

Insight: Higher education – Could board observers help with the financial challenges ahead



Recent articles have highlighted the financial pressures facing higher education institutions (HEIs). In an article in The Daily Telegraph, John Rushforth, executive secretary of the Committee of University Chairs, commented:

“There are some active discussions that I know of where people are worried about going concern now. It’s not inevitable, but something will have to give. Going bust is a possibility.”

In essence, the issue is around cost pressures where the increased costs from high inflation and wage rises cannot be mitigated by increasing fees.

Annual tuition fees for domestic students have effectively been frozen at £9,250 for the last 10 years. According to the Russell Group, universities in England now make an average loss of £2,500 for every UK student they educate.

The only lever available to HEIs is in relation to overseas students who pay fees of three to four times more than domestic students. But some institutions are now seeing pressure on the number of international students as the government changes immigration criteria.

What the financial data shows

Using data available from the Higher Education Statistics Agency, which collates data from around 300 HEIs, we look at these issues in a little more detail. Of the data available, 2021/22 is the last full year of information held, and 2018/19 is the earliest year where data is directly comparable. Helpfully, this is also pre- and post-Covid.

Student numbers

- Student numbers have increased 16% from 2.4m to 2.8m (+0.4m) in the three years to 2021/22
- UK students total 2.2m, around three-quarters of the total. They have increased by 0.2m (+11%) over the period
- Overseas students have also increased by 0.2m over the same period, but this is a 60% uplift as HEIs look to increase fees from this sector

Income

- Tuition fees have increased 25% from £20.5bn to £25.7bn (+£5.2bn) over the three-year period
- The increase in percentage terms is greater than the increase in student numbers due to the increased proportion of overseas students who pay

the higher fees

- Other income from grants, research and the like has increased by 7% over this period to £22.5bn
- The overall effect is that total income has increased by 15% over this period

Costs

- The cost base of HEIs is made up of three main elements, with staff costs accounting for 60%, other operating expenses 33% and depreciation 6%
- Overall staff costs are up 18%, with 6% relating to increases in academic staff for increasing student numbers. The balance (+12%) is due to wage growth which is higher than the c 9% national average per the ONS suggesting the influence of a heavily unionised workforce
- Other operating expenses have increased by 15% likely driven by higher energy costs and inflation
- The net effect is an increase in total costs by 15% over the period

Balance sheets

- Bank debt amounts to £14bn in 2021/22. The view is that these facilities are/were:
 - mostly with traditional banks
 - originally signed with long maturity dates (up to 25 years)
 - covenant light
- However, the HEIs have tangible assets of £62bn (likely to be mainly land and buildings) and investments of £17bn

Walking the tightrope

Whether by luck or judgement, the overall situation is that HEIs have managed to grow income at the same rate as costs over the period. This has been possible by the increase in overseas students, the one lever that HEIs have some control over.

However, not all HEIs will be the same and there will be varying results from the separate institutions – from the very good to the financially challenged.

By way of example, around 80 of the 300 HEIs generate less than 10% of their income from overseas students.

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What the future holds

Whilst the most recent financial data shows a sector managing to balance its books in aggregate, some HEIs are already feeling the pressures where they do not have the flexibility and runway to manage their position. And on top of this, the headwinds seem to be gathering strength which will draw more institutions into financial distress.

We look at these pressures and then consider what options are available.

It is important to consider these pressures in the context of a business model that runs on three-year cycles as any degree started needs to be completed – the proverbial turning a supertanker.

Income

Although there have been increases in the number of students over recent years, there are challenges to both the numbers of UK and overseas students.

- Perceptions of the value of certain courses are challenged where the expected post-graduation salaries do not reconcile with the cost of completing a degree
- Following on from this, the demand for apprenticeships are increasing and companies offering these are now a competitor to HEIs
- Government's position on migration may further impact the number of overseas students who may come to the UK. For example, the clamp down on overseas students being able to bring dependents with them

Costs

An agile organisation should be able to mitigate the majority of changes in income by managing costs. However, as we noted above, the three-year cycle of degree courses makes this harder to manage, in particular when cost inflation is mainly outside your control.

- HEIs remain heavily unionised – we have seen the impact of strike action in recent years – which removes one element of managing payroll costs
- Additionally, the existence of defined benefit pension schemes (in addition to defined contribution) and their potential funding requirements adds an extra layer of complexity
- The buildings at HEIs are the other major area alongside staff. Their upkeep faces several (and expensive) challenges from ESG requirements to the potential replacement of buildings that used RAAC
- Finally, the impact of inflation generally and increased energy costs are particularly magnified in a business model where the majority of income has been fixed for the last 10 years

Managing change in a regulated framework through enlightened leadership

Historically, HEIs are run by an academic focused 'boards'. Their purpose is to deliver the best education and should continue to do so. Similar to a corporate looking at financial and/or operation restructuring, the board needs to make sure the underlying business does not suffer as it goes through change.

Therefore, the appointment of board observers (or CROs in the more challenged situations) can help and facilitate the change, both in terms of planning, delivery and governance. Also, if a lender is involved, with little or no covenant cover, then acting as a conduit between both sides will help.

There are issues that ideally need to be resolved at Government level, but at the institution level potential actions include:

- The property portfolio is the HEIs biggest asset offering the greatest opportunity. This could be collaboration with the business sector, with potential diverse uses from life sciences to Airbnb to generate income. Additionally, sale and leaseback will be possible, but this would be a short-term gain that may be negative in the longer-term
- M&A activity between local HEIs could provide back-office synergies, reducing costs. This could be formal or a shared-service agreement. Merging HEIs may also help balance risk between academic and vocational (e.g. degree apprenticeships) courses
- Changing the offering may be a more fundamental step, be that removing 'loss-making' courses or changing the delivery model with a greater online offering at lower cost or lower fees. However, this is a longer-term solution as it will need a full three-year cycle to implement

Finally, it is important to remember that to achieve the turnaround there needs to be openness, good communications and a strong governance framework. The right person, or team, is critical to ensure there is a collaborative environment to deliver the required outcome for all stakeholders.



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