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Creating the conditions for a more resilient and sustainable higher education system in England

DECEMBER 2024

In association with

MILLS & REEVE

Executive summary

The higher education sector in England continues to face significant financial headwinds. The Westminster government's forthcoming higher education strategy will need to explain what it expects from higher education in terms of its core priorities of access, quality, and contribution to economic growth and regional civic development, and how it expects that these areas will be funded.

The sector will certainly hope for a sustainable financial settlement to emerge from the Spending Review, but given the wider economic climate the sector is likely to face funding constraints and pressure for efficiency for some years to come. It is likely, therefore, that in some areas of activity providers can best realise the public and student interest and enhance their impact through collaboration rather than competition.

This project takes as its starting point the current dearth of law and policy that addresses either short-term provision for a provider in significant financial distress or facing insolvency, or the medium to longer-term landscape in which various forms of strategic and structural collaboration between providers could contribute to long term sector resilience and sustainability.

Wonkhe and Mills & Reeve have engaged in conversations with a wide range of sector stakeholders including heads of institutions, sector representatives, and Board chairs.

Our broad recommendation to Boards and executive teams of providers is to consider the scenarios discussed in this report and use them as part of internal scenario planning, both for ongoing efforts to achieve financial sustainability and as part of strategic development for the future.

Our recommendations for government and the regulator focus on reshaping the policy conditions to encourage providers to explore the range of their options for strategic collaborations. We believe there is a case for implementing or at least initiating some of these recommendations in advance of the publication of the higher education strategy, to help inform the development of the strategy and set the direction of travel for the sector.

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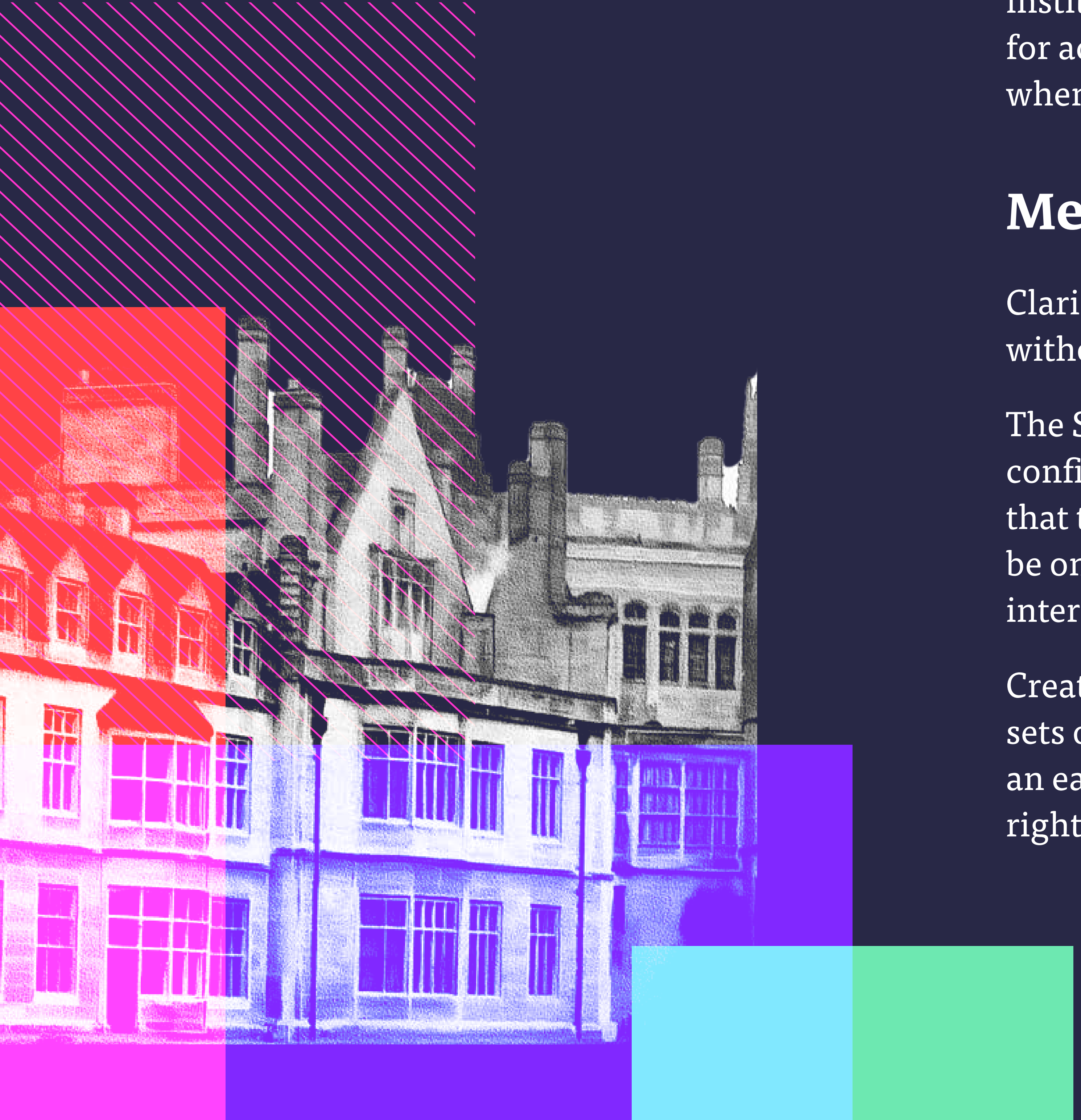
List of recommendations



Managing financial distress

Create a special administration regime to oversee orderly market exit including, where possible facilitating the orderly transfer of students, staff and assets to another provider where one can be found.

Work with lenders to articulate a working set of criteria and provisions for supporting a distressed provider back to stability.

Ask a sample of Boards to undertake scenario planning exploring the processes and conditions for successful inward student transfer as a learning exercise.

Provide clarity on the level of support available to an acquiring institution in respect of inherited liabilities to help mitigate the burden for acquiring institutions and reduce the level of due diligence required when exploring the possibility of merger or acqusition.

Mergers

Clarify the terms on which conversations about merger are permitted without concern about breaching competition law.

The Secretary of State could issue guidance to OfS to facilitate confidential "protected" discussions between providers, making it clear that the presumption of the assessment of the merits of the case should be on the basis of realising strategic opportunity and serving the public interest rather than mitigating financial distress.

Create a statutory process and regulatory framework for merger that sets out a clear process for merging organisations to follow and includes an easier and more efficient route to transferring the institution and its rights, liabilities, claims and accreditations, with associated guidance on the obligation to students during a merger scenario and protection of accreditations to existing and past students.

OfS could define the conditions under which it would consider giving special consideration to a recently merged provider in the form of a standstill period of protection from significant regulatory intervention. This could include provision for a period in which key financial and academic metrics were considered in disaggregated form, to give the newly merged provider a reasonable opportunity to stabilise.

Establish a process to name "preferred" strategic advisors to boost expertise and capacity in the sector, who could help in facilitating early discussions, advise on strategic, legal and regulatory implications.

Strategic collaboration

Publicly endorse the principle of greater strategic collaboration and formally solicit the opinion of the Competition and Markets Authority on how higher education institutions can collaborate in the public interest on what they offer to students and on how they combine resources, while protecting the elements of competition that benefit the student consumer.

Ask OfS to consider the regulatory implications of federation or networked governance models and other forms of strategic collaboration that could affect the student interest.

Develop a data publication strategy for higher education that is place-informed, working with the various national bodies to create insight around which higher education providers can convene and develop their strategic thinking.

Remove some of the VAT and procurement obstacles currently hindering shared services arrangements between institutions.

Financial sustainability challenges in the higher education sector in England

Despite the Westminster government's recent announcement of an inflationary uplift to the unit of resource (the undergraduate full-time fee cap) for higher education providers in England, the financial headwinds facing the sector remain extremely challenging.

In May 2024 the Office for Students (OfS) published an assessment of the sector's finances which set the various pressures on institutional income and costs. These included:

- Home and international recruitment numbers in aggregate lower than where they were expected to be (with a number of providers identified as being particularly vulnerable to shifts in international recruitment numbers)
- Inflationary pressures on staff pay and other costs; in combination with an eight-year freeze in the unit of resource
- The rising cost of pensions contributions
- The costs of estate maintenance and development; and the cost of investment to reduce carbon emissions

At the time OfS warned that the sector could be suffering from "optimism bias" in projecting growth in recruitment beyond that which could be realistically achieved.

An update issued in November 2024 in light of the latest aggregate international and home recruitment numbers confirmed that the sector in aggregate had fallen short of the predictions that informed the May analysis by 10 per cent in the case of home students and by 23 per cent in the case of international students. Noting that in some cases providers will have adjusted their forecasts and sought cost-cutting measures in light of the May publication, OfS nevertheless warned that as many as 72 per cent of providers could be in deficit in 2025–26.

OfS and its regulatory powers

OfS was created as a market regulator for higher education in England by the Higher Education and Research Act 2017 (HERA). Its duties, in addition to broad responsibilities to ensure that higher education providers comply with a core set of regulatory expectations, include to promote competition between providers where that is in the interests of students and the public, and to promote collaboration between providers where it judges that to be in the public and/or student interest. It is also responsible for facilitating entry to the sector of new providers and enabling the acquisition of new degree awarding powers to existing providers who do not hold them.

Its approach to regulation, as codified in HERA, sets out the criteria by which providers may be included on the OfS register of providers, with indicators of how it assesses whether those criteria are met. It remains the responsibility of individual providers to provide high quality education and student support and decide what strategies will best secure the financial sustainability of the institution in the context of the higher education market without compromising the quality of their education offer.

It is also in theory the responsibility of individual providers to secure protections for students in cases where the provider is either pursuing significant change that would affect its ability to meet its contractual obligations with students, or find that it is actively unable to meet those obligations. For example, in the case of closure of a particular course in the normal run of business providers would be expected to arrange for "teach out", or to negotiate an option of a satisfactory alternative with affected students.

In practice under the policy settlement of the last decade, while HERA makes provision for OfS to promote collaboration between providers, the market incentives have proved more compelling for institutions to follow with, at times, fierce competition for students. Those institutions that have a stronger market position have been able to recruit and grow student numbers, while those who are less successful have seen more modest growth or reduction in numbers.

The limitations of the market as an organising principle for HE at times of financial challenge

While it remains the case that higher education providers are autonomous and responsible for their own financial plans, providers have had to navigate a very challenging external environment in the last decade, with Brexit, the Covid-19 pandemic, and policy changes around immigration creating an unusual degree of instability. Until recently the reasonable prospect of continued growth in student numbers may have masked deeper structural and financial weaknesses in those providers losing market share in key areas, but as this prospect becomes less likely, many providers are looking more fragile.

Higher education providers in England are arguably not very "mature" operators in a marketised and competitive landscape and have had to learn quickly how to be competitive and seek strategic advantage, with varying degrees of success. It has been notable during this period how much activity has been focused on general marketing and promotion of the value of graduates and higher education, and how little radical innovation there has been in the sector in the sense of institutional transformation of product, or operating models.

There has been some more modest change, for example, some providers have developed provision of degree apprenticeships or have expanded higher education franchising partnerships in the UK or abroad. But arguably the changes have not kept pace with the rapidly advancing industrial landscape. In some cases, new ventures have been unsuccessful, carrying a significant cost in terms of resource, opportunity cost, and reputational impact and perhaps deterring others from taking similar risks.

There are structural and cultural systemic barriers to radical change in pursuit of strategic competitive advantage. The nature of the higher education market and demand remains focused on the traditional three-year full-time study model, with limited evidence of demand for other options sufficient to prompt investment in a different kind of offer. Most of the larger multi-faculty providers and many smaller and specialist providers are charities, and have significant commitments to their regions, and to the extension of knowledge through research, which would be given consideration as part of strategic decision-making. Capital investments tend to be significant with long-term commitments to lenders, and based on a level of assumption of a relatively stable operating environment. Staff pay and pension contributions are negotiated nationally and are not in providers' gift to change.

Culturally, higher education tends to be very consultative, with a significant degree of autonomy for higher education staff and departments and a collegial style of decision-making with a number of discussions and areas of concern that are considered to be protected academic matters. While higher education providers do function as organisations with strategic intentions, in practice effecting significant organisational change is highly resource-intensive. This is not to say that higher education providers are unable to innovate or respond in an agile way to their external environment, it is just that this is more likely to take place in a discrete domain such as an area of professional practice or an aspect of learning and teaching, rather than across the core operating model of the whole organisation except, perhaps, in times of direst need.

At a system level there are questions about the limitations of market regulation to secure public and student interest. As the financial challenges mount, providers will make rational choices about their education and research portfolios, the support that it is feasible to offer as part of the wider student experience, the extent of their capability to engage with their region, and so on. At individual provider level these choices may contribute to financial sustainability in the medium term but the aggregate impact on regional economies and culture and the national picture for some areas of subject provision and knowledge production could be significant.

While there is a legitimate argument to be made that autonomous providers should be able to manage their finances to ensure their continuing solvency, there is also a necessary and pragmatic confrontation with a reality that some may not be able to. And while there are statutory processes for when a company becomes insolvent and exits the market, no clear insolvency process currently exists for higher education providers that are not companies incorporated under the Companies Acts.[1] As such the impact on students, staff and regional economies of a large provider exiting the market in a disorderly, unplanned way could be catastrophic to the regions in which they exist and to the sector as a whole.

The current state of play

The Secretary of State for Education Bridget Phillipson has asked OfS to "refocus" its activities and prioritise financial sustainability of the sector in England as part of its acceptance of the recommendations of the public bodies report *Fit for the Future* reviewing OfS by David Behan, who was subsequently appointed interim chair of the regulator.[2]

In its updated assessment of the financial sustainability of the sector in November 2024 OfS has indicated it is working with "providers that are particularly exposed to financial risk" to discuss the plans the provider is making to address those risks, stress-testing the validity of the plans themselves and the capability of providers' boards and management teams to implement them, and "working closely with other organisations, as and when needed, to ensure that students' interests are paramount in the event of a course or provider closure." The regulator has also appointed insolvency consultants to support its financial sustainability work.

OfS has also advanced the possibility of structural change as a means of addressing financial challenge, saying:

"Where necessary, providers will need to prepare for, and deliver in practice, the transformation needed to address the challenges they face. In some cases, this is likely to include looking externally for solutions to secure their financial future, including working with other organisations to reduce costs or identifying potential merger partners or other structural changes."

[1] For further discussion of provider insolvency during the summer of 2024 immediately post General Election, and proposals for solutions from Wonkhe/Mills & Reeve and from Public First see: https://wonkhe.com/blogs/how-an-incoming-government-could-act-immediately-to-stabilise-universities-at-risk-of-financial-collapse/; https://wonkhe.com/blogs/the-government-must-mitigate-the-risks-of-a-university-going-under/

[2] Fit for the future: independent review of the Office for Students https://www.gov.uk/government/publications/fit-for-the-future-independent-review-of-the-office-for-students

Exploring the conditions for structural change: project intent and methodology

It is against the backdrop of these systemic financial pressures, and concern that the policy and regulatory environment is not currently especially supportive of structural change, strategic collaboration, or orderly market exit, that Wonkhe and Mills & Reeve embarked on a project to explore the sector's appetite for solutions that involve radical structural change. The Mills & Reeve team is experienced at providing legal advice on transformational projects for universities including group restructuring, shared services, federations and mergers. Mills & Reeve has recently led the legal work for the two biggest mergers in the sector for 20 years and has observed at close quarters the lack of a regulatory and legislative roadmap for managing mergers and other forms of collaboration.

We have also collectively observed and taken part in conversations that explore many forms of radical strategic collaboration and have given consideration to the conditions for managing market exit. We have concluded that there is a dearth of policy and guidance that can help the sector as a whole navigate this relatively unfamiliar territory. While higher education providers are in theory free to open discussion about strategic collaboration up to and including merger, the lack of a policy framework for doing so including protecting the key attributes and metrics of a university during any restructure significantly increases the opportunity cost and risks of pursuing this as an option.

This has implications for the sector and regulator's efforts to tackle the current financial sustainability crisis; but it is also an important consideration for government as it works up its forthcoming higher education strategy, due to be published in the summer of 2025.

In a recent letter to heads of provider in England Bridget Phillipson set out a number of priorities for the sector incorporating expectations of progress on access and inclusion; contribution to economic growth and skills; civic and regional engagement; quality; and efficiency. Where there is public value and interest in institutional collaborations; or where there can be gains in efficiency; or providers can collectively enhance their impact, there is merit in considering what policy and legislative changes could enable and support those activities, for the long-term resilience and efficacy of the higher education sector.

What follows is a combination of our own analysis, and insight drawn from a number of semi-structured interviews and round table discussions held in October and November of 2024 including:

- Ten one to one interviews with heads of institution or a member of the executive team (in two cases) from a range of types of provider in different regions of the country
- A round table with staff from sector representative bodies, mission groups, and regional groups
- A round table with chairs of governors from six providers
- An interview with a lender to the sector

All interviews and round tables were conducted on conditions of total anonymity.

1

Short-term scenarios for providers in immediate financial distress

A large provider becoming insolvent has been the subject of intense speculation at various points, most significantly in recent times when the last government announced a higher education restructuring regime in 2020 in light of concerns about financial instability and increased risk of provider insolvency during the Covid-19 pandemic.[3]

That scheme was subsequently closed, and there remains no formal process for managing providers at immediate risk of insolvency. In practice officials at the Department for Education (DfE), working with OfS, would most likely assess on a case by case basis the public and student impact of that provider exiting the market and would likely seek to facilitate one of three possible outcomes: market exit and transfer of students elsewhere, supporting that provider to stabilise through provision of something like a bridging loan, or facilitating the acquisition of that provider by another one – or some combination of these options.

Market exit

Where a higher education provider is structured as a limited company there is a legal path to market exit via the same means as a private company. In such cases an administrator would normally be appointed to oversee the dissolution of the organisation and sale of its assets to pay creditors – though there are disincentives for administrators to take on higher education providers because there are additional complexities involved. In the example of the market exit of the Academy of Live and Recorded Arts (ALRA) the provider was forced to liquidate because no administrator was prepared to take on the potential costs. Where a provider goes into liquidation there can be no provision for teach-out for students, or time to manage the implications for the provider's stakeholders, and what has most frequently been observed is a scramble to rehome affected students.

For higher education corporations or those constituted by Royal Charter or Act of Parliament there is no legal provision for managed market exit. The working assumption is generally that it is not in the best interests of students, regional economies and the wider HE sector that a provider should exit the market, but it is understandable that the government is not especially open to making wide-ranging statements about its commitment to protecting any and all HE provision. Not only could there be a case for market exit for some providers if there is no obvious route to financial sustainability, the moral hazard of writing a blank cheque could disincentivise the kind of transformation required to secure that longer-term sustainability.

So if market exit is to be retained as an option, there needs to be a defined process and special administration regime. Special administration regimes already exist in other sectors (for example, rail, energy, and postal services) to protect an overriding public policy objective such as continuing to provide an essential service.

Most notably, a special administration regime applies in relation to further education to provide specific protection for continuity of learner provision. Assuming a special administration regime in higher education would be similar in form to the regime in further education, the special administrator would have a duty to manage the affairs, business and property of the provider with a view to avoiding or minimising disruption to the studies of existing students through a managed wind down.

In addition the regime would explain where the responsibilities lie for, for example, securing alternative provision for students, with consideration given to questions like what is on their degree transcripts, and the extent to which those students can claim compensation, and from what source, if they do not consider the alternative provision on offer to be suitable.[4]

Optimally it should be possible to time the transfer of students to a new provider so as to minimise the disruption for the largest possible numbers of students (probably over the summer in most, but not all, cases). The current assumption, that a provider facing liquidation will also be able to make provision for teach-out or transfer of students, arose in the case of ALRA, but has not been tried in respect of a larger provider.

Even if there were to be a special administration regime in place, facilitating the transfer of thousands of students with different needs and expectations would bring its own complexities, requiring credit transfer arrangements, and renegotiation of student contracts at scale, potentially with additional compensation. The likelihood is that in some cases no satisfactory alternative provision could be found. That is before the position of students who hold a current offer

[3] https://www.gov.uk/government/publications/higher-education-restructuring-regime

[4] The Office of the Independent Adjudicator has warned repeatedly of the challenge of managing large-scale student transfer, most recently here: https://wonkhe.com/blogs/the-realities-of-student-transfer/

from the provider were to be considered – though in principle most would have other choices or could enter Clearing, they may technically have a claim for breach of contract and may seek compensation.

There is an option short of total market exit which a special administration regime could oversee: the forced closure of particular courses or departments in the provider facing insolvency, and the transfer of students on a smaller scale. Perhaps over time there could be a scaling back of activity in a managed way that allowed for teach-out, or staggering of departmental closures. However, there would still be significant liabilities for student compensation as it is highly unlikely that a provider undergoing managed closure would be able to continue to offer the quality of education or support to students offered at the outset, as staff left the organisation and resources dwindled.

Insolvent providers have responsibilities beyond their contract with students; there would be research contracts, partnerships with business and international stakeholders, liability for borrowings financing capital investment and, of course, the provider's staff who would be de facto made redundant, with the associated compensation.

While being potentially superficially attractive as the "cleanest" option, market exit could turn out to be the most expensive option, both in terms of the costs of managing the process, amounts paid to receiving providers and students to enable transfer of provision, and the long-term impacts on regional economies and innovation ecosystems of loss of an anchor institution. The effect on the health and reputation of the sector as a whole would also be formidable.

"Market failure of even a single institution, unmanaged, unfettered, destroys the reputation of that country for years. No international student will come to it. Companies won't invest in it. There'll be questions about the qualifications of any student coming out of that structure. It is incredibly damaging."

— Sector stakeholder

The merits of a special administration regime lie not only in the orderly management of market exit – which in the case of a large provider should be considered only as a last resort. A special administration regime would bring legal clarity for trustees and lenders and more secure protections for students that would aid all concerned in navigating decision making for distressed providers.[5]

Distressed purchase

It is widely assumed to be unlikely that a provider facing insolvency would be a desirable target for acquisition by another institution. We tested this proposition in our conversations with heads of institution, offering the hypothetical scenario of a head of institution receiving a call from DfE officials canvassing interest in acquiring another provider facing the possibility of market exit.

It is often assumed that there would be no appeal at all to any financially stable provider to acquire one that was fundamentally financially unstable. Certainly it is not something that any board of governors would take lightly, as there would be significant risks involved. But it is worth noting that most higher education providers feel a corporate sense of responsibility to their sector and to their region as well as to their own institution and its stakeholders. Indeed, an institution's charitable objects may be sufficiently wide to allow it to act outside what might be thought to be its own immediate interests, though this would have to be assessed on a case by case basis.

Acquisition need not be for the whole of a distressed provider's business; it is possible to imagine that some parts of the insolvent provider – for example, a business school – could be reconstituted as a going concern and absorbed into another provider, in a "cherry picking" scenario. This in itself raises complexities over the process for acquiring a part of another provider and what liabilities and debts would be attached to that acquisition. Also, provision would still need to be made for the students that remained attached to the part of the provider that was not being acquired.

"Why would we take on a failing institution to close three quarters down and get all the bad press and everything else? And there might be one or two bits in it that we might be interested in, but most of it is surplus to requirements. So there's no advantage of us going in, taking over and closing it down, you might as well just wait for it to fail and pick up the bits that you want."

— Senior institutional leader

Of the heads of institution we spoke to, the majority said they would give any such hypothetical proposal consideration, particularly paying close attention to the overall strategic fit between the two providers and the extent to which the acquisition would enhance the acquiring institution's ability to realise its mission and grow its impact. Without that strategic fit there would be no appetite to entertain the proposal, because of the significant risks and downsides, though any head of institution would take a call from OfS or DfE in this scenario very seriously before dismissing their "asks" out of hand.

[5] For discussion of the provisions of a special administration regime for higher education from Mills & Reeve see: https://wonkhe.com/blogs/higher-education-in-england-needs-a-special-administration-regime/

Concerns from heads of institutions on the headline risks of acquiring a distressed institution include:

- The costs of financing a merger or acquisition, even less welcome at a time when most providers are seeking to reduce costs and streamline to manage financial pressures
- The possible impact on institutional performance metrics, such as student outcome metrics, or regulatory assessment of financial sustainability, with associated impact on brand and reputation
- The opportunity cost of devoting management and Board time to what is likely to be a long and drawn-out process when most providers are focused on managing cost-saving imperatives
- The possibility of additional regulatory attention and associated regulatory burden
- The potential for negative perception among current staff and stakeholders of the acquisition and the destabilising effect on the academic community of integrating a new cohort of staff and students into the institution (who themselves may be suspicious of the acquiring institution's intent)
- Not being able to access sufficient information about the true financial position of the distressed provider until too late in the process to inform the decision

"There'd be a perception. You know, they're going to asset strip. They're going to close, because, you know, their biology is better than our biology. And so we're going to be out of a job. So those things are really, really hard to manage."

— Head of institution

Finance was not a primary concern, though no head of institution or Board would likely be willing to take on the full costs and risks of acquiring a distressed provider without significant support to offset those costs. It is possible to imagine some provisions that could be made to mitigate some of these risks, for example, creating special regulatory provision for providers that have recently acquired all or parts of others at the behest of government, to protect them from investigation for a period of time to allow space to stabilise, including ringfencing performance metrics.

"I'd like a degree of assurance that if I was to become the accountable officer there weren't lots of strings attached in terms of being able to do the job, and it wasn't just, 'here's the university that's in financial difficulty. Take it over and sort it out without any financial support.' I'd be very reluctant to do that, because that is heavy lifting. And then, of course, the fundamental question would be in terms of my board here, how willing would they be for some of my time and the senior management time from the university to be distracted away, because that would be a clear risk for the university. So they need to see obvious benefits in the longer term, in terms of what effectively would be a takeover situation, where we could do an economic case around the fact that the shared services that would then follow, all the efficiencies that will follow."

— Head of institution

There was a degree of scepticism among heads of institutions and particularly Board chairs that government support to any acquisition would be sustained for long enough for the merged institution to begin to stabilise and perform – those with experience of NHS mergers cited examples of where hospitals had come under pressure to take over underperforming hospitals and were then subsequently blamed for not turning them around fast enough.

"We need to talk about those spaces, to innovate, to change, to do something different, to merge, to transition to whatever it is we're going to do. But we need a sandbox in which to do it in... [and not start seeing] B3 investigations everywhere. We need the regulatory sandbox that says this is a no poke zone. We are not going to pester people. We're going to let that regulatory sandbox stand."

— Sector stakeholder

There was also a sense that the acquiring institution would be moderately likely to close down the new provision once the period of leeway had expired, if it had not been able to make a success of it. And among some Board chairs in particular there was a concern that the length of time the decision would take as to whether to take forward the acquisition plan would make the idea unachievable from the outset, though others felt that their institution could make quick decisions when the context called for it. There was also a concern from the Board chairs that the executive team might not have the experience and skills to see through a successful merger or acquisition.

Stabilising the struggling provider

Given the unpalatability or complexities of the alternatives it is not surprising that the priority of all concerned has been to seek ways to stabilise providers that have encountered financial difficulties – including avoiding any public indication that a particular provider is a subject of enhanced regulatory attention through the application of a formal condition of registration.

OfS has some complexities to navigate around its statutory role and strategic objectives here; while at the macro level the interests of students should generally be viewed as being in alignment with the ongoing survival of the provider at which they are registered, material risks to quality and delivery of contractual services may also theoretically require regulatory attention. That means that there is a scenario in which OfS could be asking a provider for assurances about how it is going to rectify issues with quality or non-delivery of services while at the same time asking for assurance about how it will remain financially sustainable. The varying roles of OfS and DfE in working with providers at risk is also rather murky and could usefully be clarified.

Moreover, a provider that is struggling financially must engage not only with the regulator but also with its lenders, who can sometimes be overlooked or taken for granted in these discussions. Our experience is that UK banks that lend to the sector tend to take a supportive view, seek consensual renegotiation of covenants where a provider is at risk of a breach, and see their interests in UK economic growth and success as being in strong alignment with the health of the HE sector as a major contributor to the UK's economic wellbeing.

The lender we spoke to was very clear about the importance of higher education to the UK economy and judged that in the majority of cases, notwithstanding current efforts to reduce costs, such as mothballing capital investments, or reducing staff through voluntary or compulsory redundancy schemes, which will have long term capacity impacts of their own, most providers remain in a good position to continue to operate without raising significant concern.

However, after the last two very challenging years, privately, lenders are increasingly concerned about their exposure to the HE sector and facing awkward questions from their executives about the long term stability of their investments, particularly for some medium sized and smaller providers.

While it would be reputationally very damaging for a lender to pull out of a relationship with an HE provider (ie to cause it to become insolvent by refusing further lines of credit) there is realistically a limit to lenders' willingness to prop up the sector in the absence of a sustainable financial settlement from government. It is also probably safe to assume that non-UK based lenders such as large US pension funds, for example, would be less tolerant.

From a lender perspective the judgement about provider sustainability rests on the calculation of whether provision of UK student education can be delivered sustainably on an ongoing basis. International student income is too unreliable to be the basis of sound financial planning. At a macro level providers need to be able to invest to continue to transform, grow and enhance their impact, so a reduction in appetite among lenders to provide finance to a subset of providers would have the impact of widening the gap between the providers that can attract investment on favourable terms, and those that are less able to do so.

While it may be preferable from a government perspective to encourage struggling providers to reach accommodation with lenders, there may come a necessity for the government to play a role in underwriting private finance, and/or providing bridging loans to providers that are unable to secure private finance. And ultimately there will need to be some criteria for judging whether any given provider has the capability to become a financially stable going concern, or whether at some point the spiral of cost-cutting and finance renegotiation reaches a tipping point where there is no longer a case for continuing to provide emergency finance.

Stability with an exit strategy

The apparent assumption that students will simply and easily be transferred from a failing institution to a stable one or that a neighbouring higher education provider will take on a financially stricken one is not a good assumption. Notwithstanding an underlying willingness among providers to offer that support, cost and institutional fit are two strong reasons for these not being valid options. In many regions and for many providers stabilisation is likely to be best for students, the region, and UK higher education as a whole.

However, it is increasingly apparent that the absence of law providing the route for insolvency of providers established under Royal Charter or as higher education corporations is a major obstacle for what OfS and DfE expect concerning the protection of students. For this reason greater clarity regarding the obligations of boards/trustees, perhaps through a special administration regime, would be welcome.

In the meantime, governing bodies could be encouraged to scenario plan in principle for the possibility of acquiring a number of students from another provider, and to stress test the organisational appetite for doing so, the provisions that would need to be made and share any specific barriers that could readily be addressed through policy change. OfS could potentially ask a select number of providers to undertake a hypothetical scenario plan as a way of moving towards a broader in-principle process for the whole sector.

2

Medium term scenarios for providers facing significant sustainability challenges: the potential for mergers

In the last section we discussed the possibilities for an acquisition as a measure to address immediate financial distress; there is an alternative version of merger/acquisition that is more focused on the medium-term outlook and the possibility that while neither provider is on the brink of insolvency there would be strategic financial benefit to be gained from merging.

This scenario could involve the de facto acquisition of a smaller provider by a larger one, with provision for maintaining elements of the history and distinctiveness of the smaller entity, or it could involve the merging of two smaller providers, perhaps offering cognate specialist subject provision. What is important in these cases is that the merger is approached as a medium-term strategic opportunity rather than a response to an emergency; once a provider is in serious financial distress there is very little prospect of managing a merger effectively with little or no resource to enable an orderly process.

Scale does not, in most cases, have an appeal in and of itself; larger organisations are harder to manage and some of the affordances of scale, for example around research, could potentially be achieved through coordination and collaboration rather than merger. But recent mergers such as that between Anglia Ruskin University and Writtle University College and City University and St George's University had a strategic rationale, both adding capacity in a specific specialist subject area and opening up potential synergies between that subject area and the wider portfolio of the larger institution, backed up by geographical contiguity.[6]

The strategic rationale for merging

Broadly our discussions indicate that while there is widespread interest in this more strategic kind of merger, there is also a recognition that there is little to be gained in the short or medium term in terms of financial savings. Efficiency could be realised to an extent through reduction of management overheads and sharing services but these are not thought to be significant enough to be drivers for merger in and of themselves. Sector stakeholders pointed out that merging two providers who were financially unsustainable would simply create one larger financially unsustainable provider.

"I think there is probably a mythology of merger which comes from the private sector and not many people in government have much experience of the private sector. And they don't understand quite how brutal those mergers are. Mergers are not nice things in the private sector. They're about sacking lots of people. They're about restructuring. They're probably about selling off property and closing things. And I'm not sure there's an appreciation of how nasty that is. And how difficult it is to translate to what are, broadly speaking, if not technically, public sector organizations which have a different relationship with their surrounding environments."

— Head of institution

There is also recognition, as in the last section, of the costs and risks associated with pursuing merger and the cultural challenges of coming to an agreement between two Boards that is palatable on both sides. Board chairs and heads of institution both emphasised the cultural barriers to mergers, pointing out that generally speaking Boards consider their role to be to sustain their organisation, not wind it up. This is given additional impetus if the institution has historic links and importance (for example having been established by the Church).

There is a question about the case for widespread mergers as a way of organising higher education. The head of a specialist institution we spoke to emphasised the concern that the distinctiveness and identity of the "junior partner" in the merger would quickly disappear if it was absorbed into another institution. More broadly, the sector is invested in maintaining a diverse portfolio of providers to serve the breadth of student demand and diversity of economic and cultural activity across the regions of the country – this investment is echoed in statutory duties imposed on OfS.

[6] An account of the Writtle/ARU merger from former Writtle registrar Holly Duglan can be seen here: https://wonkhe.com/blogs/planning-a-market-exit/

Board chairs emphasised the distinctive culture of higher education, as compared to other sectors in their experience, that could mitigate against pursuit of merger, as well as the lack of "strategic depth" and agility that could enable institutional leadership to navigate this area.

Heads of institution, too, signalled that they would not be keen to take forward conversations without external support and expertise; while there was a degree of assumption that for the right strategic opportunity, and with a sufficient will, the finer points of law and regulation could be squared off, most took the view that embarking on these conversations would most likely not be a good use of scarce management resources because of the scale and range of the obstacles involved.

"You could say that the reason there have been so few mergers in HE is that unis don't have a business brain between them, or you can say maybe it's because management have taken a careful look and decided not to waste time on speculative efforts that are going to take years to realise."

— Head of institution

"If I went to [the other university in my city] with a proposal to form a single university in the city, I'm pretty sure their Board would say, Hold on! What are they up to? They want to take us over! So there's a kind of a dynamic there which is often a perception of senior and junior, and the perceived junior rebelling against that."

— Head of institution

"I do think a merger would create a very significant level of psychological uncertainty for staff, for students, for stakeholders. Therefore I would doubt that there are many universities around the country that would want to do any kind of merger on a voluntary basis if they felt financially secure."

— Head of institution

Removing barriers to merger

Despite all these objections, it was repeatedly observed that a large number of providers in the English sector were formed originally from mergers and there is a sparse but consistent history of higher education providers merging – one observation was that there could be lessons to learn from the conditions that enabled mergers in the past.

Change, it was concluded, is needed. Despite the reticence of many sector leaders, it is likely that any reshaping may involve an increased number of mergers be it full scale ones or parts of an institution being merged into another or others. There are a number of measures that could be taken to enable an environment in which those providers who were actively interested in seeking strategic opportunities around merger to do so.

The government could clarify the terms on which conversations about merger are permitted without concern about breaching competition law. The Secretary of State could issue guidance to OfS to facilitate confidential "protected" discussions between providers, making it clear that the presumption of the assessment of the merits of the case should be on the basis of realising strategic opportunity and serving the public interest rather than mitigating financial distress.

DfE and OfS could create a statutory process and regulatory framework for merger that sets out a clear process for merging organisations to follow and includes an easier route to transferring the institution and its rights, liabilities, claims and accreditations. There could also be associated guidance on the obligation to students during a merger scenario and protection of accreditations to existing and past students.

OfS could define the conditions under which it would consider giving special consideration to a recently merged provider in the form of a period of protection from significant regulatory intervention. This could include provision for a period in which key metrics were considered in disaggregated form, to give the newly merged provider a reasonable opportunity to stabilise.

DfE or OfS could establish a process to name "preferred" strategic advisors to boost expertise and capacity in the sector, who could help in facilitating early discussions, advise on strategic, legal and regulatory implications, and in doing so reduce the opportunity cost to providers of exploring merger as an option.

"If VCs were the Secretary of State they would not wait for institutions to fall over before intervening; they would be setting up programmes to look at the public benefits and strategic priorities and intended outcomes – as they do with the NHS."

— Head of institution

"There's a danger of overstretch and I think sometimes I underestimate that risk...So you don't just need the expertise. You need expertise that you can actually trust the judgment of because in the end there's always a lot of stuff you don't know at the point where you need to make decisions. There are a lot of unknowns. So you need to kind of quantify the reasonable likelihood of some of those risks."

— Head of institution

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The long term horizon: system-wide strategic collaboration?

Mergers may not be the solution to financial challenge, though they may help to facilitate strategic growth for pockets of universities. But nearly everyone we spoke to expressed enthusiasm about the potential for a more connected sector, and the possibilities of realising additional value through increased strategic collaboration.

Collaboration was proposed as a solution to a range of non-financial challenges: creating "ladders of opportunity" between providers to improve access to HE; developing city-wide student support offers; addressing the problem of sustaining subject provision in areas of lower demand; creating a "force multiplier effect" for research; and, of course, generalised efficiency through the pooling of expertise, infrastructure and procurement power.

One senior leader suggested that rather than formally sharing services, some larger institutions could run some functions on behalf of smaller ones. The example suggested related to provision of business services, but another sector example is King's College London running the University of Portsmouth's medical school.

"We spent a lot of time and money making sure we have a very secure IT network, and we've got some real experts in that. I just wonder how well [our local specialist institution is] coping with that, because they haven't got the resource to bring in that sort of expertise. So we could just put our security blanket around them at no real extra cost to us. They would get a big benefit from it."

— Senior institutional leader

There was also a level of interest in "federated" models, bringing together a number of different providers into closer association, possibly because that is seen as offering a potential path to realising some of the benefits of scale without sacrificing institutional distinctiveness. The schools and FE sectors have models for federated governance and sharing services that could provide a template for HE.

"I've got this thing about, if you get a group of organisations working together, you can grow your capacity, and you can do really interesting things like widen access. So I'm really interested, in principle, in that kind of thing. But we don't have the money to do it"

— Head of institution

KU Leuven Association[7]

KU Leaven Association is a network of higher education providers – one university, four university colleges, and one school of arts – operating across Flanders and Brussels. The partners pool resources to fund shared services and projects and education research, and receives funding from the Flemish government for activities like science communication, applied research and student sport.

The association has ten strategic priorities, including student mobility, lifelong learning, research impact, elevation of the fine arts, efficient use of resources, and influence and impact with governments.

While it is at least in part the sector's financial challenges that have created the context for the discussion about structural reform, there is an opportunity to tell a much more positive story about how higher education can more fully realise its potential through strategic collaboration.

[7] Source: https://associatie.kuleuven.be/eng

"If there was more openness about this and it was framed in a positive way around what can we do for the region. What can we do for the city? If local government were engaged with it, you know? If there were cross government discussions around the positive components of this rather than it being seen as it's the only way to bail us out. You know that that is such a negative narrative."

— Head of institution

While most could see the appeal of a more strategically connected sector, and could articulate a whole range of areas where a more strategic approach to collaboration could realise value, everyone we spoke to felt the lack of a critical path to getting from where the sector is now, to a different future state.

"It's time for the sector to take the opportunity to evolve in whatever it's going to be for the next thirty to forty years. Nobody wants to be the first mover, nobody wants to be seen as needing a bailout – the question is how to have the conversations before you get to that point? And the question for government is how do you de-risk it?"

— Sector stakeholder

"I suppose my slight aggravation around all of this is like, how do we stop talking about it and make stuff happen?"

— Sector stakeholder

The role of central government

Although this was not universally felt, the current lack of a strategic vision and policy agenda from the Westminster government for the future of the sector in England was seen as a significant limiting factor to progress. In her letter to heads of provider in England in November 2024 Secretary of State for Education Bridget Phillipson identified five key priorities for higher education – access and inclusion, quality and standards, contribution to growth, civic engagement, and reform for efficiency – and indicated that the government would set out its full HE strategy in summer 2025.

Some felt very strongly that the sector, or smaller groups of providers, need to shape government thinking and put forward proposals and recommendations, but the general view was that until there is a national vision for sector transformation, ideally including some specific priorities for areas that are viewed as having high potential for value to be realised through collaboration, and probably a funding settlement to back it up, these conversations are likely to remain speculative.

"If we had that strong sense of the system and the regulatory approach underpinning it, universities would adapt and change as they always do."

— Sector stakeholder

"I think that [a higher education market] is the wrong framing for the future. I think we need to think of the higher education sector as a system rather than a market, and by that I mean, we need to think of ways in which institutions can play to each other's strengths and collaborate in new ways for the benefits of the regions, of their students, their partners, and in other ways."

— Head of institution

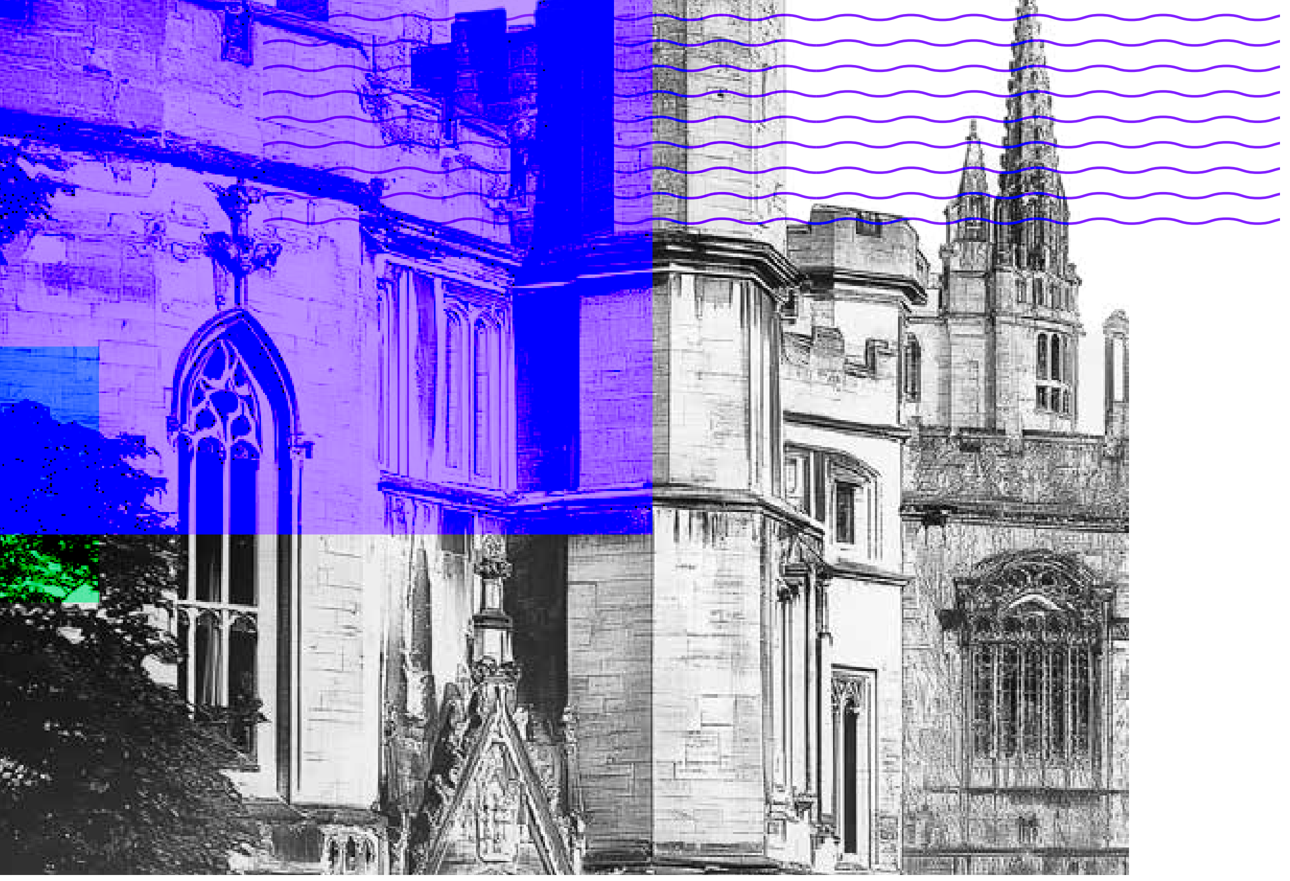
Though the government is unlikely to arrive at any settled views about how the sector should be structured, and the extent to which collaborative relationships can enhance the ability of the sector to realise greater public value, it should look closely at where there are opportunities for regulatory or funding shifts to incentivise providers to take part in exploratory conversation and where opportunities are identified, to pilot and develop shared activity.

For example, the Scottish Funding Council has convened experimental curriculum mapping activity for two regions of Scotland as part of its Regional Tertiary Pathfinders project to identify where there are opportunities to connect post-compulsory education provision to wider regional economic development.[8] While the government might reasonably remain agnostic about the structures the sector should adopt, the absence of a framework or toolkit for what a different kind of structure could look like seems to be putting the bar for engagement in constructive discussion too high.

In particular, one key role for government would be for DfE formally to solicit the views of the Competition and Markets Authority (CMA) on how higher education institutions can collaborate in the public interest on what they offer to students, while protecting the elements of competition that benefit the student consumer. At the Board round table, one chair observed that currently higher education providers are restricted in their ability to even enter into discussion about coordinating provision, though they felt that there seemed to be an expectation that they should be doing it.

Where there are ideas that the sector might wish to test with the CMA it would be much more efficient for the DfE to seek guidance than for each provider

[8] Find out more about the Regional Tertiary Pathfinders project here: https://www.sfc.ac.uk/skills-lifelong-learning/pathfinders/



to separately put in a request for guidance. The government could be explicit that it supports a strategic collaboration agenda – and given at this stage the discussions are likely to be exploratory and conceptual, such a statement and request to the CMA would not require waiting for the publication of a fully worked-up strategy.

DfE could also task OfS to commission some work to explore the application of existing federated or networked models in the education sector to higher education, and work through the implications for which elements of the OfS register and conditions would apply to individual providers within a federated model, and where it might be more appropriate to assess the collective. For example, the regulator might accept a joint approach to access and participation, or there could be a case for a single policy and point of contact for issues relating to freedom of speech or sexual misconduct, while most providers would presumably wish to retain direct and individual responsibility for quality and standards. Judgements about governance and financial sustainability would need to be made in the context of the specific provisions set out in the federation agreement.

OfS could also set out its position on strategic collaboration, the process by which providers can signal to OfS that they are giving serious consideration to a strategic collaboration where there are potential implications for student interest or general regulatory compliance, and the steps it would take to facilitate the collaboration.

The opportunities of devolution and regional collaboration

Devolution and regional economic growth agendas were seen as an enabler to allow conversations to develop among a range of regional stakeholders and education providers tied into regional development objectives. Some interviewees made the point that a conversation with local government, NHS, or other local stakeholders about sharing services, co-location, or strategic partnerships could be much more straightforward and realise much more tangible benefits in the short term than attempting to initiate discussion with another higher education provider.

"On shared services regionally, I think that could be more likely to happen, particularly in areas where there is a really strong civic mission for the universities. We very much see student mental health provision as not just about supporting our students, it's also about helping them to become better citizens. And the chances are a lot of our students because they are regional will stay in the region anyway. So actually, it's a good thing for us locally that we have students who come out of university and, you know, feel able to manage life. The challenge is always, 'are you trying to try to take my job off me?' And actually the answer would have to be, 'no, this is not about jobs. This is about us providing a better service for our students in this region.' And then could you see it then expanding to things like careers and employability, where there's a general remit across the region and there would be regional employers who were interested in all our students."

— Head of institution

However, devolution in most parts of the country is still maturing, and it will take time to realise the opportunities available. It will also depend to some degree on the appetite of regional policymakers to play a role in convening conversations and driving forward projects.

A proposed enabler was the publication of national datasets and strategic analysis of regional challenges around which higher education providers could convene. The development of local growth plans aligned to the national industrial strategy, and the kind of regional skills analysis it is expected that Skills England will undertake will support this kind of activity but it will be critical for OfS and, to an extent, UK Research and Innovation, to act in alignment with these wider policy agendas and actively seek ways to advance engagement with regional growth agendas across, rather than leaving it to providers to pick up if they have the will and connections to do so.

"I think a government playing alongside the OfS a bigger role in kind of offering that helicopter view of what are the challenges by region as well in terms of where are the risks for the skills pipeline in particular course provision?"

— Sector stakeholder

OfS is not currently constituted as a system enabler, still less an organisation empowered to undertake regional level analysis and convening of activity. Yet OfS Director for Access and Participation John Blake has already signalled that the regulator will seek ways to develop and facilitate a more coordinated regional approach to access and participation work in the next five years, which will require a level of systemic analysis to underpin judgements about what activities will be most valuable, and where there are opportunities for sharing resources.[9]

Increasingly there are formal groups representing higher education within a city or region, and these groups are likely to be able to develop their own analysis and agendas in tandem with local policymakers which could inspire others to follow suit. But if the government wants to actively encourage this kind of activity and see a step-change in systematic engagement for the benefit of regions across the country it will need to consider how the existing national bodies can work most effectively together to advance collective understanding of the specificities of the HE landscape for different parts of the country.

"I can see where the last government was coming from. You know, the sector probably hasn't served itself well in the past, where the feeling was probably that we took the money and ran and didn't pay attention to our student experience, and therefore they needed to bring in a regulator who would really challenge that and be a protector of student interests. I totally understand how it happened. But I think we've got to a point now where [OfS] is just a kind of oppositional force. And it's not really fit for the kind of things we do."

— Head of institution

University leadership and governance

While government and OfS could play a much more active role in creating the conditions for supporting strategic collaboration, and potentially facilitating it, the strategic impetus for new structures and partnerships in higher education will remain with providers themselves.

It would be sensible, therefore, for providers to audit their internal capability for engaging with strategic collaboration, socialise the idea within Boards and executive teams, and run scenario planning exercises so that where opportunities or challenges arise the provider is well-prepared to engage with them.

"I would expect and do expect new VCs to be much more on the front foot on this, and looking at it when they don't need to, and discussing with Boards when they don't need to, so that if there are opportunities they can work on them strategically as opportunities. And if there's a crisis, they've already done some of the work."

— Head of institution

"We all have a skills matrix for boards and for courts and for councils. I think, increasingly, that needs to reflect people who've got some expertise and some background in this space...I don't think there are many vice chancellors who would necessarily have the skills, the knowledge, and the background. Really, this is new territory, potentially, for us, it's new turf."

— Head of institution

While there is an element of technical knowledge and expertise involved in working through the implications of various scenarios, there is also a larger values and mindset question for institutional leaders and governors to reflect on. Generally speaking there has not been a significant tension between the success of one single provider and the broader public interest, and so for Boards taking care of one equates to meeting the needs of the other.

However, it is possible to imagine future scenarios in which, particularly, large research-intensive providers may be confronted with choices about where to put scarce resources – to further invest in

[9] John Blake's speech to the Universities UK access, participation and student success conference in November 2024: https://www.officeforstudents.org.uk/news-blog-and-events/press-and-media/what-s-next-in-equality-of-opportunity-regulation/

institutional objectives and success, or to engage in and support more collaborative activity with other providers for the benefit of a wider set of stakeholders. Obviously there will be benefits to be realised in any strategic collaboration initiative, but the discussion will need to be had about whether those benefits are worth the investment and opportunity cost, and whether they align with an individual institution's charitable objects.

Our discussions presented mixed views about whether expecting individual providers to sacrifice institutional interest for a wider public interest agenda was realistic. Certainly it would be unreasonable to expect individual providers to make decisions that put their own future sustainability at risk. But generally speaking interviewees felt that the larger values and goals of higher education should carry a significant weight in any assessment of the merits of a specific opportunity.

As Boards and executive teams consider the purpose and values questions that typically underpin strategic development, they may wish to consider where their tolerances are for compromise of institutional agendas and priorities for a larger purpose.

"In the end, for us all of these things are rooted in values. If you can really clearly align the values that you will talk about, and you try and deliver all the time with the opportunity that something presents, we can get our board to move very quickly, and if it's a stretch I don't think we'd get them there, even if we had a good business case. I don't think they'd want to take on risk, because they wouldn't see the risk as being appropriate for the profile of the institution."

— Head of institution

"Any collaboration involves a certain amount of sublimation of ego. So you have to learn to be humble. And you have to put yourself in the shoes of others and think about how this is going to help us all, rather than just be exclusively focused on your own goals, and you know there are genuine trade offs there in terms of how sometimes universities tend to operate, but for me it's all good, because the upside far outweighs any of the compromises you might be making."

— Head of institution

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