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Welcome to our Higher Education Finance Directors Survey. This is our second survey of the Higher Education sector, which has canvassed the views of Directors of Finance, CFOs and those with a senior view of the financial operations of their institutions.

When we conducted this survey for the first time last year, we called it ‘Uncertain Optimism’. Respondents reflected on a sector in the midst of a period of unprecedented change and transition. With an unclear future regulatory environment, within institutions the mood was optimistic but this did not extend to confidence across the sector as a whole. Our survey title this year ‘the Prudence Paradox’ reflects a position where university FDs remain cautious about taking more risk onto the balance sheet, but recognise the need to invest and borrow and respond to the impact of the removal of student number controls, increased focus on the student experience and pace of operating cost rises outstripping income generation.

In this survey, we have canvassed the views of financial leaders and taken a snapshot in time of their perspective on a range of issues and priorities. As well as including the questions we asked in 2013, we have added a range of new topical questions to gain greater insight into the issues facing university finance directors.

We would like to express our thanks to those who took the time to complete the survey, and to the British Universities Finance Directors Group (BUFDG) for their support in facilitating completion by its membership.

It is our intention to continue to survey the sector on an annual basis to track responses over time. This year, we increased the number of responses to 48 respondents, representing approximately 37% of the sector, covering all regions and University types.

We would like to increase this number of respondents in the future and welcome your comments, ideas and feedback, so that we can ensure the reports remain relevant insightful and of value to you and your institution.

Julie Mercer  
Partner  
Deloitte Higher Education
The affordability of pensions is another issue facing the sector. The Universities Superannuation Scheme (USS), which a significant number of Universities are part of, has a forecast deficit estimated to be £13 billion. In terms of the balance sheet, the changes to the accounting practices from IFRS to UKGAAP means that Universities will have to hold this liability on their balance sheets for the first time. This issue will affect some institutions significantly more than others where they have larger numbers of staff in the USS and potential liabilities of hundreds of millions of pounds for an individual institution.

It appears inevitable that there will be structural changes to the sector although this is not seen as arising from new private competitors. 30% see private providers as having a somewhat negative impact on their HEI and 70% say there has been no change in this area. The key challenges appear to be from within the existing sector. The focus is on which HEIs are able to maximise their recruitment efforts upon the potential student population and then being able to effectively deliver the teaching and student experience going forwards. This may require considerable investment, again going back to capital, but with the focus on teaching facilities (60% of respondents indicated this as the key capital priority). There also remains, as with wider society, a corresponding housing/ accommodation issue that needs to be addressed where numbers do increase.

The key challenges appear to be from within the existing sector.

Key messages

Last year our survey had the clear message that capital spending would be the key priority for Finance Directors (FDs), including how the money would be spent and how it was to be financed. Set against the backdrop of challenges and threats, comprising increasing costs, the changing policy landscape and the pressure on international student recruitment, there is a similar story for 2014. The top two priorities for FDs relate to the pursuit of these opportunities:

1) **driving capital spending** to improve infrastructure; and

2) **generating investment** to improve facilities through borrowing and developing philanthropic and alternative sources of income.

The third key focus, and the key emergent development during 2014, is the focus on increasing student numbers. What is evident is the consistent view from FDs that there will be real winners and losers arising from the government changes in the removal of student number controls, much more so than the changes from AAB to ABB recruitment controls, (although these have also impacted the HEIs current position and view of uncertainty in the sector).

HEIs are facing a number of pressures and challenges in this climate – whilst fee levels remain at £9,000 for the foreseeable future, wage inflation and the need to support the student experience and fund improvements to teaching facilities are all set to further increase expenditure, with 74% of respondents anticipating increased costs.

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Section 1: Financial prospects

Since we conducted our survey last year, the mood within HEIs has dampened, with 32% of respondents being somewhat less optimistic about the financial prospects for their HEI, up from 19%. Furthermore, fewer FDs are optimistic about the financial prospects of their HEI, (28% to 21%). Whilst those broadly unchanged has remained static, there is a notable shift from those being optimistic (from 36% to 23%) to those less positive (from 19% to 36%).

This perhaps reflects the upcoming election and continued uncertainty and shifting policy landscape for Higher Education. Section 5 of the report highlights that beyond the impact on the domestic student market there is a general view that policy continues to negatively impact international student recruitment across the sector. There are differing view on the impact of the relaxation of student number controls, with 28% seeing this negatively and 36% positively, potentially reflecting the different strategies of institutions, some opting for expansion and others protectionism.

Looking more broadly at the financial and economic uncertainty affecting HEIs, respondents still recorded a high level of uncertainty, up from 36% to 49%. However, this reflects greater certainty than a year ago, where 53% of respondents reported a high level of uncertainty compared to 36% today. Whilst slightly improved this is still behind the most recent measure of certainty indicated in the Deloitte Corporate CFO survey.
The majority of respondents did not feel that there had been any change in the level of risk being held on their balance sheet. This response shows a slight improvement in the mood of respondents compared to answers given a year ago, with a small improvement in the proportion of FDs seeing a fall in risk levels. This perhaps reflects that whilst there is a lot of change in the sector, the regulatory reforms are now bedding down.

We don’t think this is now a sign of easier times ahead. Despite the improved positive view of financial risk, a higher majority of FDs still did not feel this was a good time to be taking additional risk onto their balance sheet. A swing of 4% from last year’s 53%.

The HE sector appears to be much more cautious than their counterparts in the corporate sector. The improving economy means that 71% of corporate CFOs say that now represents a good time to take on risk onto their balance sheet, a swing of 4% from last year’s 53%.

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The charts to the right reflect the changing demands for credit across the sector, with two thirds of HEIs reporting that they have experienced no change in demand for credit over the last 12 months. This represents a more static position than the previous year when 53% reported a no change.

However, respondents suggest that there is likely to be an increased demand for credit over the coming 12 months with 45% predicting they will require a moderate increase in credit and 13% predicting a significant increase in credit. It is interesting to note this increased demand for new credit against a more cautious view suggested by a majority of FDs who felt that now was not a good time to be taking more risk.

... there is likely to be an increased demand for credit over the coming 12 months ...
It is worth comparing the attitudes of FDs in the university sector with their counterparts in the corporate sector. As with our 2013 survey FDs continue to see credit as increasingly available and lower cost. However, corporate CFOs are much more bullish about both measures, tracking ahead of the views of university FDs. This may reflect a sector that historically has had much more limited requirements to seek capital investment from the markets.
We asked finance directors how they expected some of the key financial metrics to change over the coming 12 months. There was a degree of consistency with the prior year with both capital expenditure and operating costs forecast to increase the most. 74% of respondents expected operating costs to increase somewhat, compared to 72% in the prior year.

It might be expected that this would be good news for operating margins, with the percentage of respondents expecting an increase in operating costs (74%) matched by the number expecting an increase in revenues (76%). However 24% of respondents expect operating margins to stay the same and 47% expect them to decrease somewhat suggesting cash increasing faster than income.

Capital expenditure remains a strong priority for HEIs, with 17% of respondents saying it is likely to increase significantly in the next year and 66% saying it is likely to increase somewhat, up from 43% in the prior year. This year we asked how HEIs planned to allocate their capital spend. 61% were going to be spending on teaching facilities and 18% on research facilities, showing that HEIs continue to prioritise academic quality and reflects a desire to ensure the estate supports modern pedagogical practices. By contrast, only 4% said capital spend was driven by student accommodation and 2% planned to spend money on administrative buildings.

**Figure 8. Top 3 Increases 2014**

**Figure 9. Where is capital funding going to be focussed in your institution over the next ten years?**
The top three areas which FDs forecast to decrease the most in 2014 – operating cash flow, operating margins and cash levels – mirror those highlighted in 2013. At the same time the cash position is becoming more positive, with 51% predicting a moderate decrease in cash in the coming year down from 78% in the prior year.

This appears something of a contradiction given the responses referred to earlier in respect of expected increases in costs and the potential risks regarding income flows and would appear to reflect a prudent approach to volatility.

However, the degree to which FDs are concerned has softened since 2013 although it remains high when compared to the corporate sector. In stark contrast 72% of corporate CFOs expect operational cash flow to increase somewhat in the next 12 months. This could be a reflection of the continued uncertainty in the HE sector compared to a more buoyant view of economic recovery in the wider market.

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Analysis of the other metrics shows that inventory levels, financing costs and hiring were the measures that respondents saw as the least likely to change in the coming year.

Although financial leverage, bond issuance and bank borrowing were not the areas that FDs thought would increase the most, they were also predicted to increase somewhat by over half the respondents. This potentially reflects the focus on alternative methods of funding as noted earlier.

This appears to contrast with the attitudes towards taking more risk onto the balance sheet – whilst FDs may not want to take more risk onto the balance sheet, the need to invest and develop the HEI, through capital and wider investment in the academic experience means that risk taking is a necessary strategy.

The other manifestation of the more active management of financing strategies and risk taking is reflected in the increase in senior finance roles in the sector in addition to the existing FD role. This is also impacting skill sets and capacity planning in the sector.
When considering the areas classed as being of “Strong Priority for the coming 12 months” the two strongest priority areas for 2014 remained consistent with 2013. The focus on capital and philanthropy appear to be congruent with each other, with a continued need to raise income from philanthropic sources in order to drive the capital programmes, given the reduction in public funding in this area. Increasing student numbers is a way of boosting income and has replaced research funding this year in the number 3 position.

The table below summarises priorities for the coming year from two perspectives – the column on the left reflects the areas classed as a “Strong Priority” with the column on the right being all priority areas for FDs, in order of importance. Whilst there are a number of areas which are consistent in their ranking, there are a number of significant shifts – most prominently on the wider focus on reducing costs and expanding organically, which move to the number 1 and number 2 rankings respectively when looking at all priority areas.

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<th>Table 1. Priorities for the coming 12 months</th>
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<tr>
<td><strong>Ranking</strong></td>
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<tr>
<td>Over 50% of FDs</td>
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<tr>
<td>Over 50% of FDs</td>
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<td>Over 25% of FDs</td>
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<td>Over 80% of FDs</td>
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<td>Over 75% of FDs</td>
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<td>Over 70% of FDs</td>
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<td>Over 70% of FDs</td>
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<td>Less than 20% of FDs</td>
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<td>Less than 20% of FDs</td>
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What is clear from the table on the preceding page is a definitive differential between the strong priority areas and therefore the likely areas of focus in the next 12 months and the wider priorities of FDs.

As reflected in the second column, there is a need to focus on affordability of pension schemes which are further increasing the financial pressure on HEIs and driving the need to focus on philanthropy, although this is more an issue for research intensive HEIs. There remains a question as to how this will change the nature of Higher Education in the future and an HEIs relationships with its stakeholders.

Whilst the percentage of HEIs in 2014 with a focus on research as a strong priority remains unchanged (36% to 34%) this has been overtaken as a key priority, not just by increasing student numbers but also by expansion of international activities and improving the affordability of pension funds.

This very much reflects the challenges of the sector. With the changes to the student number controls there are opportunities for expansion in student numbers, (reflected in responses to our questions in this area at Section 5). However, it needs to be considered how these additional numbers are to be serviced – will this necessitate further capital spending for teaching and research facilities, as well as different accommodation models, or is this an opportunity for HEIs to utilise emerging technologies and existing estate in order to offer an alternative (and cost efficient) University experience?

Within the UK there has not yet been the shift towards MOOCs (Massive Open Online Courses) as an alternative study vehicle but given materials are available globally, it will be interesting to see if potential students begin to consider this as a viable alternative.

One key determinant in this, and what should be a key factor in HEIs strategies looking forward, is to consider what employers are looking for in students and by proxy, what the students are looking for in their University experience.

Understanding this can be a key driver in capital strategy determination. Our question regarding the focus on capital spending appears to bear out the view on capital priorities and the relationship with the student experience, with 60% of respondents stating that their focus would be upon teaching facilities, (as per the chart in section 3).

The focus on investment in teaching facilities would appear to reflect the recognition that student expectations continue to rise and competition for talent will continue to increase.
In assessing responses, whilst the majority of priority areas were consistent in their relative importance (as with capital spending), there were points of divergence when considering HEIs which had more of a research focus against those categorised as more teaching led. Whilst this is unsurprising in the area of “increasing research funding” as a strong priority area, there are clear differences in strategies within the sector.

Whilst the research intensive HEIs have a real focus on addressing the affordability of pension schemes this is not a focus in other HEIs, potentially reflecting the different nature of staffing of the academic body.

There is also more of a focus on developing philanthropic income within the research intensive HEIs, in part to drive research activity itself. There may also be a perception in the teaching led HEIs that philanthropy is not an area of focus based on their current engagement strategies and return on investment. Nonetheless 1 in 5 FDs responding do not see philanthropy as a priority at all.

Future expansion and growth infer two different strategies. A change from our 2013 survey is the increased focus of research intensive HEIs on increasing student numbers, as a strong priority, a higher proportion than teaching led HEIs. We have further considered questions regarding the governments change in policy regarding AAB and ABB restrictions in the next section.

The question and role of international activities is also important across the sector. As the research intensive HEIs seek to expand student numbers, an increasing proportion of teaching led HEIs seek to expand internationally in order to diversity income sources.

Table 2. Research vs teaching priorities

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<tr>
<th>Priority Area</th>
<th>Research Intensive</th>
<th>Teaching Led</th>
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<tr>
<td>Increasing capital expenditure</td>
<td>53%</td>
<td>46%</td>
</tr>
<tr>
<td>Expanding international activities</td>
<td>21%</td>
<td>40%</td>
</tr>
<tr>
<td>Increasing student numbers</td>
<td>27%</td>
<td>21%</td>
</tr>
<tr>
<td>Increasing research funding</td>
<td>60%</td>
<td>18%</td>
</tr>
<tr>
<td>Increasing philanthropic income</td>
<td>72%</td>
<td>40%</td>
</tr>
<tr>
<td>Improving affordability of pension schemes</td>
<td>79%</td>
<td>21%</td>
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Whilst the research intensive HEIs have a real focus on addressing the affordability of pension schemes this is not a focus in other HEIs, potentially reflecting the different nature of staffing of the academic body.
In terms of areas which are not seen as priorities for the coming 12 months, this is relatively similar to 2013. The lack of focus on expansion through acquisition is unsurprising. A key factor in the HE sector (when compared to corporates) is the need for an academic driver for successful acquisition or merger. In addition, the geography of many HEIs has historically reduced the likelihood of this strategy. Current expansionary strategies are focussed on existing sites and brands, or the development of their own satellite campuses focussed on specific subjects.

Reducing leverage is not seen as a priority as in 2013, presumably linked to the changes in the funding regime. The consideration of disposal of assets also appears linked to the wider focus on capital, with HEIs looking to develop their existing infrastructure and assets rather than rationalising.

Figure 13. Lowest priority areas 2014 & 2013

- Disposing of assets: 2014 - 6% Strong priority, 14% Not a priority; 2013 - 4% Strong priority, 11% Not a priority
- Reducing leverage: 2014 - 3% Strong priority, 17% Not a priority; 2013 - 0% Strong priority, 11% Not a priority
- Expanding by acquisition: 2014 - 3% Strong priority, 8% Not a priority; 2013 - 0% Strong priority, 7% Not a priority
We further explored with FDs their views on developing shared services, given the lack of focus on this area in 2013, and to canvass if views had changed.

It was noted that there was a more positive move towards consideration of shared services from 2014 onwards, with over one third of respondents suggesting that they would likely be considering such an approach.

However, there is a higher proportion of FDs that see opportunities for cost savings from back office cost sharing than would actually seek to consider this as a priority in the next 12 months. This may reflect resource constraints in dealing with a range of priorities or a desire to observe successful models in operation prior to commencing any initiatives themselves.

Figure 14. How likely are you to consider plans for another organisation to provide you with shared services over the coming 12 months?

Figure 15. Do you believe there are significant savings to be had from back office cost sharing?
In summary

Our research shows that in respect of capital spending there is a clear focus on teaching facilities rather than the wider student experience – this reflects ambitions to increase student numbers and a recognition that today students feel more responsible for their own funding and are likely to have a greater focus on the quality of teaching facilities ahead of the wider pastoral experience.

The continued drive towards greater internationalisation of activities is reflected across the UK Higher Education sector. This includes building partnerships, creating a presence outside the UK, as well as the ability to attract increasing numbers of international students and world class academics to the UK. From a UK student perspective the opportunity to study abroad for an element of a degree programme has been relatively limited and represents a further opportunity for HEIs. The opportunities for joint venture and international development should always be considered from a risk/reward and compliance perspective – a number of HEIs have encountered difficulties in not co-ordinating activities or in seeking to run an overseas venture as they would a domestic activity.

The affordability of pensions is recognised as a key issue facing the sector. In the spotlight has been the Universities Superannuation Scheme (USS) which a significant number of Universities are part of. The forecast deficit on the USS is currently estimated to be £13 billion. In addition to this deficit the changes to the accounting practices from IFRS to UKGAAP means that Universities will have to hold this liability on their balance sheets for the first time. At this point it is unknown, or rather undecided, on the actions that Universities will take in order to plug this gap. However, what can be anticipated is that whatever solution is chosen it will not be palatable for either the staff or students. In short the result of responding to this challenge may include stopping new entrants to the scheme, moving people onto less beneficial pension schemes or increasing contributions (from both the individual and the employer). These will be in addition to the 1.6% rise in contributions expected in April 2016 following government pension changes.

Figure 16. Where is capital funding going to be focussed in your institution over the next 10 years?
Section 5: International student recruitment and government policy

The views of FDs on international student recruitment are broadly consistent with 2013. The view remains that government policy has had a somewhat negative impact on individual HEIs but a general view that policy has a much wider impact across the entire sector.

Only 5% of respondents indicated that this had a significant impact upon their international student recruitment compared to the view that this is impacting the overall sector from 1 in 3 responses. This may reflect those responding to the survey, or that the UK HE sector is robust and well regarded and as such, has been able to continue to overcome the impact of negative headlines in recent years.

However, the overarching general negative view may also impact how UK institutions respond to the global opportunities in HE, thereby compounding the perceived impact of government policy on the sector. In addition, this may also have the potential to drive increased competition in the domestic student market.

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Student number controls

Additional questions in the 2014 survey sought to gain the views on the government policy on the removal of student number controls. Whilst the AAB/ABB changes appear to have made no impact in over half of respondents, there are those institutions who have indicated this has had a positive impact – either through an increase in recruitment or in increasing their academic entry criteria or tariff, which can impact positively on the National Students Survey.

Considered in conjunction with the previous section on priority areas – the research intensive HEIs have a greater focus on increasing student numbers than their teaching led counterparts, which appears driven by the relaxation on student number controls and the desire to increase income.

Figure 18. How do you believe the proposed government policy on the removal of the student number controls will affect…

Figure 19. How do you believe the government policy on the removal of the student number controls for AAB/ABB students has affected your institution to date?
The ten takeaways

1. 12 months after the first survey FDs are less optimistic about the financial prospects of their HEI.

2. The general level of financial and economic uncertainty slightly improved but is significantly below the corporate CFO view.

3. Again, in contrast to the corporate sector CFOs, the HE FDs do not see this as a time to take more risk onto the balance sheet, although the majority felt that this had not changed since a year ago.

4. This is alongside a sense that additional credit will be required going forwards driven by a need for increasing capital expenditure and rising operating costs in the light of increased competition and volatility.

5. This is driving the search for new income sources including increased student numbers (domestically and internationally), increased research funding, further international activity and philanthropic engagement, alongside an increase in bank lending and bonds to fund capital expenditure.

6. The clear focus on capital spending on teaching and research facilities reflects the impact of the increased competition in these areas.

7. At the same time, a focus on reducing costs is a key overarching priority, although shared services are not yet part of the narrative.

8. Effective financial management is a real focus and necessity – managing pension costs, cash flow, UK GAAP, financial controls and effectiveness are all areas high on FDs agenda alongside good governance.

9. Government policy continues to present challenges and opportunities in relation to international and domestic student recruitment.

10. There is clear divergence emerging in the priority areas and strategies for research intensive and teaching led HEIs, reflecting a sector which may continue to see considerable development and change in the coming period.

All of these pressures mean FDs need to manage long term and short term financial priorities while supporting the institution to make good decisions on capital investment and where and how to borrow. This is creating a ‘prudence paradox’ which reflects the continued need for strong financial management and control at a time when ambition and investment for sustainable growth is needed.