Financial strategy in higher education institutions

A business approach
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Financial strategy in higher education institutions
A business approach

To Heads of HEFCE-funded higher education institutions
Heads of universities in Northern Ireland

Of interest to those responsible for Finance, Governance, Management, Planning

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Executive summary

Purpose

1. This guide discusses the principles and possible approaches to developing and implementing a financial strategy. It is designed to support governors and senior managers in taking a more proactive and strategic approach to managing the financial future of their institution, in order to achieve academic and financial success.

Key points

2. Part A is an overview of the key issues and principles, and Part B develops these as a set of self-challenge questions with suggestions and sources of further information.

3. There is no single right approach, as each institution is different. The guide is structured so that institutions can focus on the issues that are relevant to their circumstances and priorities.

Action required

4. This report is for information and guidance.
Part A Introduction and principles

Introduction

5. The most fundamental financial strategy issue for most higher education institutions (HEIs) is: ‘How can we achieve and sustain our distinctive mission and positioning in the current funding and financial environment?’

6. This guide does not attempt to provide comprehensive advice ‘on how to do it’. There is no single right way to develop or implement a financial strategy; each institution is different and will approach this topic in its own way. This will often involve an iterative process in which financial objectives and considerations are reviewed alongside academic and other resource strategies, to develop an overall balance which meets the needs of the institution.

7. The focus of these considerations may vary as circumstances change. Institutions will have different views about what is the appropriate balance for them, and about how broadly the scope of the financial strategy should be drawn. It is therefore not possible to meet all levels of need in a single guide; instead we have tried to identify the principles and to produce materials that can be used flexibly.

8. Part A is an overview of the principles of developing and implementing a financial strategy, and the key issues to be considered. Part B develops these as a set of self-challenge questions, with suggestions and sources of further information to help institutions in thinking through the issues.

9. The focus of the guide is on strategy. It does not aim to cover operational financial issues, or matters such as strategic analysis and risk assessment which are dealt with elsewhere. The development of this guide has been overseen by a steering group of representatives from the sector and the HEFCE. Details are in Annex A.

Why is this guide needed?

10. Most HEIs have managed in the past without a systematic and integrated approach to financial strategy. This reflects the history of the sector as a primarily publicly-funded service and the fact that institutions had fewer financing requirements (and options), and faced less acute financial risks. It is increasingly clear that to succeed academically and financially institutions need to take a more proactive and strategic approach to managing their financial future. This guide is intended to help institutions develop such an approach, in most cases over a period of several years.

1 Examples are given throughout Part B, but the following publications are particularly relevant: ‘Strategic planning in higher education: a guide to good practice’ (HEFCE 00/24), ‘Risk management: a guide to good practice for higher education institutions’ (HEFCE 01/28), and ‘Effective financial management in higher education’ (HEFCE 98/29).
What is a financial strategy and where does it fit?

11. A financial strategy is concerned with financing the corporate plan of the institution. It is one of several strategies of an HEI, all of which contribute to its mission, and should have a similar life-span to the corporate plan (usually three to five years). These strategies could be shown, in a simplified form, as in Figure 1.

![Figure 1](image)

**Figure 1** Possible strategies of an HEI (not all links are shown)

12. In this view, the academic (output) strategies for teaching and learning, widening participation, research, and for enterprise activity should be the main drivers of institutional (corporate) objectives and plans. The resource strategies, including finance, have an enabling role to ensure that the right resources are provided to support academic objectives.

13. Some institutions consulted during the production of this guide have adopted this view. However, a significant number see the financial strategy as inextricably interwoven with all the other (academic and non-academic) strategies of the institution. They described the financial strategy as ‘the glue that holds the other strategies together’, and as ‘the guardian of the sustainability of the institution’. This broader interpretation could be illustrated as in Figure 2. Again this is a simplification, and is not intended to discount the importance of human resources or other strategies.
14. This guide takes the broader and more comprehensive approach (closer to Figure 2), but does not exclude the narrower interpretation. So the guide is about financial strategy as a component of all the institution’s strategies, and it includes some issues that will primarily be addressed within other strategies (such as those for HR, research, and learning resources). We believe that this holistic approach is appropriate as institutions will have to integrate all their strategies in the long term, and therefore will need to consider both perspectives. However, the relevant parts of the guide can be used initially as an aid to developing a strategy for financing the corporate plan, if that is the way institutions wish to start.

What are the benefits and implications for institutions?

15. Institutions should develop an integrated financial strategy to ensure the viability and coherence (or balance) of their activities. In particular, it will help them to:

a. Set priorities and manage operations, recognising the financial climate and the constraints it may place on their ability to generate surpluses.

b. Identify and quantify future resource needs, including the need for investment to protect future productivity.

c. Evaluate strategic opportunities such as for collaboration, e-learning and new teaching methods, and for business development.

d. Make an integrated response to funding initiatives and opportunities which create long-term financing implications.

e. Manage resources effectively in a way that satisfies external stakeholders without damaging the culture of the institution.

f. Mitigate financial risks.
16. Most institutions receive income for activities at levels that are below the full economic cost of these services. They also do work for social and academic reasons that is unlikely to cover its costs. They operate in a mixed economy in which business entrepreneurialism is encouraged, but pressures on public funding and accountability can add costs, reduce flexibility, and inhibit investment for the long term. A ‘low-price culture’ has developed in higher education, with dangers that institutions do not invest adequately to maintain their competitive position, or to retain the staff and reputation they need for future success. Government initiatives, in the form of additional earmarked funding, can help to fund investment, but they are usually short-term and directed to government priorities. They also often require contributions from the institution.

17. Achieving an appropriate and sustainable balance is critical in this environment. As well as seeking options for financing investment, institutions may need to consider how to reposition themselves to bring activity, resources and infrastructure into a sustainable balance, while optimising outputs for any given mix of resources and opportunities. This is a complex equation and requires difficult choices, but it is at the heart of our wider definition of an integrated financial strategy. It is therefore a key responsibility of heads of institution, senior managers and governing bodies.

18. The elements needed to achieve a more sustainable balance may include business development, strategic repositioning, efficiency measures, fundraising and income generation, borrowing and other external financing, collaboration, restructuring, and merger. Each of these has costs and benefits, and they will be appropriate in different circumstances. An integrated strategy can help institutions to prioritise and use these options to create the ‘financial headroom’ they need to prosper.

Who needs to be involved?

19. The financial strategy as defined above touches every part of the institution and needs to involve a wide range of people. The groups noted below have particular roles in developing and implementing the strategy, but it will also be important to involve and communicate with other stakeholders, who include staff, students, and external bodies with an interest in the institution.

a. **Governors** are ultimately responsible for the viability of the institution and therefore have a duty to set the strategic direction and to ensure that the financial strategy is robust and effective, and is properly aligned with all other strategies and objectives. In particular, the Finance Committee (or equivalent) will be directly involved in establishing an effective and integrated financial strategy.

b. **The head of institution** has to provide strategic leadership and to manage the organisation so as to deliver the agreed objectives and plans.

c. **Members of the senior management team** have a collective responsibility for providing strategic direction and integrating the various elements into the corporate strategy, and an individual and collective responsibility for delivering the objectives.
d. The director of finance will normally lead the process of developing the strategy and advise on financial issues.

e. Heads of academic and other units need to take ownership of the strategic financial issues as they plan and manage the core activities of the institution.

Key issues to be considered in the financial strategy

20. The guide focuses on five principles of strategic financial and resource management. These are set out below, with some questions which may help institutions to assess the adequacy and completeness of their financial strategy. Each question is covered in more detail in Part B.

Principle 1 Long-term viability and matching resources with objectives

The strategy should set the financial performance objectives for a viable level of academic and other activity by the institution – in line with its corporate plan and strategic positioning – while matching resources with objectives in the long term.

1.1 How do we know if the corporate strategy is viable?
1.2 What are the financial implications of our current academic positioning?
1.3 Are our objectives, resources and infrastructure in an appropriate balance?
1.4 How do we ensure that an adequate surplus is generated?
1.5 How do we ensure that our teaching strategy is financially viable?
1.6 How do we manage the financial contribution of research?
1.7 How do we set financial objectives for income generation?
1.8 Can efficiency measures improve the financial performance of the existing activity without damaging academic objectives?
1.9 Do our financial policies and processes support the strategy?
Principle 2  Maintaining productive capacity to meet current objectives

The strategy should address the investment needs of the institution to maintain the value and contribution of human resources, physical assets, intellectual assets and information and systems, and to deliver the various resource strategies which support the mission and current academic objectives.

2.1 Do we have the right level of productive capacity in each key resource?
2.2 Are we investing at an adequate level to maintain physical capacity?
2.3 Do we have the right staff, and policies which enable staff to maximise their contribution?
2.4 Are we investing enough in staff recruitment, support, management and development?
2.5 Are we exploiting and managing physical and intellectual assets appropriately?
2.6 How can we ensure that the returns on assets and the contributions of resources are adequate?

Principle 3  Financing development and investment

The strategy should provide for the appropriate levels of financing for capital development and other investments, including the use of borrowing and other external sources of finance. Such developments should be supported by business cases, considering a range of options.

3.1 How do we evaluate the financial base of the institution?
3.2 How do we know the total cash and capital needs of the institution?
3.3 What proportion of these needs can and should be met from our own resources?
3.4 How much should we raise from external sources?
3.5 How do we decide how much we should borrow?
3.6 Are we making appropriate use of external financing?
3.7 How do we decide whether to bid for publicly-funded special initiatives and projects?
Principle 4  Evaluating strategic alternatives and managing risks

The strategy should provide a framework to help the institution assess the implications and consequences of potential strategic developments and decisions, and to evaluate and manage risks which threaten delivery of the corporate strategy.

4.1 How can the financial strategy help to support and prioritise strategic opportunities?
4.2 Have we provided enough headroom for growth and change?
4.3 How do we manage key financial risks?
4.4 How can we minimise the impact of unexpected downturns?
4.5 Have we maximised the potential contribution of strategic alliances and collaboration?

Principle 5  Integrating financial and other corporate strategies

The strategy should be integrated with the output and other resource strategies, understood and owned by those involved in the management of activities and resources, based on a realistic strategic analysis, and supported by a process of monitoring and review.

5.1 Is the strategy based on rigorous and objective analysis?
5.2 How do we ensure that the financial strategy is properly integrated with the output strategies (academic and enterprise) and other resource strategies of the institution?
5.3 Do senior academic and other managers understand and accept the consequences of the financial strategy?
5.4 How do we ensure that the strategy is implemented and reviewed, and that variations are detected at an early stage?
Part B Approaches to financial strategy

This section is designed as a resource for those developing the financial strategy for their institutions.

It is presented as a series of prompts addressing the five principles outlined above. Sources of further information are given for each principle. Where relevant, Part B also includes suggested financial performance measures (Principles 1, 2, and 3). These are provided to stimulate thinking and should not be taken as representing good practice that all institutions will necessarily wish to follow.

We recognise that there is a large agenda here, and that some institutions may find this daunting. However, not all the issues will be relevant for every institution, and even if they are, they will not all be of equal priority. The guide is based on the assumption that institutions will decide for themselves which issues are most important at any particular time, and will plan their financial strategy so that less urgent matters can be addressed over a longer period.
Principle 1 Long-term viability and matching resources with objectives

The strategy should set the financial performance objectives for a viable level of academic and other activity by the institution – in line with its corporate plan and strategic positioning – while matching resources and objectives in the long term.

1.1 How do we know if the corporate strategy is viable?

- The corporate strategy integrates the key strategies of the institution and is fully informed by financial analysis and objectives (see Figures 1 and 2 and Principle 5).
- The financial strategy considers the forward projection of income, expenditure, liabilities, cash and capital requirements (including allowance for renewing and upgrading assets and capability) on a long-term basis (see Principle 3).
- The cash forecasts and projected surpluses are sufficient to meet the needs of the institution and have been reviewed against the targets in the strategy.
- The financial strategy includes an assessment of alternatives and risks which could affect the financial performance of the institution (see Principle 4).

1.2 What are the financial implications of our current academic positioning?

- The corporate plan includes forecasts of levels of activity (student numbers, research income, and so on) for all academic units.
- These forecasts have been informed by market analysis and the recent performance of the units concerned, and have been examined and challenged for realism, balance and achievability.
- Where growth or other change is forecast, any costs associated with this (such as investment in marketing or new facilities) are included in the plan.

1.3 Are our objectives, resources and infrastructure in an appropriate balance?

It is tempting to assume that the institution simply needs more funding to enable it to invest in new activity. However, it may be that assets are poorly managed and under-exploited, or that scarce resources are being taken up by relatively low priority activity. Few, if any, institutions can afford to maintain productive capacity in every area. An important objective of the financial strategy is to provide a ‘reality check’ on the overall positioning of the institution and its expenditure in relation both to the income it is generating, and to its position and prospects in the market.

- Governors and senior managers have reviewed the overall balance of the institution’s activities and priorities, reflecting its current strategic positioning.
- They have considered the institution’s future strategic positioning in relation to its resources and infrastructure, markets and competition, and past performance, and made a realistic assessment of future potential.
1.4 How do we ensure that an adequate surplus is generated?

Surpluses are an indicator of a financially viable operation. They also provide cash, which gives flexibility to cope with contingencies, to invest and to respond to opportunities. Institutions should assess for themselves the level of cash balances to be held, but many would regard one to three months’ expenditure as a sensible range. It is an essential operational discipline to maintain robust forecasts of cash and to review them regularly.

It is important to distinguish between a trading surplus and a total operating surplus, and to understand the impact of accounting policies on surpluses. Institutions’ ability to generate surpluses is closely related to their ability to recover the full costs of activities. This varies according to the type of activity, underlining the importance of managing the mix and balance of activities.

We do not recommend a specific level of surplus, as each institution needs to decide this in the light of its requirements and circumstances (see below). In the absence of any special circumstances, many institutions would consider surpluses of 3-5 per cent to be appropriate to maintain physical assets and to have some headroom for development. Lower levels would be appropriate if there are no backlogs or if external capital funding is available.

• The institution determines the level of surplus to be targeted each year in the light of:
  - the amount of cash needed for normal operations, backlogs, and capital investment, and what alternative forms of finance are possible or advisable (see Principle 4)
  - the availability of capital funding in relation to the investment needs
  - some contingency to allow for unforeseen fluctuations in financial performance, and to accommodate risks
  - the impact on surpluses of constraining or relaxing spend year on year, in what have traditionally been seen as ‘soft’ areas – such as maintenance, training, replacement of equipment, library budgets, part-time staff, filling vacancies
  - the impact of repeated deferral of expenditure in these areas on eroding the institution’s capacity to earn future income
  - the impact on external stakeholders, including banks and other lenders.

• The institution ensures that budgeted surpluses are achieved in practice by:
  - ensuring that budget managers understand the need for institutional surpluses, accept their budgets and responsibilities, and are trained and supported appropriately
  - taking steps to recover full costs wherever possible (and not subsidising ‘commercial activities’ or those where the academic benefits do not justify this)
  - building contingency items into the budget from the outset, so that unexpected downturns in performance do not necessarily affect the surplus
  - monitoring forecast out-turns regularly in-year, and taking corrective action at an early date if this is needed to keep within the budget.
1.5 How do we ensure that our teaching strategy is financially viable?

- The potential for each of the main teaching businesses is evaluated, including a review of the market and the scope for growth or diversification, and consideration of the financial implications.
- Cost data are used to understand the financial contribution from different types of teaching in different departments, with more detailed analysis, such as course costing or benchmarking, used on a periodic basis as appropriate.
- The performance of major teaching contracts (such as for nursing and other professions allied to medicine) is evaluated in terms of total cost recovery (not just contribution).
- The institution sets targets for its performance – in terms of recruitment, retention and completion rates, employability, quality assessment, student:staff ratios, or cost per student.
- The institution considers the impact of changes in programmes offered, student mix, and delivery mechanisms (for example, more IT-based learning).

1.6 How do we manage the financial contribution of research?

Most externally-funded research is priced below the full economic cost of the work, and the cost recovery varies significantly between sponsor type (Research Council, charity, European Union, UK government department, industry).

Research is a core function for many HEIs, and is done for many reasons other than financial, but institutions with a significant research income need to understand and manage the costs of different types of research in relation to the income and academic benefits.

- The institution reviews the overall financial performance of research, and the potential for improvements in income and cost recovery.
- Performance on the recovery of research costs is benchmarked against relevant peers, for example using data from the Higher Education Statistics Agency (HESA), and from other HEIs in ‘benchmark clubs’.
- The institution considers the mix of sponsor types, the level of cost recovery that can be achieved, and the requirement for the institution to contribute to indirect costs.
- The institution decides what level of investment is justified in relation to the academic value of the research.
- Academic managers are aware of the full costs and cost recovery on different types of project.
1.7 How do we set financial objectives for income generation?

Commercial and other income-generating activity (sometimes called enterprise) is increasingly being seen as a core activity by many institutions. It can be divided into two types, and different strategies may be appropriate for each:

- knowledge-based (such as consultancy and exploitation of intellectual property)
- other (for example, conferences, residences, public use of institutional facilities).

Developing commercial income is not normally an easy option, and will probably require up-front investment, as well as some changes to the systems and culture which have been developed to serve publicly-funded teaching and research.

- As part of an enterprise strategy, the HEI is aware of the reasons for doing different types of commercial activity and their overall impact on the institution.
- Pricing is market based, informed by knowledge of the full costs and the value being delivered to the customer. Commercial activity is not priced as though it was publicly-funded research.
- Higher returns are expected for more risky (or less academically interesting) ventures.
- Commercial activities are expected to at least cover their costs.
- The institution recognises that costs associated with culture change and staff training, and investment needs, could significantly reduce returns.
- Where commercial income is channelled through subsidiary companies or other vehicles, these are reviewed as part of the financial strategy, which addresses the consolidated position of the whole institution.
1.8 Can efficiency measures improve the financial performance of the existing activity without damaging academic objectives?

Efficiency is the relationship between inputs (such as staff time, space and supplies) to institutional outputs, such as student progression and research outputs.

- Externally, opportunities are considered for repositioning to bring the institution into a better financial balance – for example through growth, rationalisation, merger, acquisition, disposal, strategic alliance, collaboration, or sharing of resources or services.
- Internally, issues might include internal restructuring, such as ‘delayering’; replacement of small academic departments by fewer larger business units (schools) with more support staffing; changes in the programmes offered; different relationships between academic units and the centre; and new resource allocation and budgeting models.
- The institution has considered the following options:
  - zero-based or priority-based financial planning rather than incremental planning
  - the scope for business process re-engineering or other similar fundamental reviews of processes and systems
  - alternative delivery methods, such as outsourcing, and market testing, within a procurement strategy
  - the balance of direct and indirect (support) costs; for example, how much academic staff time is spent on support activities.
- The institution benchmarks itself against and shares good practice with appropriate peer institutions.

1.9 Do our financial policies and processes support the strategy?

- How well do our policies, processes and culture support the strategy in terms of:
  - management structure, culture, incentives and rewards
  - resource allocation policies
  - delegation, authorisation limits
  - ability to retain surpluses and invest
  - management information systems
  - support and training to all budget holders
  - option and investment appraisal to support decision making.

- How well does our practice on pricing and costing support the strategy?
  - There is a strategy for costing and pricing.
  - The institution is using the data produced through the transparent approach to costing (TRAC) to support management decision-making.
  - Steps have been taken to ensure that heads of academic and other units understand and apply the principles of costing and pricing, and the institution’s strategy for this.
Strategic financial measures of viability

(These are illustrative. They are not intended to prescribe good practice.)

**Surplus and cash/liquid assets**
- Trading surplus or deficit, and total surplus or deficit as a percentage of income
- Accumulated surpluses (general reserves)
- Ratio of current assets to current liabilities (current ratio)
- Number of days’ cover represented by liquid resources

**Activities (such as teaching and research)**
- Surplus or deficit on each activity, for the institution and by department
- Proportion of income from non-publicly funded teaching sources
- Modules under a minimum ‘economic’ size
- Surplus or deficit on publicly-funded research and non-publicly funded research, for the institution, and by department, and by main research sponsor type
- Comparisons of the above results with peer institutions
- Mix of research funding by sponsor type
- Surplus or deficit on ‘Other’ activities, by type of activity

**Efficiency**
- Staff:student ratios (taking into account part-time staff, service teaching and so on)
- Use of space and facilities
- Support costs as percentage of total costs, and support time as percentage of total academic time

**Further information**
- HEFCE 00/24 ‘Strategic planning in higher education: a guide to good practice’
- HEFCE 98/29 ‘Effective financial management in higher education’
- HEFCE 01/28 ‘Risk management’
- HEFCE 99/21 ‘Appraising investment decisions’
- CIPFA/BUFDG ‘The role of the director of finance in higher education’
  [http://bufdg.niss.ac.uk/pub/role.doc](http://bufdg.niss.ac.uk/pub/role.doc)
- ‘Optimising consultancy: a good practice guide to the management of consultancy in universities and colleges’, Association of University Research and Industrial Links (AURIL) and Universities UK, June 2001
- ‘Transparent approach to costing’ (TRAC), volumes I and II, Joint Costing and Pricing Steering Group (JCPSG)
- ‘Pricing toolkit for the higher education sector’ (JCPSG) October 2000
- ‘Costing nursing, midwifery and other health professional teaching provision: Guidance for the HE sector’, JCPSG, November 2001
- ‘The use of indirect cost rates in costing government contracts: technical guidance’, JCPSG, October 2001 (electronic publication only)

HEFCE publications are available on the web at www.hefce.ac.uk under ‘Publications’.
JCPSG publications are available on the web at www.jcpsg.ac.uk.
Principle 2 Maintaining productive capacity to meet current objectives

The strategy should address the investment needs of the institution to maintain the value and contribution of human resources, physical assets, intellectual assets and information and systems, and to deliver the various resource strategies which support the mission and current academic objectives.

2.1 Do we have the right level of productive capacity in each key resource?

- The human resources strategy considers the total cost of staff and their role in delivering the corporate plan (see below).
- The amount and type of physical infrastructure and resources are appropriate to maximise opportunities and performance:
  - The academic strategies identify the need for buildings, plant, equipment, libraries and IT networks to deliver corporate objectives.
  - The institution has defined standards in estates, libraries, and IT areas – for the quality of teaching rooms, maintenance condition, reader spaces, network capacity and so on.
  - The estates strategy considers renewal and disposal of physical assets, and use of assets.
  - Institutional data are compared with benchmarks from the estate management statistics (EMS) system, and other sources (see references).
  - The IT and library/learning resource strategies include assessments of capacity and investment needs.

2.2 Are we investing at an adequate level to maintain physical capacity?

- The strategy considers the whole-life costs and performance of assets. This includes the balance between investing to maintain a modern, well maintained, efficient infrastructure as compared with lower spending over time which may have negative effects on staff and academic outputs.
- The strategy considers ‘spend to save’ capital investment in areas such as maintenance, which can create high financial rates of return with greater performance and reduced annual operating costs.
- The long-term financial implications for the institution are reviewed as part of the decision on affordability.
- There is a robust plan to generate sufficient income to cover the operating costs of the investment, and to refurbish or replace assets after an appropriate interval (usually 15 to 20 years for buildings, less for equipment).
- The strategy leads to a clear statement of financial requirements in terms of recurrent and capital costs for each resource, including realistic and sustainable levels of expenditure to support the productive capacity required for the institution’s corporate objectives.
2.3 Do we have the right staff, and policies which enable staff to maximise their contribution?

This is a major area which will be addressed primarily through other strategies.

- The human resources strategy provides an assessment of the numbers and mix of staff, and of needs and opportunities to maximise contributions from staff.
- The finance strategy reviews the proportion of total costs made up by staff and considers this against benchmarks for similar institutions.
- Investment in staff is addressed as part of the finance and human resources strategies.

2.4 Are we investing enough in staff recruitment, support, management and development?

This is a major issue which should be extensively addressed in the human resources strategy (see HEFCE 02/14).

2.5 Are we exploiting and managing physical and intellectual assets appropriately?

- The strategy considers the potential to generate income or support academic activity through better exploitation of physical assets.
- The institution has considered its policy on the management of intellectual property and consultancy.

2.6 How can we ensure that the returns on assets and contributions of resources are adequate?

- A proper option appraisal is carried out before making significant new investments, and there is a business plan that considers benefits and costs over the asset’s lifetime.
- There is a periodic review of assets, covering their use, their condition, and the running costs associated with them, with consideration given to disposal or redeployment where appropriate.
- High-cost areas of infrastructure are examined critically for their contribution to the institution.
- The levels of assets and surpluses and the use of assets are benchmarked against comparator institutions.
### Strategic financial measures of productive capacity

#### Estates and physical assets

Percentage of the estate that does not meet its target for maintenance condition and fitness for purpose, benchmarked against similar institutions

#### Utilisation and occupancy measures

Amount spent on major refurbishment or replacement of assets per annum as a percentage of current replacement cost or insurance value. (On average an amount of 1/20 of current costs should be spent per annum, but this varies with the type of assets. For example, it should be more for high technology research disciplines.)

Amount spent on maintenance per annum as a percentage of current replacement cost or insurance value. (Typically, where there is no backlog of maintenance, expenditure of between 1.3 per cent and 1.8 per cent of insurance value may be appropriate, although institutions would need to assess this in the light of individual circumstances.)

#### Staff

Skills profile of staff
Investment in staff development and performance management
Numbers of support staff in relation to academic staff
Percentage of academic staff time spent on non-professional work

#### IT, libraries and equipment

Spend on IT as a percentage of costs
Spend on libraries/learning resources as a percentage of costs

### Further information

- HEFCE 00/04 ‘Estate strategies: a guide to good practice’
- HEFCE 02/14 ‘Rewarding and developing staff in higher education: good practice in setting HR strategies’
- HEFCE 01/10 ‘Estates management statistics project: annual report 2000’
- Estates management statistics on the higher education estates web-site, [www.heestates.ac.uk](http://www.heestates.ac.uk)
- ‘Transparent approach to costing’ (TRAC), volumes I and II, Joint Costing and Pricing Steering Group (JCPSG)
- THE HEFCE 2002/31 ‘Teaching and learning infrastructure in higher education’
- A report on the infrastructure for arts and humanities research will be published in summer 2002
- ‘Optimising consultancy: a good practice guide to the management of consultancy in universities and colleges’, Association of University Research and Industrial Links (AURIL)/Universities UK, June 2001
- HEFCE 00/58 Related companies: recommended practice guidelines (electronic publication only)
• ‘Managing intellectual property’, DTI, UUK, AURIL, www.patent.gov.uk
• ‘Guidelines for developing an information strategy – the sequel’, JISC, March 1998
• Society of College, National and University Libraries (SCONUL), www.sconul.ac.uk
• Consortium of University Research Libraries (CURL), www.curl.ac.uk
• Universities & Colleges Information Systems Association (UCISA), www.ucisa.ac.uk
Principle 3 Financing development and investment

The strategy should provide for the appropriate levels of financing for capital development and other investments, including the use of borrowing and other external sources of finance. Such developments should be supported by business cases, considering a range of options.

3.1 How do we evaluate the financial base of the institution?

- The following are considered:
  - the institution’s asset base, and any disposable assets
  - the level of general reserves, and pattern of operating surpluses, which help to show the ability of the institution to manage over time
  - the level of endowments, which are a measure of overall wealth. Although they cannot all be spent at the HEI’s discretion, they represent guaranteed funding that will cover a level of activity
  - how the institution compares with peers and is perceived by the financial sector
  - the level and nature of future income streams – including relatively secure revenue streams such as from student residences, and more variable income such as research grants and contracts or commercial income
  - the risks, diversity and vulnerability of income. A range of sponsors can reduce dependency (if they are relatively secure), whereas reliance on a particularly ‘profitable’ contract or area may lead to vulnerability.

3.2 How do we know the total cash and capital needs of the institution?

As noted under Principle 1, adequate cash balances are critical to survival, and cash needs to be carefully forecast and managed for operational purposes. For many institutions, cash will also be the main source of funds for investment, including contributions to HEFCE and other capital grant schemes.

- All the resource strategies identify investment requirements.
- There is a plan which includes:
  - a view of prospects and capital needs over the next 5-10 years, in terms of replacement and renewal, investment in new areas of work, strategic moves to achieve mission, or technological or legislative developments
  - a resulting capital investment plan (with priorities and broad phasing)
  - sources of financing.
- All these requirements are prioritised in terms of need (urgency), potential for income-generation/development of the institution, and necessity – asking what happens to the institution in the long term if the investment is not made.
3.3 What proportion of these needs can and should be met from our own resources?

- Cash-flow forecasts identify the amounts expected to be generated from operations and identify the gap to be met from other sources.
- The institution has evaluated the relative contributions and risks of the alternative sources and the return that could be expected for a given investment in teaching, research or commercial activity.
- The potential for cost savings (which can be an equally productive source of funds) has been considered, along with the potential for fundraising.

3.4 How much should we raise from external sources?

External sources of finance can be valuable for specific purposes, but they all have a cost and associated risk. Commercial companies raise finance against future profits. Most HEIs have few, if any, future income streams which are relatively certain to be in surplus. The most common examples are fees from student residences, and income from science parks and other lettings.

- In the light of institutional circumstances, the institution has determined its capacity and its willingness to borrow or raise finance externally.
- The level (if any) of such external financing is decided as a part of the total financing of the institution.
- For specific projects, the institution considers the opportunities for public-private partnership schemes and the potential for fund-raising, and evaluates these as under Principle 4.

3.5 How do we decide how much we should borrow?

- The strategy evaluates the total financial base of the institution (see 3.1 above) and enables a consideration of the total borrowing capacity.
- The financial forecasts show the forward plans for cash and surpluses and the capital requirements (see 1.1, 1.4 and 2.2 above).
- The financial forecasts show the current levels of borrowing and gearing, and indicate restrictions imposed through the financial covenants for existing borrowings.
- The senior management team and governors have taken a view about the institution’s stance on borrowing, gearing and its impact on credit ratings. Factors to be taken into account in this consideration will include:
  - the institution’s level of reserves and assets
  - the purpose of the borrowing, and how much the activity will add to future income
  - how secure or risky this extra income is
  - what negative consequences could flow from the reduced headroom that will result from additional borrowing
  - how significant this particular opportunity is compared with others that are likely to arise over the lifetime of the proposed loan.
• The institution considers what proportion of the total theoretical borrowing capacity it wishes to take up, bearing in mind:
  – the purpose of the borrowing
  – ability to repay out of surpluses
  – ability to service the debt
  – potential future demands
  – impact on the institution’s objectives if the cash is not made available.

3.6 Are we making appropriate use of external financing?

• The institution is aware of the range of financial instruments available.
• Expert advice is obtained to ensure that needs are fully specified, particularly in terms of risks and timing.
• Both financial and non-financial criteria are considered before selecting which financial instrument(s) are to be used for a particular investment. Criteria include security, covenants, exposure to risk such as interest rate fluctuations, valuations, redemption terms, accounting and tax implications, and maintaining flexibility.
• The effect of changes in the oil price, the stock market and exchange rates are considered. Potential changes in tax legislation are identified, along with exit strategies.
• Before any major external financing, an option appraisal is undertaken, which:
  – includes detailed financial modelling of the alternative financial instruments
  – covers the full life of each instrument and considers its impact on the balance sheet, income and expenditure account, and cash flow
  – includes sensitivity analysis.
• Competitive tendering is used when financial instruments are purchased.
• A periodic review of all borrowing and exposure is carried out, including market testing.
• The review considers whether the instruments used are still appropriate to the requirements, and the scope for obtaining better terms or flexibility through refinancing.

3.7 How do we decide whether to bid for publicly-funded special initiatives and projects?

• There is an agreed set of strategic priorities so that if opportunities arise unexpectedly, or with a short timescale, the institution is ready to bid.
• Points to be considered include:
  – the fit of any new opportunity with existing strategies and priorities (diversion from current plans can have other costs)
  – the cost of bidding and likely success rate
  – the need to provide capital contributions, or recurrent income to service a capital investment
  – the impact that providing matching funds will have on other areas of investment
  – the impact on recurrent costs in future years.
Further information

- HEFCE Circular letter 23/00 ‘Borrowing in the higher education sector’
- HEFCE 99/21 ‘Appraising investment decisions’
- HEFCE 98/69 ‘Practical guide to PFI for higher education institutions’
Principle 4 Evaluating strategic alternatives and managing risks

The strategy should provide a framework to help the institution assess the implications and consequences of potential strategic developments and decisions, and to evaluate and manage risks which threaten delivery of the corporate strategy.

4.1 How can the financial strategy help to support and prioritise strategic opportunities?

- The investment plan (Principle 3) provides a framework against which to assess the costs and benefits of new ideas and opportunities.
- These are evaluated using the same techniques as capital projects: that is, full lifetime costs are identified, not just marginal costs or initial capital costs; realistic income and cost projections are included; and risks are considered.
- The risk assessment attempts to quantify risk and the impact of controls that might alleviate the risk, and provides a framework to consider levels of acceptable exposure.
- The strategic planning process includes a ‘balanced scorecard’ approach, which identifies key performance indicators across the whole range of institutional activity.
- The planned surplus makes enough resources available to support the implementation of these decisions.

4.2 Have we provided enough headroom for growth and change?

Many institutions will find that a major focus of their financial strategy is concerned with maintaining capacity in the short term, and with essential investment to remedy past problems and to maintain their position in increasingly competitive markets (Principle 2). There is thus a danger that the strategy becomes entirely defensive. This may be unavoidable in a short-term recovery situation, but it can have negative effects on morale, innovation and reputation, and the institution may miss opportunities, which can have a longer-term damaging impact.

- The institution creates headroom for positive change and development by:
  - targeting a level of surplus that exceeds immediate requirements (which may mean making hard decisions about activities that are in decline or not undertaking some activities)
  - keeping a small reserve, perhaps in the form of unused borrowing capacity or disposable assets, which can be called upon if an outstanding opportunity occurs
  - identifying the resources needed for development (which may be space or management time, as well as finance), and ensuring that these are not a constraint because they are being taken up by relatively low priorities
  - if this is a problem, considering short-term investments (such as renting space or using consultants) to free up resources for strategic developments
  - collaborating with other institutions, or partners, in areas where this is not a competitive threat, to take advantage of opportunities which the institution cannot manage alone.
4.3 How do we manage key financial risks?

Risk assessment is essential and is covered in the HEFCE guide (see ‘Further information’ below).

- Key financial risks are identified as part of the strategic planning process (these will depend on the circumstances of the institution, and will change over time).
- For each key financial risk, the institution identifies the potential impact, actions that can be taken to mitigate that impact, the level of exposure which is acceptable, early warning indicators, and fall-back plans or contingencies which can be used if the acceptable level of exposure is exceeded.
- The finance committee or other appropriate group monitors the key risks on a regular basis (probably two or three times a year).
- Each time a new financial strategy is produced, the appropriate set of key financial risks may change. These are then redefined along with the mitigating actions.

4.4 How can we minimise the impact of unexpected downturns?

- To minimise the unforeseen, the institution undertakes scenario planning, examining a wide range of consequences, and quantifying these within reasonable assumptions.
- Early warning or leading indicators are used, related to the key financial and non-financial targets, with plans to take remedial action at the first signs of problems, rather than after these have become embedded.
- The institution undertakes critical reviews of non-contributing activity and of high-cost activity which makes a relatively low contribution, has high demands on scarce resources, or is relatively vulnerable to uncontrollable external events. Early action to reduce such losses can greatly improve resilience, rather than waiting until they threaten institutional viability.
- Where possible, adequate contingencies are built into budgets for cash, income and surplus, so that when unexpected downturns do occur there is still financial headroom to allow for recovery.
4.5 Have we maximised the potential contribution of strategic alliances and collaboration?

There have always been strong reasons for collaboration among academics on their academic work, and this is widespread throughout higher education. In the current higher education environment, there are now also strong drivers to encourage collaboration more generally.

- Governors and senior managers have considered the potential benefits of the following (which are neither mutually exclusive nor comprehensive):
  - collaboration on services and infrastructure (such as sharing facilities or buildings, and consortium arrangements for internal audit)
  - strategic alliances between HEIs (for example, shared or rationalised provision, or joint marketing)
  - strategic alliances with further education institutions (such as franchising and assured progression routes)
  - strategic alliances with commercial organisations (for example in facilities management)
  - structural relationships between institutions, which can include federal relationships and merger.

- If any options appear worth pursuing, then a more systematic option appraisal or feasibility study is undertaken.

Further information

- HEFCE 01/24 ‘Risk management: a briefing for governors and senior managers’
- HEFCE 01/28 ‘Risk management: a guide to good practice for higher education institutions’
- HEFCE 99/21 ‘Appraising investment decisions’
**Principle 5  Integrating financial and other corporate strategies**

The strategy should be integrated with the output and other resource strategies, understood and owned by those involved in the management of activities and resources, based on a realistic strategic analysis, and supported by a process of monitoring and review.

5.1  **Is the strategy based on rigorous and objective analysis?**

- Managers directly responsible for academic units are involved in the strategic discussions and decision-making of the institution.
- The process of developing the strategic plan involves objective analysis of the environment, markets, and potential performance of the institution. If members of the senior management team have little recent experience outside the institution, consideration is given to involving an external adviser or facilitator.

5.2  **How do we ensure that the financial strategy is properly integrated with the output strategies (academic and enterprise) and other resource strategies of the institution?**

- The resource strategies consider the health of assets and resources and the sustainability of their contribution to academic objectives.
- The draft academic, finance, and resources strategies are all reviewed and approved by the same group, which includes heads of key academic and other departments. This is not a one-off process and it may take a number of iterations to bring all these strategies into alignment and within the available resources. This is the critical process of balancing the objectives, resources and infrastructure of the institution, as discussed in Part A.
- A ‘balanced scorecard’ approach is taken, which considers a broad range of key indicators for the institution so that investment and resources can be balanced across all strategies.
- The financial strategy summarises the main financial and other assumptions behind all the institution’s strategies, and provides the opportunity to identify inconsistencies between them.
- There is a consistency (in assumptions and methods) behind departments’ business plans and strategies.

5.3  **Do senior academic and other managers understand and accept the consequences of the financial strategy?**

- Managers directly responsible for academic units are involved in the strategic discussions and decision-making of the institution.
- Managers responsible for academic and other units have appropriate training,
information and support to enable them to understand the implications of the financial strategy for the planning and management of their units.

- The process of developing the strategic plan involves strategy away days or similar sessions, which include governors and all relevant managers. The strategy and key objectives are communicated effectively within the institution.
- The process of monitoring and review involves all the relevant managers.

5.4 How do we ensure that the strategy is implemented and reviewed, and that variations are detected at an early stage?

- There is a formal process for monitoring and review, with reports to key institutional committees at pre-determined intervals.
- Managers directly responsible for academic units are involved in this process.

Further information

- HEFCE 01/20 ‘Guide for members of governing bodies of universities and colleges in England, Wales and Northern Ireland’, Committee of University Chairmen
- HEFCE 00/24 ‘Strategic planning in higher education: a guide to good practice’
Annex A

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