National Audit Office

Report
by the Comptroller
and Auditor General

Department for Education

The higher education market

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Key facts

£9bn
up-front funding for higher education in England, including grants and tuition fee loans. Increased from £6 billion in 2007/08

85%
of up-front funding directly followed students in 2015/16, up from 23% in 2007/08

32%
of undergraduates from England consider their course value for money, down from 50% in 2012

2 million	approximate number of students currently in higher education
£50,000	average debt on graduation for a student starting a three-year degree in 2017
58%	of 15- to 18-year-olds, the typical age at which decisions on higher education are made, had not received any form of financial education that would improve their financial capability and help protect them from making poor choices
26%	of 18-year-olds from the most disadvantaged backgrounds entering higher education aged 18 or 19, up from 21% in 2011
87	providers in the top 90 institutions charged the maximum permissible tuition fee of £9,000 per year for all of their courses in 2016/17
£1.5 billion	increase in capital investment between 2011/12 and 2015/16 by English universities
2%	of students switch provider each year
55%	drop in the number of part-time students between 2011/12 and 2015/16

The convention used throughout this report is that academic years are written as 2012/13 and financial years are written as 2012-13.

Summary

1 In England, higher education covers all taught education above A-level and equivalents. Most of the 2 million higher education students are on degree courses in universities. Higher education also includes other courses such as certificates, diplomas and foundation degrees, and is also taught in colleges and alternative providers.

2 Government invests in higher education for its key contribution to creating a skilled, educated economy and society. The Department for Education's (the Department's) up-front public funding for higher education in England, in the form of grants and tuition fee loans, is now over £9 billion a year, an increase from £6 billion in 2007/08. Up-front funding per undergraduate increased in real terms over the same period, from £5,381 to £7,903 in 2016 prices.

3 Students pay for higher education with student loans, which create a legal obligation for them to make repayments based on earnings after finishing their studies. This is different from most further education courses or apprenticeships, where costs are fully met from general taxation or contributions by employers. Any unpaid student loan balance is written off after 30 years. The Department estimates that around 40–45% of the value of student loans will not be repaid.

4 In recent years, the government has increasingly delivered higher education using market mechanisms, in particular relying more on student choice and provider competition to improve quality, and value for money. Some 85% of up-front funding now directly follows student choice (up from 23% in 2007/08) via tuition fee loans, which the Department increased from £3,000 to a maximum of £9,000 in 2012 while reducing grant funding accordingly. The Department also removed student number caps from 2015/16, to increase access to more young people and allow popular providers to expand.

5 The Higher Education and Research Act 2017 introduced further market reforms. It establishes a new regulator, the Office for Students (OfS), with a remit that includes a focus on competition, student choice and outcomes. The OfS will take a more risk-based approach to monitoring provider performance, and its new regulatory framework is intended to promote increased choice and diversity. Further changes will make it quicker and simpler for new providers to enter the market, with an expectation that greater competition may mean some providers will exit.

6 In introducing these reforms, the Department set objectives to ensure that everyone with the potential to succeed, irrespective of background, can: access relevant information to make good choices; choose from a wide-range of high quality universities; and benefit from excellent teaching that helps prepare them for the future. The government's January 2017 industrial strategy green paper also set actions relevant to the sector to address skills shortages in the economy, provide higher quality careers information and advice, and test new approaches to lifelong learning.

Scope of this report

7 Our past work on delivering public services through markets has identified that government often needs to intervene to correct market failures. For example, public service users often need significant support to make good choices, such as from GPs or care workers. Higher education has a number of features that make it a particularly complex market. It is inherently difficult to choose a course before experiencing it; most students only attend higher education once and cannot learn from experience; and outcomes are uncertain and depend on the ability and commitment of each student as well as the quality of the provider.

8 This report examines the extent to which market dynamics in undergraduate higher education support government's objectives, and whether the Department intervenes effectively to correct market failures. Our assessment of value for money rests on the following key factors:

- the extent to which prospective students are able to make informed choices on whether to enter higher education, what and where to study, and understand the long-term implications of taking on debt (Part Two);
- whether prospective students from all backgrounds can access higher education (Part Two);
- whether student choice and provider competition is driving higher teaching quality and efficient course pricing (Part Three); and
- the extent to which higher education is delivering government's objectives related to skills needs in the economy (Part Three).

The Department began consulting on a new regulatory framework for higher education in October 2017. The detailed proposals in the consultation focus on the challenge of improving student choice in the market, by enhancing the information available and promoting good student outcomes, and seek to address a number of the areas covered in this report. Our findings are presented in this context.

Key findings

Supporting effective student choice and access to higher education

9 **Making an informed choice on whether to enter higher education, and what and where to study, is critical given the lifelong impact of this decision.** Graduate outcomes vary widely by subject, provider and family background, as well as other factors such as prior attainment and local labour markets. The difference in median earnings between subjects 10 years after graduation is estimated to be up to £24,000, and between providers up to £13,000. Graduates earn, on average, 42% more than non-graduates. However, graduate earnings for some providers and subjects are lower than for non-graduates, emphasising the importance of making an informed choice (paragraph 2.6).

10 **Prospective students are in a potentially vulnerable position when deciding whether to enter higher education and take on a student loan.** Higher education involves a potentially significant financial commitment, unlike other options such as apprenticeships. The average student debt, for a three-year course, on graduation is £50,000. This represents a legal financial liability, and is one of the largest financial commitments most students will make in their lives. It is likely to be second in scale only to mortgages which average £139,000 in the UK. Research in 2016 found that 58% of 15- to 18-year-olds, the typical age at which decisions on higher education are made, had not received any form of financial education that would improve their financial capability and numeracy to help protect them from making poor choices. The Financial Conduct Authority, which regulates financial service firms, identifies financial capability as one of the key drivers of vulnerability (paragraphs 2.7 and 2.8).

11 **Higher education has a more limited level of consumer protection than other complex products such as financial services.** Higher education providers must comply with general consumer law, to ensure they do not make misleading claims and that courses match their description. Student loans also have certain statutory protections, in that repayments are income-contingent and any unpaid balance is automatically written-off after a set period. However, higher education has some features in common with complex financial services, due to the complexity of the product, uncertainty over long-term outcomes, and the financial commitment of a student loan. Where financial products are complex and retail consumers may be vulnerable to making poor choices, the Financial Conduct Authority expects financial services firms it regulates to disclose clearly the risks of such products to potential customers, to minimise the risk of mis-selling or sale of unsuitable products. There are limited comparable requirements in higher education, however, despite strong financial incentives for providers to attract as many students as possible. Prospective students have very little access to independent advice (paragraphs 2.9 and 2.10).

12 The Department has improved information available to help prospective students choose their course and provider, but only one in five use it and additional support does not adequately reach those who need it most:

- The Higher Education Funding Council for England (HEFCE) now publishes key comparative data on providers and courses, including satisfaction scores, costs, and employment and earnings outcomes. Almost all users of the data find it useful, but only 20% of prospective students have used the data, dropping to 2% of prospective part-time students (paragraph 2.12).
- Careers advice in schools is an important component of making good choices, but is not well targeted. Stakeholders we interviewed felt that subjects chosen from age 13 were crucial in determining options available later on, but only 60% of 13- to 14-year-olds have access to an external careers adviser at school. Our analysis found that students who already discuss their future with teachers and parents are 40% more likely to also have access to external careers advisers than those who do not. The Department does not have an overarching strategy covering this area (paragraphs 2.13 to 2.15).

13 The proportion of young people from disadvantaged backgrounds entering higher education has increased, but participation remains much lower than for those from more advantaged backgrounds. The Department attempts to make higher education accessible to everyone by correcting market incentives for providers to prioritise certain groups. For example, providers charging maximum fees must spend a proportion of these fees on strategies to improve participation and outcomes for under-represented groups. The percentage of 18-year-olds entering higher education aged 18 or 19 from the lowest participation areas of the country (which correlates closely to lower socio-economic status) increased from 21% to 26% between 2011 and 2016. However, 59% attend from the highest participation areas. Research shows this gap is mostly explained by educational achievement at school (paragraphs 2.16 to 2.18).

14 Increased participation among disadvantaged students is weighted towards lower-ranked providers, which risks creating a two-tier system:

- Between 2011 and 2016, the lowest ranked universities saw an 18% increase in the share of students from low participation areas, compared to 9% in the highest ranked. Applications have generally shifted towards universities with stronger reputations and higher entry requirements in response to market changes, placing more financial pressure on other providers. If these trends continue, a two-tier system may develop between providers that can compete for the most high-achieving candidates and those that struggle to compete at all (paragraphs 2.20 and 2.21).
- There is also a risk of reduced choice for people who are unable to move away to study, if financial pressures cause providers to close courses or exit the market. It is estimated that around a fifth of students live at their family home while attending higher education. Students from disadvantaged backgrounds are less geographically mobile and more likely to live in their family home while studying (paragraph 2.22).

Provider incentives to reduce cost, and improve quality

15 **Only 32% of students from England consider their course offers value for money, down from 50% in 2012.** This figure is the lowest in the UK. Furthermore, 37% of students from England consider their course poor value. Most stakeholders we interviewed considered that these results are likely to be affected by the increased contribution English students are making towards course costs (paragraph 3.3).

16 **There is no meaningful price competition in the sector to drive down prices for the benefit of the student and taxpayer.** When the government introduced higher fees in 2012, it expected price competition to drive fees to an average of £7,500. In 2016, 87 of the top 90 English universities charged the maximum permissible fee of £9,000 a year for all courses. Evidence shows that students use price as a proxy measure for quality, and the providers we spoke to were concerned that lowering prices may signal poor quality. Providers also choose the purchaser in higher education, which differs from most traditional markets where the buyer chooses the product or provider. These factors result in weak incentives to reduce costs and fees (paragraphs 3.5 and 3.6).

17 **Market incentives for higher education providers to compete for students on course quality are weak:**

- The relationship between course quality and providers' fee income is weak. We found that, on average, a provider moving up five places in a league table gains just 0.25% of additional fee income through increased student numbers. Providers are attempting to attract students by investing more in marketing and in facilities, with capital investment in English universities increasing from £2.35 billion to £3.80 billion between 2011/12 and 2015/16. Stakeholders we spoke to were concerned that this investment would not lead to a proportionate increase in teaching quality, and was unsustainable (paragraphs 3.8 to 3.11).

- The Department has introduced its Teaching Excellence and Student Outcomes Framework to incentivise teaching quality. The Department published the first results in June 2017, based on measures including dropout rates, satisfaction scores and employment outcomes. Many stakeholders expressed concern about whether ratings meaningfully reflect teaching quality. However, most also felt that the framework will encourage providers to focus more on educational quality and outcomes (paragraph 3.12).

18 **Students can do little to influence quality once on a course, despite improvements in complaints handling.** In a traditional market, consumers can incentivise quality through complaints and redress where services are unsatisfactory, or can switch to another provider. The sector ombudsman considers that providers have improved their handling of complaints and feedback, with a 25% drop in student complaints referred to it since 2014. However, students are unable to drive quality through switching providers. Switching rates in higher education appear low at 2% a year. Our analysis found no correlation between switching and satisfaction scores (paragraphs 3.14 to 3.20).

19 There is not yet evidence that more providers entering and exiting the market will improve quality in the sector, and protections for students are untested. Since 2011, the government has sought to reduce barriers to entry, including allowing new providers to award their own degrees on a probationary basis. But it is unclear what value degrees will have where providers with probationary powers are not awarded full degree-awarding powers. Increased competition is likely to lead to more courses or providers closing, and there is not yet evidence that providers that struggle financially will be of any less quality than those doing well. The new regulatory framework will require each provider to have a plan approved by the OfS to mitigate disruption for students in cases of closure (paragraphs 3.21 to 3.27).

20 Government increasingly relies on the market to meet its objectives on skills and lifelong learning, but incentives to meet these priorities are weak:

- Providers' costs vary widely, in 2012 ranging from £7,000 for some subjects to £20,000 for others. The Department provides grant funding for high-cost courses, many of which it considers strategically important, but providers report that this does not fully cover their additional costs. We found that the cheaper a course is to run, the more likely a provider is to maintain offers in the face of declining applications or expand student numbers in response to more applications. The overall proportion of students taking science-related subjects has increased since 2011, but there remain significant gaps in priority areas such as engineering and technology (paragraphs 3.28 to 3.32).
- Lifelong learning in higher education institutions has fallen significantly since 2011, with a 39% drop in mature students and 55% drop in part-time entrants. Providers have a financial incentive to prioritise young, full-time students, who are typically less costly to teach and have lower dropout rates than mature and part-time students (paragraphs 3.33 to 3.35).

Conclusion on value for money

21 The Department increasingly relies on market mechanisms to deliver higher education, with 85% of the £9 billion annual funding now directly following students. Some aspects of market delivery have brought benefits: there is more choice for more capable candidates, and a higher proportion of students from disadvantaged backgrounds are entering higher education. However, only 32% of students consider their course offers value for money, and competition between providers to drive improvements on price and quality has yet to prove effective.

22 The decisions students make when entering higher education have lifelong implications for their career prospects, earnings and debt. While information available to students to support them in making these decisions has increased, students taking out loans lack the level of consumer protection available for other complex products such as financial services. Furthermore, the taxpayer will bear the cost of student debt written off, but government has limited influence on the overall size and therefore funding for the sector, or the course mix. The Department needs a more comprehensive approach to the oversight of the higher education market, and must use the proposed regulatory reforms to help address the deficiencies identified in this report, if students and the taxpayer are to secure value for money.

Recommendations

The Department should:

a **Ensure that careers advice in schools and other support reaches those that need it most.** It should capitalise on opportunities to join up careers advice and tertiary education, now that it has responsibility for both policy areas.

b **Work with the OfS to monitor the sector and identify criteria to determine whether it needs to intervene, particularly where providers are failing.** This could include clear objectives for regional provision, to avoid areas of little or no provision developing that restrict access to the disadvantaged and less mobile. It may also involve monitoring closures, and establishing step-in criteria where necessary, to protect priority subjects or the interests of students when providers close courses or leave the market.

c **Commission an independent review of the new regulatory arrangements once these have had time to bed in.** This could include the existing commitment to review the Teaching Excellence and Student Outcomes Framework, and would help it understand the extent to which the overall arrangements correct for weak market incentives to improve quality.

d **Work with the sector to understand incentives for providers to offer courses in government's priority subject areas, and address deficiencies where necessary.** It should work with other departments, such as the Department for Business, Energy & Industrial Strategy, in determining skills needs in the labour market.

The OfS should:

e **Look to learn from other regulators in making the most effective use of its new powers.** The OfS will be a market regulator, with similar challenges to regulators addressing competition and consumer issues in other sectors. The Department has set an expectation that the OfS should learn from regulatory best practice. This learning could include:

- reviewing the effectiveness of competition in the sector, with assistance from the Competition and Markets Authority as necessary;
- ways to empower students to make informed decisions, whether through direct regulation or other means; and
- understanding how to monitor potential threats to the sector and translate these into effective stress-testing and preventative action (particularly in student protection plans).