for great success and there is an urgent need for fresh thinking in institutions if they are to sustain themselves. The old ways will not work for much longer.
- 14.17 In the face of such financial pressures the case for mergers and closer institutional collaboration is likely to become strong, and governing bodies have a major role to play here. Mergers are rarely popular with staff, and may be seen by many senior managers as undesirable outcomes because they usually reflect badly on those whose institution is forced to merge. However, if carefully implemented they may be of strategic benefit. In such a situation it may be that a governing body that has to drive consideration of merger and collaboration forward, as a fundamental part of its strategic role. More widely, collaboration on a regional or specific service basis which stops short of merger might be a more practical way of securing the benefits of scale.

"We need a radical rethink about how we're going to afford to run this place in the future. It's not enough just to try and breakeven, but we need to generate substantial surpluses"

LAY GOVERNOR

14.18 In the meantime, the essentials of financial governance remain: good internal control, effective risk management and governance which works through commitment and knowledge. But governors should keep an eye open for some of the signs of distress which could suggest the need for investigation. They include:

- Actual and predicted deficits - why?
- Poor liquidity.
- High levels of borrowing relative to peers.
- Tight banking covenants.
- Over reliance on unstable sources of income.
- Inability to adjust spending to short term income fluctuations.
- Poor sector comparisons.
- Poor quality statistics and management information.
- The quality of the estate.
- Lack of openness on the part of officers - keeping governors at too great a distance.
- Falling forward research order book.
- Poor student recruitment performance.
- Unwillingness to confront the need for change.