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Sink or swim?
Facing up to failing universities

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Executive Summary

The idea of a university going to the wall is one that we have steadfastly ignored in Britain for many years. Yet with the economic downturn threatening every stream of university revenue this is a nettle that we must finally grasp. There are many who would argue that the very notion of a university ever going under is an outrage that should not be discussed. We disagree. The deeply-embedded culture of shoring up struggling institutions as fast and as quietly as possible means that universities are unable to learn lessons from failure in other institutions. There have been 27 university mergers since 1997, but there is little or no information available about them and there has been no political discussion about dealing with failing institutions. Given that the Higher Education Funding Council for England (HEFCE) will distribute just under £8 billion of public money to 131 institutions in 2009-10, we feel strongly that our no-fail culture must be questioned.

Outside London the economic and social impact of a major university going under would be so great that a merger – carefully planned and with a clear institutional mission – would almost certainly be the preferred option. Yet within the capital, where there are an astonishing 42 higher education institutions competing for students, there should be a realisation that a university could close, if that is shown to be the best use of public money and assuming that students can be satisfactorily located elsewhere. The government should also be thinking hard about allowing private providers to take over all or part of a failing institution, especially where no other suitable university partner is keen to step in.

Given the amount of public money that goes into higher education we do not believe that there is sufficient accountability. This is not necessarily the fault of the funding council. It is currently trying to walk a precariously thin line between protecting the all-important autonomy of universities and operating sufficient oversight that it can spot and help institutions before they get into really hot water. Yet the fact that London Metropolitan University has somehow over-claimed in the region of £50 million of public money suggests that this oversight regime is not working as it should be. There needs to be a debate within the sector about how universities are reviewed. And there must be more clarity about exactly what powers HEFCE has. It is time for the government to stop pretending that failure does not happen and to start giving a clear steer on how it should be dealt with.

Recommendations:

- The government and HEFCE should work to provide better information for the sector on institutional mergers. When mergers or takeovers happen they must be driven by a clear vision of what the new institution's mission will be rather than simply a political desire to prop up a failing institution.
- The government should consider allowing private providers to take over all or part of an institution in the case of failure. Currently private providers cannot receive funding from HEFCE. The government could overcome this problem by offering a contract to a provider to deliver particular education services. This could be an acquisition or the private provider could effectively rent the university under a Private Finance Initiative agreement.
- The government must clarify exactly what powers HEFCE has to intervene in the case of failure. We suggest that HEFCE should have a definite remit to suspend a university's grant and remove the management team if there is evidence of serious mismanagement.
- The somewhat casual system of one-day light touch checks every five years by the funding council is insufficient. The government should initiate a debate about the best way forward. Options could include mission groups such as Million Plus or The Russell Group undertaking an annual audit of their institutions, or the funding council amending their institutional risk criteria to allow for a larger number of universities with weak finances and management to be audited regularly.

Introduction

Moral hazard: the impact of a no-fail culture

The idea of a university going to the wall is one that we have steadfastly ignored in Britain for many years. Yet with the economic downturn threatening every stream of university revenue this is a nettle that we must finally grasp. Most people in the sector regard the failure of an institution as a physical impossibility. Indeed there are many who would argue that the very notion of a university ever going under is an outrage that should not be discussed. We disagree. In fact it is not true that a university could not go bankrupt, although there are a number of obstacles, and a deeply embedded culture of shoring up struggling institutions as fast and as quietly as possible. Given that the Higher Education Funding Council for England will distribute just under £8 billion of public money to 131 institutions in 2009-10, we feel strongly that the acceptability of a no-fail culture should be questioned.[1]

There is not yet a real market in higher education, despite the increased competition caused by the rapid expansion of the sector. The cap on top-up fees was set so low that almost all institutions currently charge the maximum £3,000 fee for all subjects, which has created a practically flat playing field. However, if (or when) the fees cap is lifted the arrival of a real market should present the possibility that one or more institutions may not survive. It is a broadly accepted fact that for a market to be successful there must be an element of failure. For instance, students might vote with their feet by choosing not to attend a university, and if they did so would it be right to prop up that university regardless?

This no-fail culture is something that should be interrogated now, regardless of the fee situation. With the current culture of hushing up serious institutional problems one has to ask whether universities are able to learn any lessons from failure in other institutions. An environment in which everyone knows they are ultimately cushioned may encourage ill-defined missions and governance problems. If quality is allowed to deteriorate at any one institution this is not simply an issue for them but for the reputation of UK higher education as a whole. We feel strongly that taxpayers, students, parents, businesses, and others who use university services have a right to a greater level of accountability.

How damaging would it be if a university went under?

Universities are major employers, between them employing 1.2 per cent of the UK's total workforce.[2] Outside London many universities are the largest or second largest employer in their locality, thus the economic impact of a key institution going under in the same areas would be extremely detrimental. Similarly, the loss of student provision in these areas could have very serious social consequences, particularly if an institution in question is the key 'access' university in the locality, providing vital education to hard-to-reach groups of the population. Consequently, outside the capital mergers and partnerships should be explored wherever possible when a university faces possible bankruptcy. As we will discuss later, these mergers must be properly thought through and transparent. A mere sticking plaster merger will simply defer the problems and waste more public money.

However, in London the environment is very different, and all of the senior university figures we spoke to agreed that the loss of an institution in the capital is far from unthinkable.[3] There are a staggering 42 higher education institutions in London, many of them competing for the same pool of students.[4] The merger of London Guildhall University and the University of North London to form London Metropolitan University in 2002 was driven partly by a realisation that there were too many similar institutions competing for students in the same space. We will discuss later why this merger was problematic, but it is important to note that the broader problem of a crowded London marketplace has not gone away. Nonetheless, a move to close a London university would obviously be a very serious matter, and a number of issues would need to be carefully resolved, not least ensuring that the interests of existing and future students are protected.

What are the legal obstacles to a university going bankrupt?

The legal ease with which a university could be closed depends upon the period and manner in which it was established. Many older (pre-1992) institutions were set up by Royal Charter, and liquidating them would therefore require an Act of

Parliament. Similarly, older institutions set up by Act of Parliament would need to be disestablished in the same manner.

This means that although not impossible, the liquidation of an older university would require a majority vote in Parliament – something that may be extremely hard to secure given the potential for such an issue to become emotive.

Many more modern institutions (and some older ones, such as the London School of Economics) are established as companies limited by guarantee. They could be disestablished relatively simply under the provisions of company law. Finally, post-1992 statutory institutions could be disestablished in the same way that they were set up – by statutory instrument under the 1992 Act.[5]

How political are these decisions?

Politics inevitably plays a huge role in any decision to prop up a failing institution. Within Westminster the question of whether an institution is really viable may well be secondary to the question of where the institution is located. We hear much about universities being autonomous institutions, but any government would be aware that a failed university would be unlikely to win them any PR points. Although several vice-chancellors we spoke to felt strongly that at some point in the future a university should be allowed to go under, Ministers have avoided this issue completely and as a result there has been very little public discussion about it. This must change.

No university has yet gone bankrupt in Britain; however since 1997 there have been 27 mergers, most of which received little or no publicity.[6] There is every sign that the Government's preference for face-saving mergers is set to continue. Tellingly, in his first address to vice-chancellors in October 2008 the new Higher Education minister David Lammy asked: "Do you have the right number of institutions? In the commercial sector there would have to be many mergers over the next few decades – far more than we have seen in higher education. Could more be done to encourage that among universities?"[7] The government is understandably keen to protect its investment in higher education, and mergers may seem like the obvious answer. However, as we will discuss later in this paper, propping up a failing institution by forcing a marriage of convenience can prove to be a costly mistake.

What is on the horizon for our universities?

London Metropolitan University has been the centre of a media storm in recent months, following the announcement that HEFCE is clawing back millions of pounds of its funding after discovering that the institution made incorrect student data returns. This is a stark reminder of how quickly a university's finances can become a source of very serious concern. But this situation raises a more fundamental question that applies to the whole sector: what happens if a university comes close to the brink?

This crisis scenario has suddenly become much more real for many institutions. The current economic downturn will threaten every stream of universities' revenue and management teams are preparing for a difficult and uncertain time ahead. Professor Adrian Smith, the government's director general of science and research, criticised the lack of political discussion about top-up fees, saying: "That debate has been kicked into touch...in the meantime, universities are going bankrupt because they don't have enough money."[8]

Public funding

Top of the list of financial concerns for universities is the dire state of the public finances and the likelihood of a significant cut to government funding of higher education in the next two years. Vice-chancellors and education experts we spoke to were modeling the impact of a real-terms cut of between five and ten per cent. No one was in any doubt that such a cut would hit institutions very hard. As one senior education consultant put it: "Until the economic downturn there was no reason for HEFCE to think in these terms [about universities going under]. But if we assume a cut of ten per cent in the HE budget in 18 months' time the viability of some institutions will come into question."[9] Ministers have not made any definite commitment to cut or protect funding. But in a speech in April 2009 John Denham, the Secretary of State for Innovation Universities and Skills made it obvious that times would be tough, saying: "As you will be acutely aware we have a review of fees and funding on the horizon. Undoubtedly, higher education institutions will have to account for the extra investment in HE. And we expect you to share the drive towards ever greater efficiency."[10]

Student numbers

Financial concerns have been exacerbated by a clampdown on student numbers by the government. Predictably the recession has triggered a record number of applications from would-be students – UCAS application figures show the number of applicants to UK universities and colleges is up 8.8% on this time last year – as students try to upskill and stay out of the gloomy employment market.[11] However, universities are unable to increase capacity to meet this demand and boost their income. In the annual grant letter to HEFCE in January 2009 John Denham stated unequivocally that there would be no increase in student numbers and institutions would be penalised heavily for any over-recruitment.[12] This strict cap will remove a key financial safety valve for many universities. As one vice-chancellor put it: "Universities have managed themselves out of trouble by expanding. They have stuffed themselves full of cheap students and shed science and engineering. They now have a capacity problem – over capacity at one end and under capacity at the other."[13]

International students

The UK is the second largest importer of international students in the world and the UK has the highest tuition fees for them, with the average annual fee at around £9,500 (as opposed to £3,000 for home and other European students).[14] [15] Many institutions rely heavily on international student income, so any fluctuations in the market could leave less protected institutions in serious trouble. Recent research by accountants Grant Thornton predicted that seven UK universities would fall into the red if their international student income dropped by even ten per cent.[16]

The sample of London institutions below shows that many are heavily reliant on income from students paying overseas tuition rates. Annual fees for overseas students at the institutions listed range from between £7,600 to £19,540 for undergraduate courses and £8,500 to £19,500 for postgraduate courses.[17]

Table 1 Dependence on international fee-paying students at a selection of London institutions

University	% Overseas (ie non-EU) students[18]	Annual fee income from all full time students (£m)[19]	% Annual full time fee income from overseas students[20]
Brunel	15%	38.4	43%
City	15%	60.7	52%
Greenwich	15%	34.1*	48%
Imperial	25%	82.3	74%
Kingston	9%	48.2	32%
London Metropolitan	16%	45.1*	45%
London Southbank	9%	25.4	37%
Middlesex	17%	48.1	45%
Queen Mary	18%	51.4	52%
Thames Valley	9%	17.0	41%
UCL	21%	84.6	62%
Westminster	14%	45.4	43%

As yet there has been no significant reduction in international student demand, and the weak pound is undoubtedly helpful in enticing students despite fears about a global drop in graduate employment. However, universities are anxious about the future for international students as the impacts of the global recession hit home.

Other financial threats

Research funding is also likely to be squeezed during the downturn. The UK's biggest research charity, the Wellcome Trust, announced in February that it was cutting its budget by £30 million, having lost £2 billion from its asset base since the downturn began.[21] It also warned universities to expect a rise in the level of competition for grants as other funding sources dry up. Universities expect research and other funding from business to be cut back in the coming months, as employers focus on paring back their activities. And while UK universities are not as dependent on endowments as some of their US counterparts, they will also inevitably feel the effects of a difficult fundraising market and in particular an unwillingness amongst many philanthropists to support new causes.

Mergers

Universities are vital for the regions, and a merger may make sense to guarantee the survival of an established institution. The word is often euphemistic, referring instead to a takeover following poor institutional management by one of the parties involved. However, despite 27 mergers taking place since 1997, there has been very little political or public discussion about failure in the higher education sector during that time.[22] We found it difficult and in many cases impossible to find information about the mergers that have already taken place.

HEFCE is concerned about keeping its list of institutions 'at higher risk' (and the criteria for appearing on that list) secret, but this does not stop the sector from constantly speculating about which institutions are currently on it. The consensus among our interviewees was that the majority of mergers in HE have been poorly managed, costly, often driven by political rather than economic factors, and as a result have rarely delivered the efficiencies expected. It seems clear that while some degree of confidentiality may be necessary for commercial reasons, the lack of openness about these merger deals is fuelling poor performance.

Snapshot: what mergers have occurred in the past?

University College Cardiff

University College Cardiff (UCC) was forced by the government to merge with the University of Wales Institute of Science and Technology (UWIST) in the late 1980's to avoid imminent bankruptcy. This is perhaps the most striking example of government intervention concerning a failing British higher education institution. It is often called a merger but was really a state orchestrated takeover. The government and the funding council took a justifiably hard line and for once the process was relatively transparent. The circumstances surrounding the takeover are now firmly etched into the collective history of the higher education sector and are widely described as a clear example of a rogue and irresponsible vice-chancellor running a university into the ground by spending money that it did not have, leaving the government no alternative than to replace the senior management team and inject a serious amount of cash to avoid insolvency.

In January 1986 the permanent secretary of the Department of Education and Science (DES) took the unprecedented step of appointing the accountants Price Waterhouse to report on the state of UCC's finances, both current and future.[23] The university's denial of these financial estimates was disappointing (if not predictable), and as Shattock writes, "represented a flight from reality on the part of the College's senior administrators and the College Council".[24]

In February 1987 the University Grants Committee (UGC), HEFCE's predecessor, installed two external teams to take a grip on UCC's finances and to draw up recovery plans, threatening to cease the college's installments of the recurrent grant with immediate effect and potentially withdraw its charter.[25] This raises the question of whether HEFCE has similar powers – a notion that remains untested. Based on our interviews, individuals close to HEFCE are unsure whether such a tough stance could be taken now.

In hindsight it would appear that the Government's severe intervention has been justified, with the newly formed Cardiff University exceeding all expectations, particularly with strong performances in research.[26]

London Metropolitan University

London Guildhall University and the University of North London (UNL) merged to form London Metropolitan University in 2002. There is a widespread belief among senior figures in the sector that London Metropolitan's current financial difficulties stem from its very problematic beginnings. The merger was complicated by many issues including: the troubled finances of both institutions, in particular UNL which had a whole host of problems relating to the ownership of its buildings; an overly optimistic estimate of HEFCE's likely cash injection (the two universities received less than half of the £13.3 million filler they felt they needed);[27] and a worrying lack of buy-in from staff at both institutions. One education consultant explained that "HEFCE's view was that it would supposedly be cheaper to fund a merger than a bail out of both institutions".[28] However, given the fact that the merged institution is now in such serious financial difficulty this seems unlikely to be proved accurate.

There was a clear political motivation behind the partnership. A governor of one of the merged universities told us that he was called by HEFCE at the time in order to check that he was planning to vote "the right way", in favour of merger. He added: "We were misinformed about staff support for the merger. If I had known the real position of staff I would have been opposed to it."[29]

In July 2008 HEFCE cut London Metropolitan's grant for 2008-09 by £15 million, following the discovery that it had made incorrect student data returns.[30] The funding council is currently trying to claw back £36.5 million in grant money for the years 2005-6 to 2007-08.[31] London Metropolitan is challenging this claw-back in the hope that the funding body will accept a fair portion of the responsibility for not picking up the problems with student data much earlier. This is a very serious point. If London Metropolitan University was on the 'at higher risk' list of institutions receiving close monitoring, why did the funding council not pick these errors up sooner? And if the institution was not on the 'at higher risk' list should it have been? As one education consultant pointed out: "Problems like London Metropolitan's don't arise out of the blue."[32]

The university has argued that it is very hard to keep an accurate tally of student numbers as many of its students are 'access' students with complicated lives and commitments that may cause them to drop out of higher education without warning. We are sceptical about this claim, given there are so many institutions that juggle with similar complications without making reporting errors of this magnitude.

Overpayments are not a new issue within the sector, but the scale of London Metropolitan's overpayment is totally unprecedented. Due to the complications and complexities with student data returns, particularly for universities with a large number of non-traditional students, a number of institutions have had some retrospective adjustments made to their teaching grants. Data obtained from HEFCE through a Freedom of Information request shows that almost £100 million was overpaid in teaching grants across all institutions between the years of 1999-2000 to 2007-08.[33] This figure may seem large, but in fact represents only 0.2 per cent of the £42.4 billion spent on total recurrent funding over the period.[34]

Yet it is striking that no institution has come anywhere near the size of London Metropolitan's miscalculations. Note that the £100 million figure for net overpayments includes HEFCE's proposed claw-back of £36.5 million of London Metropolitan's teaching grant for the years 2005-06 to 2007-08 – this represents over a third of all overpayments across all institutions for that period. This data also shows that some other institutions with large numbers of 'access' students have had significant amounts reclaimed by the funding council in recent years. For instance, HEFCE reclaimed £2.077 million from Birmingham City University for over-claims in the years 2006-07 to 2007-08; it reclaimed £1.339 million from the University of Hertfordshire for 2007-08; and it reclaimed £0.96 million from the University of Portsmouth for 2007-08.[35] Yet no institution has come anywhere near the size of London Metropolitan's miscalculations.

A report by SQW Consulting in June 2008 on student non-completions found that while "the sector's perception that [HEFCE's student non-completion] definition itself is complex and opaque", all of the case study institutions "were clear about the significance of student non-completion data" and "understood the potential impacts, both in funding and reputational terms, which an increase in student non-completions could have on their institution".[36]

An examination of London Metropolitan's accounts show that it is not at a point where it is about to go under, but it is evident that it faces an extremely difficult year ahead. The magnitude of budget cuts and staff redundancies that it has to deal with will depend heavily upon whether HEFCE is able to claw-back the full amount of recurrent grants that it has proposed.

Manchester

A very different sort of merger was undertaken at Manchester in 2004. It was a grand and ambitious political experiment to create a super-university outside of the 'golden triangle', in the North. This was strongly politically driven, with a clear steer behind the scenes from the then-Chancellor Gordon Brown. While it is hoped that the merger will prove to be a success, there is concern in the sector that political enthusiasm may have clouded adequate judgment, particularly given how much money was invested in this project.

The University of Manchester was formed by the joining together of the Victoria University of Manchester and the University of Manchester Institute of Science and Technology. It is the most expensive merger in the history of British higher education, made possible by an enormous £80 million of additional funding secured from government and regional bodies, although this figure is not widely known.[37]

The new university has incredibly ambitious plans, not least to be one of the top 25 universities in the world by 2015.[38] It has achieved strong performance in recent years including winning the Sunday Times University of the Year in 2006 and good results in the most recent Research Assessment Exercise.[39] [40] However, the jury is still out on whether the merger will prove successful, and more importantly whether the significant cash injection was a justifiable use of public money. One higher education consultant predicted that "a merger of this kind will take ten years to mature."[41] There is considerable scepticism in the sector and it remains to be seen if this is simply a case of sour grapes or genuine concern.

How do mergers happen now?

A large number of mergers have taken place since the mid-1990's, with the common pattern being for pre-1992 universities to absorb specialist colleges or further education colleges. There are very few examples of mergers between two universities.[42] A host of these mergers have been failures – with many of the incorporated colleges eventually ceasing to exist – while many more merger proposals have failed to even get off the ground. Imperial College London's costly takeover and subsequent disbanding of Wye College is a case in point.

Lampeter

The University of Wales Lampeter is set to merge with Trinity University College and lose its name following a long period of decline and financial difficulty.[43] The two institutions began talks after Lampeter received a "limited confidence" rating from the Quality Assurance Agency (QAA) in 2007 after failing to adequately monitor the quality of its degrees.[44] A report commissioned by the Higher Education Funding Council for Wales (HEFCW) in June 2008 which identified "very real problems of leadership and management" called for interim management to be put in place and raised the possibility of a merger to save the institution.[45]

Professor Alfred Morris was brought into Lampeter as its interim head while vice-chancellor Robert Pearce retired after a period of sick leave and pro vice-chancellor Barry Burnham resigned.[46] The fact that Lampeter (or what remains of the university) has reached a point where it is now in very serious trouble, and yet very little information exists in the public domain about exactly how this came to be or what could have been done to rectify the situation, is unhelpful for the sector as a whole.

What makes a successful merger?

Opinion varies in the sector on whether or not two merging institutions need to have similar or different (and complimentary) strengths. There is however consensus that the new institution must, above all else, have a unifying and clear mission, establishing the identity of the university, its outputs and its vision. Merging two universities that are already struggling financially will rarely create a new sustainable institution and should be avoided. Common problems such as poor estate management, spiralling staff costs and plunging student retention rates cannot simply be solved by welding two institutions together and relying on efficiency gains from improved management systems and a change in senior personnel.

Wide-ranging buy-in from senior management and staff is also crucial for a merger to be successful. “Culture is a big problem”, one HE consultant explained, “and in higher education you have cultural organisational features that make mergers very difficult. The troops on the ground often don’t want to do it.”[47]

Mergers are very costly, and institutions will always hope the funding council will step in. This raises the serious question of how much extra money the state should give to institutions that have managed public money badly. It is worth noting that one of the key strengths of private providers is their access to capital. This may prove an appealing option for the government in this difficult economic climate as a means of avoiding a significant burden on the public purse.

What role could private providers play in stepping in where failure has occurred?

As we have discussed, at present the default mode when an institution is in crisis is to consider merging it with another university. However, private providers could have a key role to play in stepping in where institutions are failing. They might not be suitable or willing candidates to take over an entire university, particularly a large one with many powers devolved to individual departments, but they could have a useful part to play if an institution is broken up into smaller parts. One private company told us that they would look to move into vocational subjects such as business, law and technology.[48] In the US there is also quite significant private provision in health and education courses.

It is worth bearing in mind that the number of plausible candidates for any merger (or takeover) is often very limited. Universities tend to be risk-averse institutions and taking on a sinking ship carries significant financial risk. Our interviewees mentioned several institutions in need of partners in the sector right now – some with no obvious contenders. As one vice-chancellor explained, this dilemma is further compounded by the fact that if an institution was approached by HEFCE as a takeover candidate, “they would need to be dragged kicking and screaming” to the negotiating table,[49] because showing excessive eagerness may shrink the cheque that the funding council is willing to write to push the merger through. In such a case allowing private companies to bid may provide better value for money for the taxpayer. Moreover, private education providers have much greater access to capital, not to mention significant expertise and potentially more efficient management systems where poor management has been at the route of an institution’s problems. They often have experience of multi-site operations, and sizeable experience in technology, infrastructure, human resources and finance.

Historically, the ability to receive degree awarding powers from the Quality Assurance Agency (QAA) was a significant barrier for any private provider wishing to enter the higher education market. Yet QAA’s criteria changed as a result of the 2004 Higher Education Act and now allows private bodies to apply for their own degree-awarding powers; the profit-making BPP College and the not-for-profit College of Law have since received degree-awarding status.[50] Furthermore, institutions no longer have to award higher degrees or undertake research in order to offer undergraduate courses.[51] If a private provider were to take over all or part of a failing institution, it is unlikely that they would be required to re-apply for such powers.

Currently private providers cannot receive funding from HEFCE, and this is the most significant obstacle to their entry into the higher education marketplace. However, the government could solve this problem by offering a contract to a provider to take-over all or part of an institution and deliver particular education services. There would be two possible options here: the merger could be done as a full acquisition or the private provider could effectively rent the university under a Private Finance Initiative agreement for a number of years.

Some of the senior university figures we spoke to speculated that private education companies would not be willing to enter the university sector while the cap on top-up fees is set so low. However, a senior figure in one private education company countered that: “The £3,000 fee cap would not put us off, because there are a lot of inefficiencies in universities. If we charge a £3,000 fee and draw down £3,000 of funding we could make a profit by getting rid of inefficiencies. I feel confident that we could make a ten per cent return.”[52]

In fact a bigger barrier to entry for these companies may be opposition from academics themselves, and the unions in particular. Sally Hunt, Secretary of the University and College Union, has made her position very clear: “We are not prepared to watch our universities risk hard won reputations and future financial health by signing capital and revenue over to what are in effect private sector property developers. We've seen the disastrous consequences of this kind of privatisation across the public sector and will fight it wherever it rears its head."[53] Bearing this in mind, there would need to be a very clear steer from the government that private providers have something valuable to offer to the market, if they are to be more actively involved.

Poor Governance

While most institutions are run very well, it is not clear that there are sufficient safeguards when things go wrong. A failing institution and a failure of governance inevitably go hand in hand. Higher education institutions are legally independent corporate institutions and hence the governing body has "ultimate responsibility for all the affairs of the institution".[54] Almost all institutions are dependent on public funds allocated primarily by the four UK funding bodies, and are therefore accountable to them for the use of the funds allocated, and in particular for meeting the terms of a financial memorandum.[55] The problem is that the funding bodies (such as HEFCE) are limited in their ability to intervene in cases of failure of governance, and are wary of encroaching on the firmly held (and important) principle that institutions should remain autonomous from the state and free to make strategic decisions of their own accord.

It is clear from our interviews that serious governance problems are not as rare as one would hope. One senior government source recalled an occasion when a routine funding council audit discovered that an institution would have gone bankrupt within only three months. Shockingly, senior management appeared to be unaware of the dire financial position of the institution, with the internal audit committee having recently signed off a good bill of health to the board. In a similar case the funding council found that as a result of devolving its finances to individual departments, the management of one institution was blinded to a very large total deficit that had begun to accumulate. Again the board had no indication that the institution was running itself into serious financial difficulties.[56] In these two cases HEFCE stepped in and averted a crisis, but these examples show very clearly that poor management and governance can seriously threaten the viability of institutions.

One vice-chancellor said that it would be possible to “bounce a board incredibly easily; you choose which information to give [at board meetings]”. He added: “The failure of UK higher education has always been a failure of governance. Some boards are just dire – governors don’t ask and management don’t tell.”[57]

Thames Valley University

The crisis at Thames Valley University (TVU) in the late 1990s is a clear example of the impact that poor leadership and governance can have on an institution. In 1997 the university was accused of ‘dumbing down’ standards to pass more students, resulting in the Quality Assurance Agency stepping in to launch a full-scale investigation.[58] The ensuing report was damning, cataloguing a host of failings including “disbelieving external examiners, a disaffected workforce, poor management, weak communications and serious questions about standards”.[59]

The vice-chancellor, Mike Fitzgerald, was forced to resign. HEFCE appointed an external review team, led by a vice-chancellor with experience of handling management failure, along with an education consultant from Pricewaterhouse

Coopers. At the time HEFCE warned that compliance with the review team's recovery plan could be "a condition of future grants".[60] QAA sources suggested at the time that TVU governors were ignorant of what was going on – they were not asking the right questions and they were not picking up on weaknesses in the university's management.[61]

The Role of the Funding Council

What powers does HEFCE have now?

HEFCE's powers to intervene when institutions are struggling are not clearly stated or understood. As a public regulator HEFCE is unusual, in that it doesn't have the power of direct intervention like other regulators such as the Learning and Skills Council. This is largely due to the fact that HEFCE deals with institutions that are independent, self-governing organisations. As a result, HEFCE cannot require vice-chancellors or governors to be replaced, but instead must work with a board to make any necessary changes. For example, HEFCE might say that they do not have confidence in a particular vice-chancellor or management team, and as a condition of their grant they expect the board to redress that situation (without directly demanding the removal of staff). As outlined in their model financial memorandum support strategy for institutions and related bodies 'at higher risk', HEFCE might also "request" an interim management team, or possibly secondments, which they may share the costs of.[62]

Crucially, it is not clear whether HEFCE's powers are as strong as its predecessor the UGC. This is largely because the financial context has meant that such powers have not been tested. HEFCE is certainly a different beast from the UGC, with much less of a planning role, and there is significant debate in the sector about exactly what HEFCE's role should be going forward. Many suggest that it should have more strategic power, particularly at regional level.

Provision for the very small number of institutions deemed to be 'at higher risk' is generally good, however there is a real question about whether problems are missed elsewhere.[63] HEFCE's Assurance Service team, which consists of around 15 people, is responsible for monitoring and reporting strategic risk and institutional failure in all English higher education institutions. Their most visible and publicised role is to categorise institutions into two bands: those 'at higher risk' and those 'not at higher risk'.

The Assurance Service team has three main auditing activities:[64]

- **The 'single conversation'** – this is an annual process whereby institutions report back to HEFCE on their data collection, risk management and corporate governance practices, and assure them that their money is going where it should be going;
- **Assurance audits** – for all institutions 'not at higher risk' an assurance audit takes place once every five years for approximately one day. These are extremely light touch, and HEFCE starts from a presumption that all of the information supplied in the single conversation can be relied upon. The purpose of the audit is simply to gain additional assurance on the reports institutions send through each year. This process is in consultation with those responsible for external auditing, including the institution's vice-chancellor and senior team, the auditors and the chairs of the governing body and audit committee. HEFCE classifies the vast majority of institutions as low risk and as a result most audits tend not to have a particular focus, although more frequent audits are tailored for those institutions deemed to be 'at higher risk';
- **Data audits** – this is another audit carried out on a five-year schedule. It is not harmonised with the assurance review. Because the whole system of accountability is so dependent on data, and there are serious financial consequences for any major discrepancies (as in the case of London Metropolitan) in this audit, HEFCE takes a very close look at an institution's numbers and systems to ensure there are no irregularities or difficulties.

What needs to change?

We agree with the sector that it is very important to safeguard institutional autonomy. However, we are concerned that the somewhat casual system of five-yearly one-day checks by the funding council is not sufficient for organisations that receive such large sums of public money. The government should initiate a debate about the best way forward. To avoid any unnecessarily heavy-handed political intervention the sector might decide that it could better regulate itself.

One option that we recommend exploring is the introduction of an annual audit by the mission groups representing the different parts of the university sector, in addition to HEFCE's audit. For instance, Million Plus or the 1994 Group would review their own member organisations. Universities would doubtless benefit from the very specific planning expertise of their own coalition. Some might argue that these groups would have a worrying conflict of interest here. Yet we feel that on the contrary their vested interest in maintaining the reputation of their part of the sector should mean that they are likely to review their own institutions in a tougher manner than HEFCE's "extremely light touch" audit implies. Such a solution would require these groups to fundamentally alter their remit but should suit the sector because it puts institutions' own bodies in charge.

Another option would be for the funding council to audit more institutions more regularly. Our higher education system contains some of the best institutions in the world, but also a significant number of institutions which are financially weak. Given the size and variability of the sector now a one-size-fits-all model may no longer be appropriate. Instead the funding council could set out criteria – including financial health and governance record – for monitoring some institutions more closely than others and offering more guidance. There would then be three groupings for auditing: light touch, (five-yearly) regular (annually) and ongoing (for institutions actively 'at higher risk').

Outside of the standard regulatory audit process, HEFCE has regional advisers who visit each institution annually to discuss their performance against strategic targets. At a time when the sector is facing considerable change, and with some institutions clearly demonstrating an inability or unwillingness to clearly define and refine their strategic mission, such a system could be extremely useful in keeping institutions out of trouble. Universities should of course remain free to ignore any advice that they are given, but as these advisers have the potential for an unusually in-depth and broad understanding of the sector their views could be very helpful.

Unfortunately some of the feedback from the sector is that such reviews are currently weak and often dismissed out of hand. One senior university manager told us: "The regional advisers tend not to have prepared well and the advice is often rather low grade. They could be useful in suggesting opportunities as well as threats, but the people doing this job would need to be really good."[65] HEFCE should review the role of regional advisers to improve their feedback and guidance to institutions.

Above all, there is a real need for clarity about HEFCE's powers to intervene in the case of failure. We suggest that HEFCE should have a definite remit to suspend a university's grant and remove the management team if there is evidence of serious mismanagement. It could be argued that HEFCE already has these powers. In the financial memorandum that all universities have signed up to, the funding council states that in extreme cases with 'at higher risk' institutions it can take measures including 'engaging with the chair of the board or audit committee', 'engaging with the whole governing body' or 'requesting the appointment of interim managers or secondments from HEFCE'.[66] However, language such as 'engage' and 'request' is surprisingly weak. More importantly, most of the senior figures we spoke to from within the sector felt that it was unclear and unproven to what extent HEFCE could intervene in times of serious mismanagement. This needs to be clarified. If there is a clear breach of the rules and a misspending of public money the government (via its funding council) must surely be seen to step in.

Conclusion

The British higher education sector contains some of the best institutions in the world: universities that lead not only in terms of their education and research but also in how they are managed. However, in a sector of its size there will inevitably be some weakness. In the UK there have been some clear examples of serious mismanagement with major financial consequences, although many crisis situations have been kept firmly out of the public domain. This leads to two crucial questions. First, do we have sufficient systems in place to detect and deal with these problems when they arise? And second, if an institution does come close to the brink, should we allow it to go under?

Given the amount of public money that goes into higher education we are not convinced that there is sufficient accountability. This is not necessarily the fault of the funding council. It is currently trying to walk a precariously thin line between protecting the all-important autonomy of universities and operating sufficient oversight that it can spot and help institutions before they get into really hot water. Yet the evidence that London Metropolitan has somehow over-claimed in the region of £50 million of public money suggests that this oversight regime is not working as it should be.

There needs to be a debate with the sector about how universities are reviewed. And there must be more clarity about exactly what powers HEFCE has. None of the senior university figures we spoke to were quite sure about exactly what the funding council could or could not do when a university was being mismanaged. This is a very harmful message to be sending out. It is time for the government to stop pretending that failure does not happen and to start giving a clear steer on how it should be dealt with.

We believe that the current assumption that no university can go under is damaging. An environment in which all vice-chancellors and governors know that if they get into trouble they will be bailed out can only encourage bad practice. Moreover, an environment in which politically-driven mergers happen behind closed doors means that institutions are not learning from each other's mistakes. Nor is public money always being spent wisely.

While outside London the economic and social impact of a major university going under would be so great that a merger or takeover – carefully planned and with a very clear institutional mission in mind – would almost certainly be the preferred option, that is no reason not to debate and discuss what should happen if institutions are failing.

A model for London

Within the capital, where there are an astonishing 42 higher education institutions, there should be a realisation that a university could close, if that is shown to be the best use of public money and assuming that students can be satisfactorily located elsewhere. The government should also be thinking hard about allowing private providers to take over part of a failing institution, especially where no other university is keen to step in.

The London higher education sector is ripe for some really adventurous thinking. Rather than trying to force financially unstable institutions together with a vain hope that this will achieve efficiencies, failure should be met with creative solutions. For instance, the government could take over a struggling access institution and rebrand it as a national institute of lifelong learning, with colleges run by both the private and public sector. The new institute could provide a model for other regions to follow, with a clear progression from further education to higher education for local students of all ages and backgrounds. Something similar to this (without the involvement of private providers) was planned in Bradford in 2001, but there was insufficient political will and the model collapsed. In our new economic climate we cannot afford to prop up failing universities simply to save face. In higher education, as elsewhere, we need transparency and creative solutions.

Recommendations

- The government and HEFCE should work to provide better information for the sector on institutional mergers. When mergers or takeovers happen they must be driven by a clear vision of what the new institution's mission will be rather than simply a political desire to prop up a failing institution.

- The government should consider allowing private providers to take over all or part of an institution in the case of failure. Currently private providers cannot receive funding from HEFCE, and this is the most significant obstacle to their entry into the higher education marketplace. However, the government could overcome this problem by offering a contract to a provider to deliver particular education services. There would be two possible options here: the merger could be done as a full acquisition or the private provider could effectively rent the university under a Private Finance Initiative agreement for a number of years.

- The government must clarify exactly what power to intervene HEFCE has in the case of failure. We suggest that HEFCE should have a definite remit to suspend a university's grant and remove the management team if there is evidence of serious mismanagement.

- The somewhat casual system of five-yearly one-day light touch checks by the funding council is insufficient. The government should initiate a debate about the best way forward. Options could include mission groups such as Million Plus or The Russell Group undertaking an annual audit of their institutions, or the funding council setting the criteria for auditing a larger number of universities with potentially weak finances and management.

- At a time when the sector is facing considerable change, and with some institutions clearly demonstrating an inability to clearly define their strategic mission HEFCE should take steps to improve its network of regional advisers to offer better advice and guidance to institutions.

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