GOVERNOR BRIEFING NOTE

Updated: 18 December 2018

6. Commercial operations

Introduction and aim

Commercial operations typically include the operation of campus-based services and facilities, including student accommodation; applied research, consultancy and training for private clients; and international recruitment. The purpose and operation of these activities varies. Each however impacts the successful operation of the provider.

Topics covered

1. The scope of commercial operations

Higher education providers engage in commercial operations – activities managed primarily on a commercial basis or for commercial gain – for different reasons. Typically, commercial operations include, but are not restricted to:

- Campus services and facilities, including student accommodation.
- Research, consultancy and training undertaken on a commercial basis.
- Recruitment of international students.

2. Campus facilities and services

Higher education providers offer a range of facilities and services on their campuses, typically including catering and the provision of student accommodation (and for some providers accommodation for staff). These services are normally run by the provider (or a third-party) as commercial operations, although the services may be supplied to the user at 'cost' (i.e. the price charged only recovers the cost of supply). Generally, campus services are expected as a minimum to break-even to avoid the risk of a cross-subsidy being paid from the provider's core funding for teaching and research.

3. Management of campus services

Campus services are normally managed by a professional services manager and team of staff with relevant specialist knowledge and expertise. The delivery of the services requires a different style of management to that found in academic departments.

4. Contracting-out

Providers may elect to manage and run their own commercial operations, contract them out to a third party ('outsource'), or operate a joint venture with a partner organisation. For services judged to be 'non-core', many higher education providers examine the benefits of contracting out the service – outsourcing – to a third-party provider. For example, catering services is an area where outsourcing is frequently used, leading to commercial contract caterers running the food and refreshment outlets on the provider's campus(es). Similarly, a provider may enter into a contract with a commercial bus company for the purposes of operating a dedicated bus services to and from its campuses[1].

5. Deciding to outsource

Outsourcing is normally chosen by the higher education provider if it judged that a specialist service provider is able to offer better value-for-money than would be achieved by the provider operating the service in-house, or when the provider does not have the necessary expertise to provide the service. Once the decision to outsource a service has been decided, the process of selecting and appointing a preferred supplier will normally be managed by the providers' procurement (or equivalent) team. This may include issuing a tender specification, inviting tenders, negotiating with potential suppliers, selecting a preferred supplier who is judged best able to meet the provider's specification and entering into a contract with the chosen supplier.

6. The role of student accommodation

As the majority of students in the UK are residential students, student accommodation is an important factor supporting student recruitment[2]. Prospective students and their parents frequently enquire about the availability of accommodation at open days prior to submitting their Universities and Colleges Service (UCAS) application form. A lack of suitable accommodation may have a negative effect on student applications. As a result, most providers aim to have sufficient 'bed spaces' to offer accommodation for, as a minimum, all 'new' first-year undergraduate entrants. Similarly, international students generally prefer to live in university-provided or sponsored accommodation, removing a key uncertainty when deciding where to study in the UK. Providers with therefore typically give priority to first-year and international students when allocating the accommodation they have available.

7. Growth of student accommodation

Over the last ten years, the demand for student 'bed spaces' has increased alongside the growth in student numbers. Rising demand and the ability to use income from student rents to fund new provision has encouraged investment in new capacity by providers, and increasingly investment by private investors and developers[3].

8. Private sector investment

Given conflicting demands for the same resources, providers may be reluctant to use internal reserves or their borrowing capacity to fund additional student accommodation. An alternative is for the provider to work with a private sector investor who builds or refurbishes accommodation on behalf of the provider. This may involve the provider giving a 'guarantee' to the private investor as to the level of student occupancy. Typically, to bring forward the private investment and secure exclusive use of an accommodation block the provider 'guarantees' to supply sufficient students to achieve a minimum occupancy level and thereby the income stream required to make the proposition financially attractive to the private sponsor. The guarantee transfers risk from the private sector investor to the provider. The term of such guarantees is normally long and may be, for example, 20 years.

9. Quality of accommodation

Students increasingly expect a higher quality of accommodation and associated facilities, than was the case for earlier generations of students. Typically, new or refurbished accommodation features single rooms with en-suite facilities, wi-fi connectivity, a communal kitchen and social facilities. Wi-fi is considered by students to be an essential requirement[4].

10. Dated accommodation

Providers with dated student accommodation need to be mindful of the need to refurbish and update facilities to ensure the provision remains attractive to students.

11. Will demand continue to grow?

The balance between supply and demand for student accommodation varies by location. Some locations have high levels of provision compared to demand; in others supply is more limited. Falling numbers of young people in the 2018-19 age cohort and new capacity coming on stream, allied to weak recruitment by some providers, has led to suggestions that in some locations, conditions of excess supply could emerge. As a consequence, some would-be sponsors of student accommodation are more circumspect when considering whether to add further capacity in the near term.

12. The Governing Body's role

Irrespective of whether the provider is directly investing in new accommodation or guaranteeing levels of usage for a private investor, Governors will be expected to endorse the decision being made. In deciding whether to support a proposal to develop new student accommodation, Governors should consider the need for additional student bed spaces (i.e. current balance between supply and demand), the likely affordability of the planned bed spaces to the student (i.e. anticipated level of rent) and the risks associated with offering any funding or occupancy guarantees requested from the developer (i.e. how big a risk to the provider?)

13. HE services for private clients

Applied research, consultancy and training activities may be undertaken at the bequest of a private client. Providers will usually charge commercial rates for supplying such services. To meet their needs, private client may request:

- Applied research or consultancy to solve a commercial problem.
- Access to specialist facilities or equipment to develop or test a prototype.
- Bespoke training programmes or short courses to up-skill their workforce.

14. Knowledge exchange

Commercial services supplied to private clients are referred to as 'third-stream' activities (to distinguish them from teaching and other forms of research) and labelled knowledge exchange (KE). KE includes a wide range of activities, involving the provider's knowledge or assets being utilised by external organisations or communities. The work is important in assisting the development not just of beneficiary organisation, but also to an area, region or the national economy. This is links to the 'knowledge economy': the use of high-level knowledge to produce competitive goods and services enabling organisations and countries to compete globally. Some activities are also part of a provider's civic engagement[5].

15. Third-stream funding

Higher education is central to the knowledge economy. To encourage providers to develop and expand their KE activities the devolved administrations of the UK distribute public funding to support the growth of third-stream activities.

16. Third-stream activities

Encouraged by the allocation of public grant funding, many providers have developed significant KE operations. These may include central service hubs, often working in conjunction with local – local economic partnerships (LEPs) – or national (UK Research and Innovation) Bodies to develop new activities in order to support economic or business development. Higher education providers are local 'anchors' and may play a key role in 'place-making'[6].

17. Incubation facilities

As part of their KE activities, many higher education providers have developed and operate incubation facilities to support start-up businesses, including 'spin outs' from their research base or student or graduate start-ups. Some providers also operate science parks, which may be run as a separate trading arm of the provider[7].

18. Measuring third-stream activity

Third-stream activity is measured annually by the Higher Education Business and Community Interaction (HE-BCI) survey. The survey is managed by the Higher Education Statistical Agency (HESA). The survey comprises of two parts: Part A is qualitative; Part B quantitative. Data from Part B impacts the allocation of third-stream funding.

19. Public funding

Public grants to higher education providers to support third-stream activities are made through the Higher Education Innovation Fund (HEIF) in England[8] and Wales, and through the Universities Innovation Fund in Scotland.

20. Investment to provide services to private clients

The delivery of the commercial services may use existing teaching or research facilities and staff, but can involve additional investment by the provider in specialist facilities. Significant investment decisions should be considered by the Governing Body, including assessing the associated strategic and financial benefits and risks.

21. Subsidiary companies

Most providers operate subsidiary companies to manage some aspects of their commercial operations. The reasons for such developments are:

- This removes the potential conflict between a provider's 'public' role in operating as a charity, providing activities for public benefit, with the desire to run activities for profit.
- The profits of a subsidiary company are normally reduced or removed by charging the company an 'overhead' for the professional support (e.g. management time, accounting services) provided by the parent organisation. This defrays the provider's costs, and reduces the overall tax charge.
- There are normally tax benefits from operating with a subsidiary company, including the ability to recover value added tax (which a 'public' provider is unable to do) and remit profits back to the parent organisation.

Governors should expect to examine and comment on the business plans for any subsidiary the provider is operating and to regularly monitor its performance against agreed outcomes. Members of the Governing Body may be asked to be directors of the subsidiary company.

22. Revenue from international students

An area of significant growth for UK providers has been international student recruitment and transnational partnerships. Although offering the benefits of greater cultural diversity within a student cohort, the main driver to the growth of international student recruitment has been financial[9]. Growth of international students allows providers to increase and diversify their income streams.

23. Reliance on international students

The importance of international recruitment varies by provider. For some providers, international students make up a very significant proportion of their student body. The Governing Body should establish how reliant the provider is on recruiting international students and the extent to which future financial forecasts are sensitive to changes in recruitment numbers and the level of associated risk[10].

24. Recruiting international students

Many providers have built networks of recruitment agents or partnerships with local organisations (e.g. local-based education providers) in their target countries for student recruitment. Links may also be established with UK based language schools, sixth form and further education colleges, who offer pre-HE programmes.

25. Enabling international recruitment

The recruitment of international students may require additional investment by the provider in student accommodation or support facilities to enable the provider to offer an attractive 'package' to potential international applicants.

26. Conclusions

Commercial operations typically run by a higher education provider are diverse and encompass many different facilities or services. They may be significant operations in their own right, and critically support the provider's core activities or important aspects of its mission. Their importance can be easily overlooked.

27. Questions to review

Q Is the Governing Body clear as to which activities are run as commercial operations and their scale?

Q What services are delivered 'in-house', and which are 'outsourced'.

Q Is the provider seeking to increase the quantity and/or quality of the student accommodation under its control?

Q How will any desired increase in student bed spaces be secured?

Q Is there a need, and are there plans, to refurbish the existing student accommodation to keep it up-to-date?

Q Have the plans for international student recruitment and developments been reviewed? Do they withstand close examination?

Q Do governors see the business plans for subsidiary companies and review their performance?

End notes and further reading

1 The location of higher education providers varies hugely. Some are located close to good public transport networks, while others occupy locations poorly served. Whether a provider needs to seek the services of a bus operator will depend on its location and the provision or absence of existing public services. Further, in some instances, to secure planning consent for the construction of a new building, the provider will be required by the planning authorities to provide additional public transport services as part of 106 planning agreement.

2 Compared to most other countries, the UK is unusual in that the majority of students move away from home and become residential students (the 'boarding school' model) in order to study at a higher provider. There is a significant number of 'commuter students' who travel to their place of study from their home. For a discussion of the needs of commuter students see David Maguire and David Morris (2018), Homeward Bound: Defining, understanding and aiding 'commuter students', Higher Education Policy Institute, Report 114, December.

3 The 2018 accommodation costs survey jointly undertaken by the National Union of Students (NUS) and Unipol found that the proportion of purpose-built student accommodation provided by the private sector has increased from 39% in 2012-13, to 50% in 2017-18.

4 The 2018 accommodation costs survey found that 58% of purpose-built student accommodation now comprises self-catering en-suite accommodation. Further, the costs of renting student accommodation have generally out-paced inflation while the quality of the accommodation has been improving.

5 Civic engagement is broader than knowledge exchange, describing activities by which a provider engages with its local civic community. These include, for example, the provision of public spaces, involvement of senior managers with local policy Bodies or groups and the public use of the provider's facilities.

6 Higher education providers play a significant strategic role in a community, and help to 'anchor' the local economy. Higher education providers are an important fixture within a local economy and play a major role in its economic development.

7 Considerable efforts have been made by many providers to promote and support start-ups. Typically, this includes the provision of workshops helping students and graduates to explore the opportunity to develop a business, as well as physical spaces.

8 Research England has been tasked to develop a new 'Knowledge Exchange Framework (KEF) to evaluate and benchmark the contribution UK higher education providers make to the exploitation of the knowledge they generate.' The KEF once in place is expected to be used to allocate third-stream funding.

9 The Higher Education Policy Institute report number 100, November 2017, How much is too much? Cross-subsidies from teaching to research in British universities, found that international students paid more than the full economic cost of being taught. On average over the duration of their degree each non-EU student contributes over £8,000 to UK research.

10 Prior to its closure at the end of the first quarter in 2018, the Higher Education Council for England's (HEFCE) annual collation and assessment of provider's financial forecasts suggested that the sector as a whole was being highly optimistic as to the expected growth of international student numbers. At the time, HEFCE suggested that the actual growth in international student numbers was likely to be below the increase forecast.