



Learning and Skills Council

**Delivering Value for Money
through Infrastructural
Change**

**Commercial in Confidence
Final**

KPMG LLP
20 May 2010

This report contains 85 Pages

pltw/128

Contents

1	Background to the Project	5
1.1	Preface to the Report May 2010	5
1.2	The purpose of the report	5
1.3	Background	6
1.4	Methodology	7
1.5	Sources of Information	7
1.6	Limitations to the Scope of the Review	7
1.7	Confidentiality and Disclaimer	8
1.8	Acknowledgements	9
2	Executive Summary	10
2.1	The Brief	10
2.2	The context for change within the FE sector	11
2.3	England's current FE sector	12
2.4	What organisational infrastructure models are out there?	13
2.5	How much strategic partnering is there?	13
2.6	Myth or Reality?	14
2.7	What are the "blue sky" ideas?	15
2.8	What are the barriers to innovation?	15
2.9	What have we learnt from elsewhere?	15
2.10	Conclusions and Recommendations (1)	16
2.11	Recommendations (2) - the positive options	16

3	Our approach to the assignment	17
3.1	Definition of Terms	17
3.2	Defining Key Questions	18
4	How is the sector organised, governed and regulated?	19
4.1	The Diversity of the Further Education Sector in England	19
4.2	A range of Sector Delivery Models	20
4.3	The legal framework	22
4.4	The impact of the Regulatory Framework on delivering VfM	25
4.5	The LSC and Managing Under-Performance	27
5	Myth or Reality - Is bigger better?	30
5.1	The literature review	30
5.2	Testing the Hypotheses	31
5.3	Key conclusions from the analysis	32
5.4	The evidence for the size of Sixth Forms in School	40
5.5	Is there an optimum size of college?	41
5.6	Does size affect a college's strategy?	41
5.7	Does rural and urban FE provision have to be treated differently?	41
6	How much strategic partnering is there?	43
6.1	The Government's Vision of Collaborative Working in FE	43
6.2	The FE approach to Shared Services	48
6.3	Progress towards shared services within the FE college sector	50
6.4	Federations in the FE Sector	51
6.5	The ultimate strategic partnership - merger	52

7	What are the ‘blue sky’ ideas from the sector?	55
7.1	Introduction	55
7.2	Systemic Change	55
7.3	Radical Infrastructural Change	57
7.4	Evolutionary Infrastructural Change	57
8	What are the current barriers to innovation?	58
8.1	The types of barriers	58
8.2	Barriers for private and voluntary sector involvement in FE	61
9	What have we learnt from elsewhere?	63
9.1	Global examples of FE structures and change	63
9.2	Organisational structure	63
9.3	Larger delivery units- the view from abroad	64
9.4	Transferability from other sectors in the UK	66
10	Conclusions and Recommendations (1)	69
10.1	The Present State of the Sector	70
10.2	Recommendations	71
10.3	Summary diagram	74
11	Recommendations (2)-Immediate Opportunities	76
11.1	Introduction	76
11.2	The new options	76
11.3	KPMG Thought Piece 1 - Delivering a College Improvement Partner Service (CIPS)	77
11.4	KPMG Thought Piece 2 - Future Features of a “Modern Merger”	81

1 Background to the Project

1.1 Preface to the Report May 2010

This report was commissioned by the Learning and Skills Council (LSC) in July 2009. The field work with the sector and the subsequent analysis was carried out over the summer and into the autumn of 2009. Internal changes at the LSC as part of the preparation for the Skills Funding Agency and the Young People's Learning Agency (YPLA) have somewhat elongated the original timescale set for publication and dissemination. The unintended consequence of this delay, is that some of the detailed figures provided in this report, have now been superseded by more recent releases. For instance, the report quotes AoC estimates on 2008-9 finances. These are now in the public domain (on the Skills Funding Agency website). The figures for 97% of Colleges show a deficit of £34 million before the property strategy write off and a £230 million property strategy write off. LSC capital grant payments of £59 million make the net write off £171 million. Similarly, our estimates of the level of cuts colleges may expect in 2010/11 and the number of GFE's from 1st April 2010 have been overtaken by time.

To update these and other instances, would further delay release of the report and would not affect the conclusions and recommendations in anyway. We would ask readers to bear with the effects of time, and to concentrate on the overall messages in the report and its intention to stimulate debate.

1.2 The purpose of the report

KPMG LLP has been commissioned by the Learning and Skills Council (LSC) to undertake a review of Further Education (FE) colleges' current delivery models, and, to identify with the sector, potential new ways of shaping the delivery infrastructure in a way which could provide better value for money (VfM) for individual colleges, and for the sector as a whole.

We were asked to work with representatives from the sector, and add our thinking and experience to current expertise across the FE system. We have also consulted with representatives of schools and the private sector to consider the part that they may play. We have identified current college delivery models that the sector deem to be efficient and effective and we have drawn out 'Blue Sky' thinking about what *could* be possible, if current restrictions are removed or ameliorated. Of particular interest to the LSC, is the identification of new and innovative ways to help failing colleges, other than by the traditional merger route, or by advances of funding.

A 2007 Audit Commission report¹ highlights that seeking efficiency is one of the most important drivers of innovation. Machinery of Government will bring many changes to

¹ *Innovation: seeing the light* (Audit Commission, 2007)

the sector at an unprecedented time of fiscal restraint. The LSC has commissioned this work on the basis that it is therefore, a good time to work with colleges to review current delivery models and to identify potential new ways of shaping the future.

We intend that this report offers constructive solutions and some challenges which will help the LSC, its successor bodies and the FE sector to use the current economic situation as a ‘burning platform’ which will catalyse change.

1.3 Background

Over the last five years, FE colleges have been highly successful with the majority offering good and outstanding provision. According to Ofsted, inadequacy rates are currently under seven percent. However, there are still a small number of colleges which have both poor quality and failed financial health. There are a larger number of colleges which are ‘at risk’ of failing in either or both of these measures.

The current financial climate within the public sector means that all colleges are under pressure to achieve, not just quality provision, but value for money i.e. delivering ‘more for less’. The current economic downturn and the resulting pressure of tightening government budgets, has the capacity to test the FE sector’s resilience in ways it has not experienced ever before.

The immediate effects of the economic crisis on public sector organisations, (including the FE sector) is already visible. The reduction in tax revenues, coupled with an increase in the total cost of social security payments, has reduced the amount of money available for other public services. The imperative is for all public services to deliver promised improvements despite reductions in budgets.

About 80% of college income currently comes from the LSC. Some 65% of this is spent on staff. The AoC² has stated that, for the second year in a row, colleges collectively expect to make an operating deficit in 2008-9 – and this excludes the £200+ million write off for abortive capital costs and any consequences from the reduction in the Train to Gain budgets.

Feedback from our consultation indicates that the expectation of the sector is for significant cuts in the region of 5% -15%. It may be that these are under-estimates. In addition, there will be higher VAT bills from January 2010 and increased Pension liabilities. It is expected that the revaluation of the Teachers and Local Government Pension Schemes will also lead to increased employer contributions from April 2011. On the near horizon too, are other pressures from Government to reduce costs, and especially estate costs. In June 2006, the Prime Minister launched new targets for sustainable operations on the Government estate which are already impacting on HE and will be expected to impact increasingly on FE.

² *AoC advice to Principals, AoC, 2009*

In the light of all these financial pressures, it is inevitable that every college in the sector will need to deliver greater value for money or risk failing. The issue for the LSC, its successor bodies and the Departments, is to consider whether cost reduction at an individual organisation level will be enough to deliver the amount of saving required, without affecting front line delivery or whether radical restructuring of the entire sector will be required. .

1.4 Methodology

We used a combination of desk analysis and direct fieldwork to undertake this study. The key components of our methodology were:

- **A comprehensive literature review** of existing research which looked at documents identified by the LSC in the original tender such as the Webb Review, documents found by the KPMG team and a wide range of work recommended to KPMG by FE stakeholders who were interviewed over the course of this study. A full list of literature reviewed can be found in Appendix 1
- **A consultation process** which focused on key stakeholders across the FE sector – the organizations and individuals we needed to speak to were agreed with the LSC and engaged through a combination of face-to-face and group interviews. Some consultees were also interviewed on the telephone. We used an ‘incubation room’ approach (which involved setting up a dedicated area with visual prompts to catalyse discussion with consultees and capture their thoughts) to bring together ideas.

In addition to consulting key FE stakeholders in England, we have also consulted those in Scotland, Wales and Northern Ireland. So that international comparators could be identified, we have consulted with the equivalent colleges in the USA and Canada, thanks to the assistance of Geoff Hall, Principal of New College Nottingham. Our KPMG colleagues in Australia and the Netherlands have also provided information and contacts for FE in those countries.

A list of all stakeholders consulted can be found in Appendix 2

- **Quantitative analysis** of data on colleges’ performance – this was undertaken using information taken from the LSC’s own data sources and publicly available.

1.5 Sources of Information

We have drawn on a wide range of sources in undertaking this study, including interviews, previously published research and the LSC’s own data which is publicly available. Throughout this report we have sought to make clear the distinction between opinions and perceptions recounted to us by consultees, views expressed in research papers or official documents, and conclusions drawn from statistical analysis.

We have also drawn on KPMG’s experience of working in FE, and the wider public sector.

1.6 Limitations to the Scope of the Review

The FE system refers to a range of organisations including, but not exclusively, those funded by the LSC. This comprises:

- FE colleges and providers
- Independent specialist colleges and schools
- Learndirect/UFI
- School sixth forms
- Providers of personal and community development learning (PCDL) including local authorities
- Providers of learning and skills for offenders
- Special school sixth forms
- Providers in the voluntary and community sector
- Work based learning providers
- Employers holding contracts with the LSC through the LSC's National Employer Service

This review has looked primarily at the English FE College sector, including Sixth Form Colleges, school 6th Forms and specialist colleges. It contains comment on, and information from, related areas such as English secondary school provision and education systems in other countries, but these are not the focus of the current review.

We also note that the data on which the quantitative analysis is based has not been validated by KPMG. We have made every reasonable effort to ensure our own findings are accurate and evidence based but note that further, focused work would be needed in order to confirm the accuracy of this data, particularly at college level.

In addition, we have not provided detailed costings of the specific options and models outlined in this report. In order to provide the most measured advice, we requested that the LSC provide us with details of how many failing colleges there had been over a 5 year period, the reasons for failure, the interventions that had been made, and whether this had led to recovery or if the colleges remained as financially failing organisations. Unfortunately, within the timescale of this project, it has not been possible for the LSC to provide this further information. Without the detailed information available, we can therefore only provide a high level response.

1.7 Confidentiality and Disclaimer

This report is strictly confidential and has been prepared for the Learning and Skills Council. It is issued in accordance with the terms of engagement agreed by the Learning and Skills Council and KPMG LLP. The addressees for this report are the Learning and Skills Council ("the Addressees"). This report should not therefore be regarded as suitable to be used or relied on by any party wishing to acquire rights against us other than the Addressees for any purpose or in any context. Any party, other than the Addressees who obtain access to this report or a copy and chooses to rely on this report (or any part of it) will do so at its own risk. To the fullest extent permitted by law, KPMG LLP owes no duty to any parties other than the Addressees, whether in contract or in tort or under statute or otherwise (including negligence) in respect of this report, for its work or for any judgments, findings, conclusions, recommendations or opinions that KPMG LLP has made.

1.8 Acknowledgements

We would like to record our appreciation to all those who have contributed to this review and particularly to those members of staff of the LSC, and all the many stakeholders with whom we made contact during our work, who gave so willingly of their time throughout this review.

2 Executive Summary

2.1 The Brief

KPMG LLP has been commissioned by the Learning and Skills Council (LSC) to undertake a review of Further Education (FE) colleges' current delivery models, and to identify with the sector, potential new ways of shaping the delivery infrastructure to provide better value for money (VfM) for individual colleges and the sector as a whole.

We consulted extensively across the FE sector, including college principals and other staff, representative bodies, private and voluntary sector providers. This was vital to the success and credibility of the project. Our consultation was able to provide us with anecdotal evidences and myriad examples of noteworthy practice. The literature review provided a more academic counter-point to this. A summary of both the people consulted and the literature reviewed is found in the Appendices to this report.

Together we have identified current aspects of college delivery models that seem to be efficient and effective and we have drawn out 'blue sky' thinking about what *could* be possible, if current restrictions are removed or ameliorated. Of particular interest to the LSC, is the identification of new and innovative ways to help failing colleges, other than by the traditional merger route, or through advances of funding which is a drain on the public purse, and which rarely solve the basic issues.

With change come new opportunities. A 2007 Audit Commission report³ highlights that seeking efficiency is one of the most important drivers of innovation. We intend that this report offers constructive solutions which will help the LSC, its successor bodies and the FE sector to use the current challenging economic situation as a 'burning platform' which will catalyse change.

2.1.1 The definition of Value for Money

The definition of value for money (VfM) that we worked with can be broadly defined as the extent to which an organisation has obtained the maximum benefit from the goods and services it acquires and/or provides. VfM should be distinguished from 'efficiency', which is a narrower concept relating to cost. The Department for Communities and Local Government (DCLG) defined efficiency in the following terms in 2007:

³ *Innovation: seeing the light* (Audit Commission, 2007)

2.1.2 **Infrastructural change**

We have defined infrastructural change as that which is undertaken within and by an organisation. This includes undertaking activities such as collaboration in order to effect VfM. This relates directly to the scope of the current project, and has allowed us to focus our research on current and possible future infrastructural changes within the FE sector.

Infrastructural change relates to what colleges can do to themselves and with each other and partners. **Systemic change** – in this context changes which would affect the whole FE sector – is therefore the next step up from this. As one moves from infrastructural change to systemic change there is a corresponding reduction in the level of college independence. The diagram at Fig 2 page 16 illustrates the movement within the change process.

We have, in the course of this project, considered all three stages as it has become evident that VfM gains could well be greater across the sector as a whole if changes were made at a systemic as well as a college by college, and also college with partner level. It is also likely that improving vfm in the college sector could lead to improved vfm in the schools sector and elsewhere in the public sector where there is collaborative provision with colleges.

2.2 **The context for change within the FE sector**

FE Colleges are key to the Government's twin ambitions of continued economic growth and greater social inclusion within the UK. This now has to be achieved even more urgently in an unprecedented climate of fiscal restraint.

The Machinery of Government Changes (MOG) which establishes the Skills Funding Agency (SFA) the Young People's Learning Agency (YPLA) from 1st April 2010 changes established funding routes for colleges and gives a range of new responsibilities to Local Authorities (LA). A new statutory sixth form college sector will be created from 1 April 2010 and will become part of the LA "family". These fundamental changes will require the FE sector to develop new ways of working with each other, with existing partners and with a range of new partners.

Pressures on the public purse will intensify at a time when there are also fundamental changes to the range of FE college responsibilities. The raising of the participation age to 18 (ie the need for more training/learning places) and also the introduction of Diplomas driving more collaboration with schools, will put increased pressure on already stretched budgets.

*Models for Success*⁴ set out a challenging agenda for FE colleges at a local, regional, national and international level. The expectation was that there would be a wide range of delivery models. These would include federations, collaborations, companies and joint ventures with a range of partners including schools, other colleges, employers, the third

⁴ DIUS 2008

sector and the private sector. All these it was considered had been made accessible to the college sector through a series of enabling legislation.

The document makes clear that the Government's policy is not to reduce the number of corporations in the FE college sector. The policy emphasis is very clearly on local colleges for local people and locally managed. With this focus came an implicit discouragement of merger and an encouragement to use the range of other collaborative arrangements available to colleges.

2.3 England's current FE sector

FE Colleges are characterised by their diversity. The statutory age range for all FE colleges in England is from 16⁵. There were 492 named colleges in the original Further and Higher Education 1992 Act (FHE Act) *Models for Success* identifies that, at 1 April 2008, there were 376 colleges.⁶ Of these, 51% of colleges are classified as General Further Education,(GFE) 26% are Sixth Form Colleges, 13% are Tertiary colleges, 5% are Agriculture and Horticulture, 4% are Specialist Designated Institutions, and 1% Art, Design and Performing Arts. The reduction in numbers from 1992 has been a result of merger, rather than closure without replacement, of which there has been only a few. Of the 113 Sixth Form and Tertiary Colleges, it is expected that under the new Act (Royal Assent Nov 12th 2009) many of these will opt to become part of the Local Authority family. Certainly it is expected that 100+ will take that route. On that basis the current estimate is that there will be no more than **270 GFE colleges from 1st April 2010.**

Colleges vary in size from large GFE's with annual incomes in excess of £120m serving over 30,000 learners, which also deliver Higher Education, to small, specialist single focus institutions with incomes of less than £2m and a few hundred learners.

Over the last five years, FE colleges have been highly successful, with the majority offering good or outstanding provision. According to Ofsted, the inadequacy rates at inspection are currently under seven percent. These statistics still mean that a small number of colleges deliver poor quality provision. Poor provision fails not only learners, but also the UK economy, which needs successful, skilled people to raise productivity, now more than ever.

Poor quality of provision is often accompanied by the failing (or failed) financial health of the college. Colleges' interpretation of the seriousness of a deteriorating financial position has not always match the reality until it is past the point of no return. Some Governing Body members may tolerate a more relaxed view of deficit and insolvency than in their day job in the private sector.

⁵ Many colleges offer 14-16 provision but the legal responsibility for this age group is with the local authorities.

The LSC has introduced a range of improved measures to manage under-performance which are designed to minimise the risk of single college under-performance and failure. In practice, in some cases, this process can lead to elongated dialogue between the LSC and failing colleges. The LSC has cushioned some failing colleges by providing additional funding in the form of either exceptional support funding, or more latterly, advances of funding which it requires to be paid back. Very weak colleges have often been encouraged to merge and supported by the allocation of additional funds to support the harmonisation costs of the two institutions and/or by the provision of capital support grants. Historic deficits have been written off in many cases to give the merged college a new start. Harmonisation support following merger has not been restricted to failing colleges. In the past, it has also been made available to stronger colleges which have chosen to merge for strategic reasons. This funding is no longer available and the sectors' view of merger will have to change.

In addition to the small number of colleges publicly known to be failing, there are a significant number of other colleges which the LSC has identified 'at risk' of failing in one or both of the measures of quality or financial health in the future. KPMG estimates that there may be an increase in the number of colleges in financial / quality difficulty within the next few months.

2.4 What organisational infrastructure models are out there?

Colleges' currently organise themselves in a multiplicity of ways. Some have complex organisational infrastructures with multiple sites (some at a distance from the administrative centre) with a great deal of local delegation and separate branding to replicate the strengths of the smaller, specialist niche provider but supported by the administrative economies which come with scale. Other colleges have chosen to remain small, specialist and focused primarily on one market in one locality.

Analysis to determine if any one organisational model is better than another, indicates that underlying all the apparent infrastructural variations, without exception, **is one single core model**. In this report we refer to this core model as the **Single Accountability Framework (SAF)**. This sets the boundaries for internal and external innovation. The OfSTED regulatory inspection arrangements and the LSC audit regime for colleges reinforce the impact of the SAF by focusing and rewarding only single entity activity.

2.5 How much strategic partnering is there?

Colleges have made wide use of most of the range of collaborative opportunities made available to them. However, the impact of the SAF drives the success, (or failure) of various collaborative strategic partnering models which in turn impacts on the ability of colleges to more effectively deliver VfM. The focus on individual accountability is a major contributory factor to the lack of trust between colleges, and their willingness to share data and delegate strategic decisions to others. It particularly inhibits the development of **Federative activity** which could be a useful alternative to merger and a basis for the development of **shared services**. Often merger is the only option available to failing colleges.

2.6 Myth or Reality?

There has been consensus that the **quality of the college leadership and the quality of the governance arrangements are the major determining factors** influencing the success or failure of a particular college. There has been less agreement about the **influence of size as a factor** in delivering VfM.

We researched and tested three hypotheses:

1. *Larger colleges have better results i.e. there is a statistically significant positive correlation between the two.*
2. *Larger colleges have lower unit (administration) costs.*
3. *Some components of total cost e.g. support services, management, are lower in larger colleges.*

We found evidence that suggests **all three hypotheses have elements of truth, particularly hypotheses two and three**. All conclusions were discussed with the LSC to ‘sense check’ whether they correlated with the experience of sector professionals. Each of these hypotheses was tested separately for four College types – GFEs; Sixth Form Colleges; Tertiary Colleges; and Specialist Colleges of Agriculture. Notwithstanding some caveats on the data sources, it is possible to demonstrate the following general conclusions, which are confirmed from other sources:

- **Efficiency:** larger colleges have lower administration costs as a percentage of total costs than smaller colleges and are also able to provide provision with a lower level of base funding for 16-18 year olds.
- **Success rates:** size of college has very little impact on success rates – although there is a slight positive correlation between college size and success rates. Furthermore, larger colleges achieve, on average better OFSTED gradings than those obtained by smaller colleges.

We researched whether there is an **optimum size of college** which every college should aspire to. We found no consensus on this matter from consultees, nor does the data identify any “sweet spot” for college size. This is equally true if one varies the question and asks whether there is a critical mass beneath which an institution is unable to offer high-quality FE provision.

Our consultation showed that **innovations** such as acquiring companies, entering in to joint ventures and leading plans to merge with other colleges **are more common in larger colleges**. This evidence was largely anecdotal and drawn from consultation, but was a common theme amongst those interviewed, particularly college principals and other senior management.

We considered if **size had an impact on college strategy**. Consultation showed that this seems to be linked to confidence and ability to make ‘business’ type decisions, and that larger colleges are more likely feel able to do this. This is linked to factors such as:

- Experienced, high-quality senior management (and the ability to invest in and attract such people).
- A sufficiently large organisation (critical mass) to take calculated financial risks without jeopardising the college's financial position.

There may be different structural considerations in rural and in urban settings, but the general conclusions remain.

2.6.1 Sixth forms in schools

Our analysis confirms that undertaken by the Audit Commission in 1985, and repeated as recently as 2002. This indicates that school sixth forms with less than around 150 learners tend to have poorer success rates.

2.7 What are the “blue sky” ideas?

A large number of 'Blue Sky' ideas, have emerged from consultation and research. our consultation indicates that the FE college sector shows an appetite for major change. Most respondents' ideas fell into the category of systemic change. Several commented that to do anything less was “tinkering at the edges”. Those advocating systemic change did so on the basis that although individual colleges could be made even more efficient, such changes would only deliver limited savings and the fundamental factors inhibiting the response of the sector would remain

2.8 What are the barriers to innovation?

We have identified a number of barriers which prevents colleges being innovative in improving VfM. A fundamental cause of many of them is the impact of the legal and regulatory framework for colleges which imposes a limit to the flexibility of strategic partnerships. The influence of this framework, which emphasises risk, exacerbated by an implicit tendency towards competition between colleges, has created less tangible but equally, in some cases, impenetrable cultural barriers which discourage innovation. In addition, there are acknowledged factual barriers, such as the current tax rules, pension and OJEU issues which are all a particular disincentive to involving private and voluntary sector providers who wish to invest in the sector.

2.9 What have we learnt from elsewhere?

2.9.1 From overseas

Over the last twenty years there has been a clear global trend towards systemic change towards larger delivery units for education below the level of Higher Education i.e. the phase equivalent to our FE. This is observable in Canada, USA, Australia and The Netherlands and closer to home in Scotland, Wales Northern Ireland and the Irish Republic. Large single delivery units serving whole regions or large administrative areas have either been established from the inception of the FE service, or are being formed by merger of smaller organisations. This is not at the loss of local identity as smaller delivery centres continue to exist.

2.9.2 Lessons from other sectors in the UK

There are lessons for FE elsewhere, from the schools sector, the private sector and from other Government depts. These have successfully dealt with many of the key barriers inhibiting the development of VfM in the FE college sector.

2.10 Conclusions and Recommendations (1)

The financial health of the FE sector is in general deteriorating rapidly, and requires urgent action. **Systemic change** – the Government should make some key decisions about the infrastructure of the sector, before serendipity and individual college ambition takes the lead. **Radical Infrastructural Change** – there are lessons, especially from the schools sector which would remove a number of the barriers preventing innovation, especially by collaborative action and through investment from the schools sector. **Evolutionary Infrastructural Change**- changes that are entirely possible within current legislation and which can be determined by individual colleges should be an immediate priority. Lead responsibilities, high level benefits and risks and an indicative timescale for realisation of greater VfM are provided.

2.11 Recommendations (2) - the positive options

We provide two KPMG Thought Pieces which put forward some practical cost effective models for immediate action by colleges which will allow the sector to seize the initiative to radically improve VfM *now*.

We do not think that the sector has fully exploited the potential it has to *lead* change. Quality provision in FE must be maintained as the sector down-sizes the number of GFE college providers, possibly by up to 50 colleges. For many failing, struggling and vulnerable colleges, merger may either a) take too long – 10 months minimum in our experience or b) represent the last resort.

We provide the model for an option within the present legal and regulatory framework which would be speedy to implement, and could be cheaper than present options. The working title is *College Improvement Partner Service* (previously known as a *Managed Service*). It would use the strengths of the sector in support of weaker colleges, and it would retain college independence at a time when turn round may still be possible, or if some time is required to properly prepare for merger.

We also provide thoughts on the “*modern merger*” which bears a closer resemblance to the private sector “asset acquisition” model without abandoning the emphasis on meeting learner, employer and community needs within a locality.

3 Our approach to the assignment

3.1 Definition of Terms

This section defines the two key terms for this report; value for money (VfM) and infrastructural change.

3.1.1 Value for Money

Value for money (VfM) can be broadly defined as the extent to which an organisation has obtained the maximum benefit from the goods and services it acquires and/or provides. KPMG has undertaken work with the National Audit Office (NAO) on VfM in the public sector (in this case looking at shared services) which defines it as:

“The wider focus on value for money rather than efficiency alone [which] reflects the audit agencies’ concern to see public sector organisations improve the effectiveness and professionalism of corporate services functions, as well as their efficiency.”⁷

VfM should be distinguished from ‘**efficiency**’, which is a narrower concept relating to cost. The Department for Communities and Local Government (DCLG) defined efficiency in the following terms in 2007:

*“**Efficiency**” is defined as achieving the same outputs for less resource or additional outputs for the same resource. Consequently, an action that fully or partially alleviates a cost pressure is countable as a cash-releasing efficiency, but an action that frees up cash at the expense of the overall effectiveness of service delivery is not an efficiency gain.”⁸*

The definition of VfM arrived at by Imperial College (an Higher Education Institution-HEI), is useful. This concluded VfM, “*not only measures the cost of goods and services, but also takes account of the mix of quality, cost, resource use, fitness for purpose, timeliness and convenience to judge whether or not, when taken together, they constitute good value.*” Imperial College concluded that, “*achieving VfM may be described in terms of the ‘three Es’ - economy, efficiency and effectiveness.*”⁹

3.1.2 Infrastructural and Systemic change

Infrastructural change relates to what colleges can do internally to change the way they operate, and what they can do with each other and non-sector partners. **Systemic change** – in this context changes which would affect the whole FE sector – is the next step up from this.

⁷ *Improving VfM in public sector corporate services*, KPMG/NAO, 2007

⁸ *Delivering value for money in local government*, DCLG, 2007

⁹ *Value for money policy*, Imperial College, 2009

As one moves from infrastructural change to systemic change there is a corresponding reduction in the level of college independence. The diagram at Fig 2 illustrates the impact on independence within the hierarchical change process.

We have, in the course of project, considered all three levels of change as it has become evident that the impact of VfM gains could well be greater, if changes were made at a systemic level, as well as at a college by college, and college with partner level.

3.2 Defining Key Questions

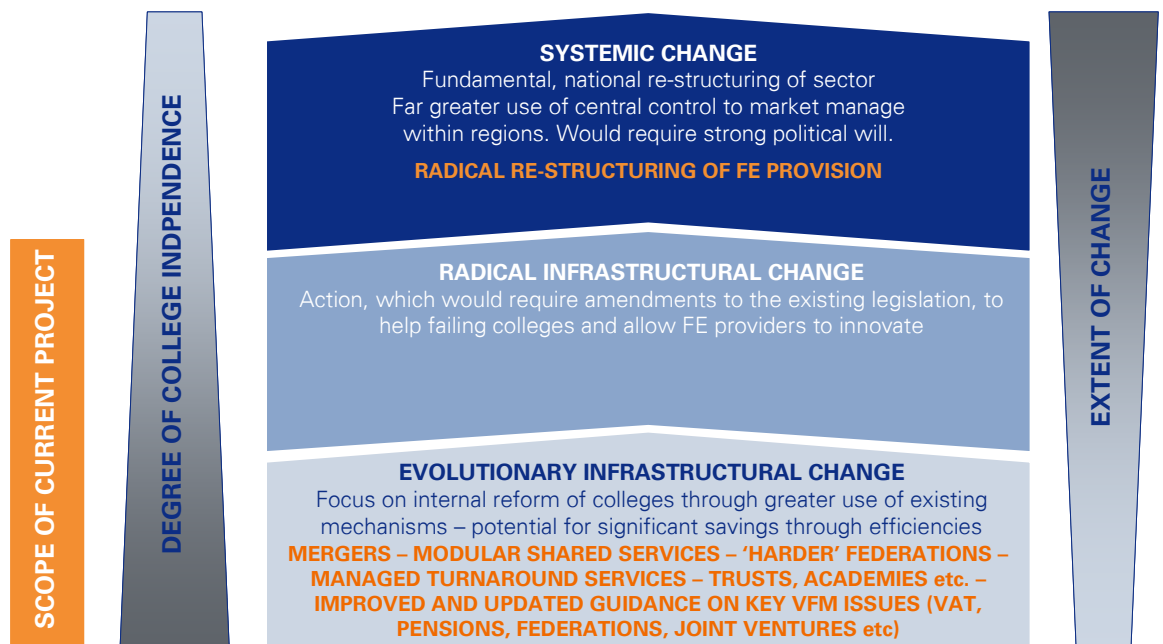
We began by seeking evidence to answer two key questions:

- *How do colleges internally organise to deliver VfM? i.e. what can colleges change within their own internal structures to deliver VfM?*
- *How do colleges engage with other organisations to maximise collaboration to deliver value for money? i.e. what can colleges do in partnership with other colleges – or schools, universities, private training providers or similar – to improve their VfM within the existing legal framework?*

This approach has helped frame the key issues to be addressed by the sector if VfM is to be improved. We then use the evidence to:

- Categorise good practice.
- Set out the current legal and other barriers to the delivery of further innovation.
- Identify new models and innovative strategies which could deliver value for money were those barriers to be removed.

Figure 1: A hierarchy of strategic options for change

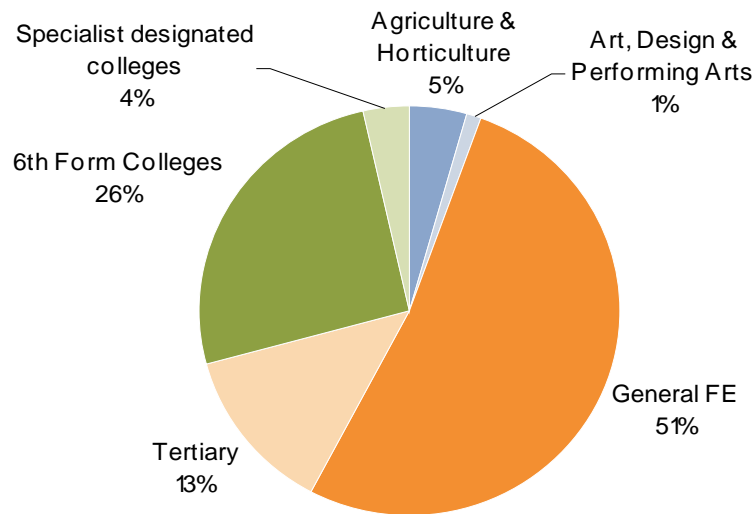


4 How is the sector organised, governed and regulated?

4.1 The Diversity of the Further Education Sector in England

FE Colleges in England are characterised by their diversity. Their statutory age range is from 16¹⁰ with no upper age limit, although individual funding streams define age boundaries. All deliver Further Education, some deliver Higher Education; some deliver Local Authority funded Post Compulsory Development Learning (PCDL); others deliver neither. A few, like most Agriculture and Horticulture colleges and some specialist designated have residential places, but most do not. All colleges co-exist with school sixth forms, adult education services, private trainers and community charities to a greater or lesser degree depending largely on the historical pattern of provision in their Local Authority area. College vary in size from large GFE's with annual incomes in excess of £170m serving over 30,000 learners, to small, specialist single focus institutions with annual incomes of less than £2m and a few hundred learners.

Figure 2: Types of colleges within the FE sector



¹⁰ Many colleges offer 14-16 provision but the legal responsibility for this age group is with the local authorities.

4.2 A range of Sector Delivery Models

The organisational models put forward by the sector as delivering best VfM include the following listed below. Example case studies are provided in the Appendices. The descriptive terminology is ours for ease of reference although tested out on respondents to the consultation.

- a) **The ‘private sector’ college group model** – formed through merger and acquisition focusing on specific market -facing branding and creating local identity despite its size eg. Newcastle College.
- b) **The ‘hub and spoke’ model** –a central administrative function supporting a number of operational delivery arms. Formed in various ways, including either through merger or by diversifying the basic departmental structure– Capel Manor College and Sheffield College.
- c) **The ‘learning brands’ model** – formed in various ways including through merger, establishing companies, retaining the local identify and/or focus on specific markets –Sussex Downs College, Guildford College, Derby Colleges and the proposal for Bicton and Exeter Colleges.¹¹
- d) **The County College model** – formed through merger of single colleges in an area to create a large single entity which provides FE for all or most of a geographic county– Wiltshire, Staffordshire, Derby, Leicester. An interesting variant is Cornwall College, where a large college has developed almost as a confederation of smaller units across a considerable geographical area. The concept of the “County College” goes back to the 1944 Education Act.
- e) **The ‘joint governance’ model** – where a college provides a sixth form in a school – the City of Sunderland College has developed a model of good practice where it supports 4 sixth forms in 11-16 schools which otherwise would not be able to support an individual sixth form. Each sixth form has a distinct local identity and an Advisory group formed between the college and the school, which has a large say in the direction of each centre. **The “federated” school/college model** is a variation of this – where a college works with schools in its area to provide a shared sixth form
- f) **The ‘progression’ model** – where a college establishes an internal structural model to aid progression. In the case of Barnfield College, this is through the sponsorship of Academies and linking with local schools to provide progression routes; New College Durham, is one of a large number of Mixed Economy colleges which have a significant level of Higher Education and have grown in this way. It is worth noting that there is more HE in FE now than existed in the whole university system before the Robins Report.¹²

¹¹ The proposal for Bicton is that it “federates” and becomes a subsidiary company of Exeter College, retaining its focus and separate identity. However, as the Corporation of Bicton is being dissolved, with the transfer of assets and liabilities to Exeter College, albeit via a company structure, technically, this is a merger.

¹² *If I were you, I wouldn’t start from here*: Comments on the structure and organisation of further education for the Foster Review of Further Education Adrian Perry, Senior Visiting Fellow, University of Sheffield

- g) **The ‘niche provider’ model** – Sixth Form Colleges, Land-based Colleges, Art & Design Colleges. Because they focus on a single market, they are often by form small.¹³

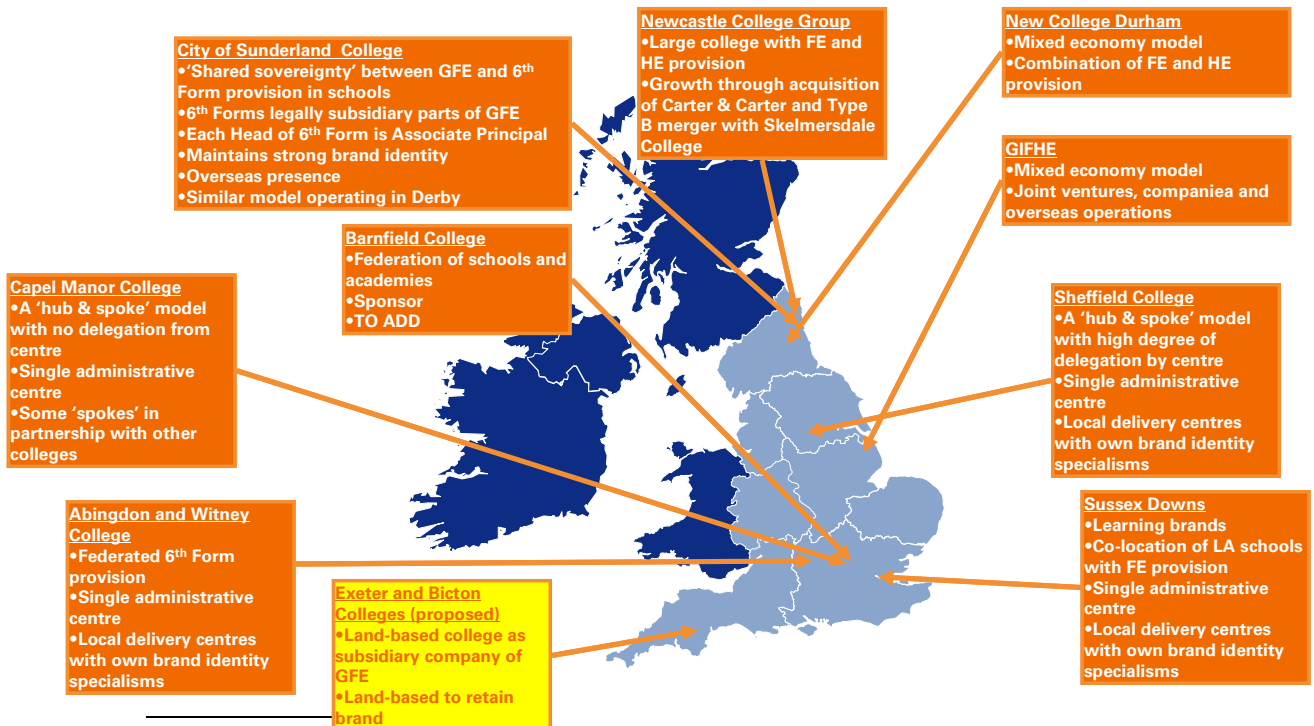
The type of organisational infrastructure adopted by colleges has usually been driven by a response to the external environment in which the college operates, rather than by a conscious decision to deliver better VfM. The fact that it may be more efficient and effective is often a welcome by-product of the primacy of the educational case. In many areas, the organisational infrastructure of individual colleges and/or their relationship with one another and other partners was determined by the Local Authority in the 1980’s and has not changed much since then.

4.2.1 Common principles of the FE college infrastructure

Two common principles observed in FE colleges, large and small, and confirmed by consultation, are:

- Delivery arms are most effective if they are marketed with a specific and distinct learner focus which matches the target market – the “ segmented” approach or the specialist” niche” provider ;
- Economies of scale can be achieved by establishing a central administrative core/ internal shared services to support the delivery arms - thus minimising administrative costs and releasing more funding to the front line.

Figure 3: Examples of college infrastructure in the English FE sector



¹³ Although there are some larger and very popular Sixth Form Colleges, even the largest does not approach the size of a large GFE

However, in all these models and the variations presented to us, the core organisational structure is built around the legal framework within which all Colleges in England operate. This framework sets the freedoms and the limits of innovation- see details below

4.3 The legal framework

In order to understand how radically the sector could be changed, it is essential that we fully understand the context in which colleges operate, and the extent of their freedom and the boundaries within of their sphere of operation. We identified that it was essential first of all to consider the impact of the legal and regulatory framework in which colleges operate. We also considered how far colleges could control their internal and external environment in the light of this framework in order to deliver VfM.

Under the Further and Higher Education Act (1992), (FHE Act) colleges became self-governing and responsible for their own affairs. The core of this legislation remains in place, although amended in part by the Learning and Skills Act 2000, the Education and Inspections Act 2006, and the Further Education and Training Act 2007, and now the Apprenticeship, Skills, Children and Learning Bill 2009.

The FHE Act specifically established, what we will call for ease of reference in this report, a ‘**single accountability framework**’ (SAF). The central principle of the SAF is one of the individual and corporate accountability of the Principal and the Governing body. It is the SAF which sets the boundaries for innovation and, its perhaps unintended consequence, is that it has inhibited a number of developments, (especially those which involve collaboration,) expected to be initiated by wider Government policy. Although subsequent legislation since 1992 has included clauses intended to enable more flexible collaboration between colleges and other sectors, the SAF as interpreted in the Instrument and Articles of Government override these. The effects of the SAF are further strengthened by the impact of the regularity frameworks of inspection and audit.

4.3.1 The role of governors

The SAF requires there to be a single board of governors in each college. Acting corporately, the Governing Body has certain formal duties, powers and rights in accordance with the college’s Instrument and Articles of Government. FE governors are responsible for overseeing the running of the College and are involved in determining business and financial policy, strategic development and ethos. The Governing Body, together with the Principal as Chief Executive, constitutes the highest level of decision-taking in the College and has the ultimate responsibility for all the affairs of the College. The Corporation owns the land, buildings and other assets, employs the staff, and decides on the future strategy of the college

The Governors have ultimate responsibility for the running of the College, taking key strategic decisions and setting objectives, while the Principal is responsible for College operational issues, as well strategic positioning.

The Governing Body has corporate responsibility to the LSC for the use of the public monies that they receive and for meeting any conditions attached to that funding e.g. a requirement to prepare and submit annual accounts, or supply information about student numbers, and to meet agreed targets. A key responsibility for the Governors is that they must not allow the college to continue to trade whilst insolvent.¹⁴

The Instruments and Articles of Governance identify the functions that a Governing Body may not delegate. For the purposes of this report, the most relevant functions not to be delegated include:

- (a) the determination of the educational character and mission of the institution;
- (b) the approval of the annual estimates of income and expenditure;
- (c) ensuring the solvency of the institution and the Corporation and the safeguarding of their assets;
- (d) the appointment or (subject to Article 12(9)) the dismissal of the Principal or holder of a senior post.

4.3.2 **The role of the Principal**

The SAF requires the Principal to be the “*College’s designated accounting officer, with ultimate executive responsibility [to Parliament] for the management of the College*”. The Principal is the College’s designated accounting officer, with ultimate executive responsibility for the management of the College. S/he ensures proper and effective financial planning and management of the College’s affairs in accordance with the Financial Memorandum with the Funding Body.

“As accounting officer, the principal may be required to appear before the Parliamentary Committee of Public Accounts, alongside the accounting officers of the LSC and the Department, on matters relating to the College’s use of public funds and College funds”¹⁵

The functions that the Principal must not delegate include the management of budget and resources. Otherwise, the Principal may delegate to the holder of any other senior post, functions that are necessary to enable the responsibilities of the Principal to be discharged properly. This power of delegation raises an interesting point as to whether a Principal could be Accounting Officer for more than one college at a time. We have consulted the LSC on whether the ability to delegate functions would free a Principal of one college to take on the Accounting Officer duties of another college.

¹⁴ In practice, historically this has meant that some colleges in serious difficulty are insolvent and are reliant on the LSC for support to get out of this.

¹⁵ Financial Memorandum between colleges and the LSC. Clauses 14 and 15

We are told that the LSC's legal advisor considers that it would be difficult for someone to be the accounting officer for two institutions on a permanent basis. He or she would have to be an employee of both institutions and there would be a question in the long term about whether they could properly discharge the function in relation to two corporations. It is pointed out that although it has been done in the past, it has been for a temporary period either as a precursor to a merger or to cover a vacancy. To attempt to maintain this over a longer period could create fundamental conflict of interest issues.

Respondents to consultation point out that the college infrastructure and the context in which it operates in 2010 are radically different to that pertaining in 1992. As we see in the following pages, some colleges have complex internal organisational structures which resemble that of multi-national companies. Within a single FE college, there may now be several subsidiary companies, Academy Trusts, joint committees with schools etc and/or a dispersed structure with locally branded "colleges". Each entity may well have a great deal of delegated local authority and be some distance from the "parent". The Principal in 2010 can therefore be accountable for a number of different legal entities operating within the primary over-arching legal structure of the FE College, and s/he can operate more like the CEO of a multi-national corporation.

In the school sector, Executive Heads perform the Accounting Officer function in relation to a number of schools within legally constituted "hard" governance federations. There is still a single line of accountability to a single board of governors in this model. The schools within a hard federation have separate heads, and a great deal of delegation for budget and resources. The flexibilities afforded to school federation means that they can therefore act corporately in a way that a federation of colleges cannot. In one sense, the nearest example we found of this model operating in the FE sector was Newcastle College group – which is not a Federation.

4.3.3 Amendments to the legal framework of FHE Act to provide increased flexibility

The powers of the further education college governing bodies were set out in sections 18 and 19 of the FHE Act 92. It is clear that over time, ministers realised that the SAF was acting as a deterrent to collaboration. In the Lords, Hansard, May 6th 2007, the Lord Adonis made the Government's intentions clear:

"Our intention is to enable further education institutions to collaborate with a range of partners, including schools, universities and others, to develop flexible and innovative models of delivery which will improve quality across the system, increase learner choice and enable efficiencies."

Therefore, the FHE Act has been amended by the Learning and Skills Act 2000, the Education and Inspections Act 2006 and the Further Education and Training Act 2007. These have extended the College Corporation's principle powers to:

- Provide further, higher and secondary education, and to participate in the provision of secondary education at a school.

- Supply goods or services in connection with the provision of education.
- Conducting an educational institution.
- Providing facilities such as accommodation and recreational facilities for staff and students.
- Acquiring and disposing of property.
- Entering into contracts, such as employing staff borrowing money and granting security (subject to the requirements of the financial memorandum).
- Investing money.
- Forming or investing in companies and becoming members of charitable incorporated organisations; with the consent of the LSC, they may use either of these powers for the purpose of conducting an educational institution.

However, these further amendments to the SAF are only in the context of the *Instruments and Articles of Governance* (2008) which confirms the emphasis on individual and single Corporation accountability.

4.4 The impact of the Regulatory Framework on delivering VfM

The impact of the SAF on innovation, collaboration and ultimately the freedom to deliver VfM is reinforced by the impact of the inspection and audit regularity framework. In 1997, in the aftermath of the excesses of franchising and in particular, the well publicised difficulties of Bilston and Halton Colleges, the regularity framework was tightened. Inspection and audit frameworks may not recognise the more formalised relationships between colleges and other partners which may be required in the future to deliver VfM.

4.4.1 The Inspection Framework

College respondents to our consultation frequently cited the Ofsted inspection regime as inhibiting their ability as strong colleges to support weaker colleges. All the Colleges consulted perceived that the Ofsted framework for the inspection of leadership and management actively penalised principals who are not available constantly to their senior managers and governors. As one principal told us:

“We were all aware that x college was in difficulty, but we could not take the risk of penalising our own good colleges by going in to help”

Another respondent told us that he believed that the inspectorate did not like large colleges, nor colleges with off-site partnership arrangements such as providing sixth forms in schools, as they stretched their resources at inspection and challenged the inspection framework.

We have consulted OfSTED about colleges' perceptions of the restrictions of the inspection regime. Their response is that there is now a specific judgement to be made about partnership working under section B3 of the new framework¹⁶ which has to be graded in the report. The important phrase is that *'the provider develops partnerships with...others that lead to tangible benefits for learners'*.

"The onus is on a college to supply evidence for this judgement and there is no fixed template for this. Thus if, through partnership working with another college, there are tangible benefits to learners at the college being supported, this can be recognised by inspectors.

*The second key point is that Ofsted does aim to recognise the benefits of peer review and development between colleges, again where this has led to tangible benefits for learners. Thus if through Peer Review Development(PRD), there is a more informed process of quality improvement which leads to better outcomes this can be recognised in an inspection report. Again the onus is on the college being inspected to provide evidence to support this conclusion"*¹⁷

In our view, although these guidelines may be helpful for the relatively straightforward collaboration and partnership models which currently exist, they may not recognise the more formalised relationships between colleges and other partners which will be required in the future to enable the sector to improve VfM.

Inspection of collaborations and federations is an issue which we note the school inspection regime is currently considering. Currently, schools are subject to individual inspection reports, and will complete individual Self Evaluation Forms. However, the White Paper published on 30 June 2009 has committed Ofsted to exploring the development of co-ordinated joint inspections for federations, joint sixth forms, and where there is an executive head over two schools and how the self-evaluation form can be developed to reflect federation

4.4.2 **The FE audit regime**

The stringent FE audit regime has been identified as contributing to a significant element of college costs with some College respondents considering that the cost outweighs the benefits. An alternative argument is made though that the rigours of the audit regime can and should be exploited by senior managers to ensure that the college is provided with a range of essential management information upon which to base decisions and in which they and the LSC can have confidence. A more major problem in our view is often the colleges' inability to understand and make use of the management information that can be generated and validated by the audit regime.

Currently, audit is of the single institution. As with the inspection regime, it may be necessary to develop joint audit arrangements across collaborative ventures to reflect more formalised partnerships entered into to deliver VfM.

¹⁶ *Common inspection framework for further education and skills 2009*

¹⁷ *Ofsted spokesperson November 2009*

4.5 The LSC and Managing Under-Performance

The LSC has made significant improvement in the management of risk, principally through the development of its guidance into Identifying and Managing Under-Performance¹⁸. This takes into account both financial and quality under-performance issues and identifies the procedures in place and the actions to be taken.

4.5.1 The impact of the LSC Intervention measures

The Learning and Skills Council's Statutory Intervention Policy¹⁹ was presented to the Houses of Parliament and published in October 2008. It is intended to be kept under review and the policy statement will remain in place for the next two years, "or for as long as the LSC continues to exist (if less than two years)". It is therefore inevitable that the policy will be revisited with the establishment of the MOG arrangements. To support this review, the LSC has commissioned an evaluation of the present intervention model which has just completed its first year report.

According to a Guide on the Policy published by LSIS, under MOG "the Skills Funding Agency (SFA) will retain performance-management responsibility for providers of post-19 education, including intervention powers. YPLA will not have these oversight powers; under the new arrangements, the local authorities will be responsible for commissioning education provision, and thus 14-19 providers will be regulated by the Department for Communities and Local Government (CLG) through the same national indicators used to measure the rest of local government. It is not clear if the SFA will carry forward this intervention policy ".

4.5.2 The principles of the current intervention model

The current intervention policy is a staged approach with the intention that any statutory intervention will typically occur at the end of a lengthy process of support and dialogue. As such, there is a series of stages leading to intervention. These are:

- 1) the annual commissioning dialogue;
- 2) identification of under-performance;
- 3) support and challenge;²⁰ and
- 4) (as a last resort) intervention

Stages 1 to 3 provide flexibility for the LSC at local and regional level to respond to the circumstances of any individual college; they also allow for discretion to enable the LSC to consider its response on a case-by-case basis.

¹⁸ January 2008. This document outlined the criteria for taking action where underperformance is evident, the action that should follow and the support given to colleges and providers

¹⁹ Pursuant to section 56B of the Further and Higher Education Act 1992(as amended by the Further Education and Training Act 2007)

²⁰ Identifying and Managing Underperformance (published in January 2007 and revised for each commissioning year sets out the process for stages 1 -3.

The view of many respondents to consultation is that the present intervention process can elongate the time over which colleges are allowed to fail. Governors and senior managers may not view the deteriorating financial situation seriously enough so action to address the issues may be delayed. As we note below in the discussion on the impact of changes to the Financial Memorandum, such delays can be compounded by the unintended consequence of the “looser” definition of “solvency” which has crept into guidance over the last few years.

We are also told that the local and regional flexibility has in some cases given rise to different treatments between regions in the way they are tackling the issue of failing colleges. We found no clear understanding in the sector as to which colleges are at risk and which are considered “safe”. Whilst failure rarely comes out of the blue – “*We saw X college in a downward spiral.*” was a frequent comment- the seriousness of the situation, the length of time it can continue, and the range of potential outcomes to resolve the situation is veiled in mystery to many external observers.

There is no doubt that the development of the Framework for Excellence, and the introduction of Minimum Level of Performance (MLP) together with the formalisation of the issuing of Notices to Improve is a huge step forward in managing underperformance in the sector. There are sometimes unintended consequences however of this approach. One failing college told us that it was issued with a Notice to Improve based on previous performance, and as specified in the process, lost the funding for the provision in question. However, the financial consequences of this action led to a further decline in its ability to manage a balanced budget. As this particular college had been in decline for several years, it may simply have accelerated the inevitable, but there may be cases, where recovery may have been made more difficult if some other intervention had been possible.

4.5.3 **The approach to Financial Under-Performance**

The LSC’s Financial Planning Handbook 2009-2012 explains that LSC responsibilities, under its financial memorandum with (now) the Department of Business Innovation and Skills (BIS) to “*monitor the financial health of providers and, as part of this duty, to keep their level of balances under review*”.

In addition to this formal requirement, the LSC assesses colleges’ financial health to understand the degree of risk they may represent to the LSC if they do not have the financial resources to continue operating.

The handbook explains that when a college ceases to operate, or there is a significant deterioration in its financial position, the LSC faces the risks of:

- learners suffering when their learning provision is disrupted or terminated
- the LSC being unable to recover any funds owed to it by the college (for example, funds paid on profile in excess of learning provided at the time learning ceases).

Both risks could compromise the LSC’s statutory responsibility to ensure proper and reasonable provision of facilities for post-16 learning. To reduce these risks, the LSC seeks assurance that the college has the necessary financial resources to:

- remain able to operate throughout the life of its funding agreements with the LSC
- fully discharge its obligations under those funding agreements with the LSC.

The two key financial documents used by the LSC to seek this assurance are the college's three-year financial plan and the college's financial statements.

The perception of some private sector respondents to the consultation is that colleges have a more flexible interpretation of the term “*solvency*” than would pertain in the private sector where returning a deficit budget in a single year, let alone for several years, would set alarm bells ringing and lead to intervention by shareholders or administrators.

Similarly, some College respondents to our consultation have identified that the requirements in the Financial Memorandum between the LSC and the College to ensure that the college remains solvent, appear to have softened in tone and intent over recent years. So although the timescale of three years for colleges to plan to return to financial health has remained, there have been a number of examples where colleges have apparently been allowed to fail for very much longer than this. One example provided to us was Yorkshire Coast College.²¹

There is now a procedurally correct, but because of this, necessarily elongated, iterative process of dialogue and negotiation between the college and the LSC.

“Where a college’s financial health is graded as ‘inadequate’ for the previous year (forecast or actual outturn) or the current year (budget), this will form the basis for issuing a Financial Notice to Improve, in accordance with the LSC’s published guidance, Identifying and Managing Underperformance (IUMP)

Where a college’s financial health is identified as declining year on year, this will normally form the basis for requiring a financial improvement plan or equivalent, except where a college is implementing a major capital project, in accordance with the LSC’s published guidance, Identifying and Managing Underperformance”.

Although we understand this is not intended to be the case, there appears to be implicit in these statements, and the actions that have followed, the view that *some degree of failure* is to be tolerated and there are no *immediately* dire consequences of delivering a deficit budget; instead, a protracted period of dialogue with the LSC is envisaged.

In our experience, the consequence of the time this process takes for some LSC's and Principals and Governing bodies is that one or both may be complacent for too long, or strive to elongate the dialogue, before robust remedial action - by which time it is often too late to salvage the college. The option of closure for a failing college is not seriously contemplated by colleges as a consequence because it has happened so rarely.

²¹ There may be others but the LSC has not been able to provide us with a list of colleges receiving advances of funding or the reasons for this.

5 Myth or Reality - Is bigger better?

Principals were asked to define the features of their college's organisational structure which drove quality and efficiency and delivered the best VfM. The consensus was that the **quality of the college leadership and the quality of the governance arrangements are the major determining factors** influencing the success or failure of a particular college. There was less agreement about the **influence of size as a factor** in delivering VfM.

Since incorporation, the strategic response of colleges to enhance the stability of their organisation has tended to be to:

- Increase the size of the organisation in terms of turnover, student roll and income, or;
- To remain small, specialist and focused as a niche provider- but to still be as big as possible for their type and situation

We found a tendency for all colleges, whatever their type, to be as large in terms of enrolment and turnover as they could be, although the specialist niche providers accepted that there was a limit to how far they could grow. We did not find one “healthy” college which was inclined to stand- still or reduce in size voluntarily.

Some large colleges have chosen to incorporate the strengths of the small, specialist and focused niche provider in their internal structures, through specific “branding” and local delegated management.

The Department for Universities, Industry and Skills (DIUS) in 2008 produced two reports²² which championed the cause of retaining the current diversity of college size and focus, and implied a negative view of the potential of very large colleges to meet local need. Indeed, it challenged the view that larger colleges, and especially those created by merger, were any more efficient or effective than smaller local colleges.

This chapter explores the evidence base using college data and 3 high-level hypotheses to test whether the assertion that bigger is better, is myth or reality.

5.1 The literature review

Broadly speaking, the literature reviewed suggested that bigger is, indeed, better, at least in terms of efficiency of administration. This fits with well-known theory of economies of scale first outlined by Adam Smith as long ago as the 18th century.

This overall finding must be placed in the context of an FE sector which includes a wide range of college sizes. The DIUS report by Laura Payne²³ categorised colleges into three

²² *Models for Success and the related report The Evidence Base for Size and College Mergers in the Further Education Sector*

²³ *The Evidence Base for Size and College Mergers*

categories: large (over £29m annual turnover); medium (£14-29m); and small (under £14m). Furthermore, there was unanimity from those consulted that, while bigger may be better as a general rule in some cases, this absolutely could not be taken to mean that all large colleges were good, and all small ones bad. As Perry & Fletcher comment, there are, “*good and bad colleges at all sizes, and many outliers.*”²⁴

As we noted above a very strong finding from consultation was that factors other than college size were more important critical success factors. Quality leadership and management was the most commonly cited factor, with quality governance a close second.

5.2 Testing the Hypotheses

Providing a robust quantitative foundation on which to base conclusions relating to VfM was vital. Identifying appropriate sources of quantitative data was vital to this, and we have worked with the LSC to identify the most appropriate source for information. These were based on **four, high-level hypotheses** which are listed below:

4. *Larger colleges have better results i.e. there is a statistically significant positive correlation between the two.*
5. *Larger colleges have lower unit (administrative) costs.*
6. *Some components of total cost e.g. support services, management, are lower in larger colleges.*
7. *Mergers accelerate the rate of improvement in results and/or lead to reductions in unit cost.*

Following discussion with the LSC and investigation of the availability of data, we focused on the first three of these hypotheses, and defined these statements in more detail. The fourth hypothesis was considered too complex to research within the timescale and there were concerns as to how much value it would add. We specified ‘unit costs’ as ‘administration costs’ with reference to the proportion of a college’s budget taken up by such costs. Analysis of this specific point is found below with specific definitions of the criteria used to define college size and the results.

In broad terms, we found evidence that suggests **all three hypotheses have elements of truth, particularly hypotheses two and three.** All conclusions were discussed with the LSC to ‘sense check’ whether they correlated with the experience of sector professionals.

We have tested each of these hypotheses separately for four College types – GFEs; Sixth Form Colleges; Tertiary Colleges; and Specialist Colleges of Agriculture

²⁴ *By Accident or Design?*, CfBT/Perry & Fletcher, 2008

5.2.1 Sources of data

Recognising that no comprehensive and fully validated dataset from the FE sector existed, with the agreement of the LSC, we have used data from the LSC's own Allocation data and the Financial Statements Database which has in turn been collected from FE colleges. We have also considered OFSTED inspection evidence. We have also drawn on existing work to cross-reference our findings and test them against similar work. In particular, we have looked at two key publications mentioned above, *The Evidence Base for College Size and Mergers in the Further Education Sector* (Payne/DIUS, 2008) and *By Accident or Design* (Fletcher & Perry/CfBT, 2008).

5.3 Key conclusions from the analysis

These initial conclusions have been drawn from analysis of data taken from the LSC's provider allocation and financial statements databases. We are aware of some concerns over the accuracy of this data so would caution against drawing firm conclusions on this basis without further validation. Notwithstanding the caveats on the data sources, it is possible to demonstrate the following general conclusions:

- **Efficiency:** larger colleges have lower administration costs as a percentage of total costs than smaller colleges and are also able to provide provision with a lower level of base funding for 16-18 year olds.
- **Success rates:** size of college has very little impact on success rates – although there is a slight positive correlation between college size and success rates. Furthermore, larger colleges achieve, on average better OFSTED gradings than those obtained by smaller colleges.

5.3.1 College size and administration costs

The graphs below show administration costs as a percentage of total costs for four types of colleges: GFEs; Sixth Form Colleges; Tertiary Colleges; and Specialist Colleges of Agriculture. **For all types of colleges, the bigger they are the less the proportion of administration.**

Figure 4: Administration costs as a percentage of total costs in GFE colleges, 2007/08

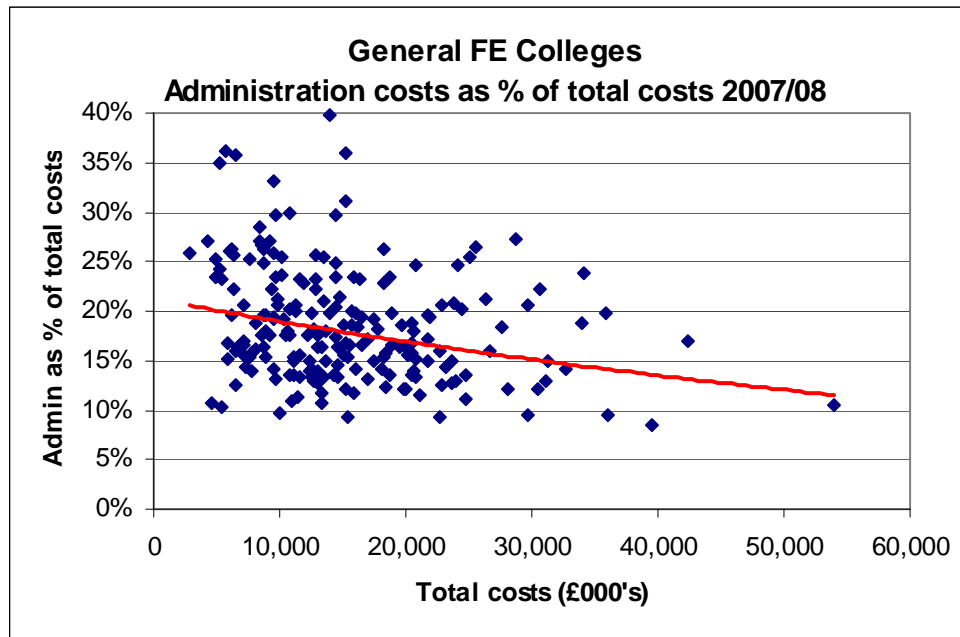


Figure 5: Administration costs as a percentage of total costs in Sixth Form colleges, 2007/08

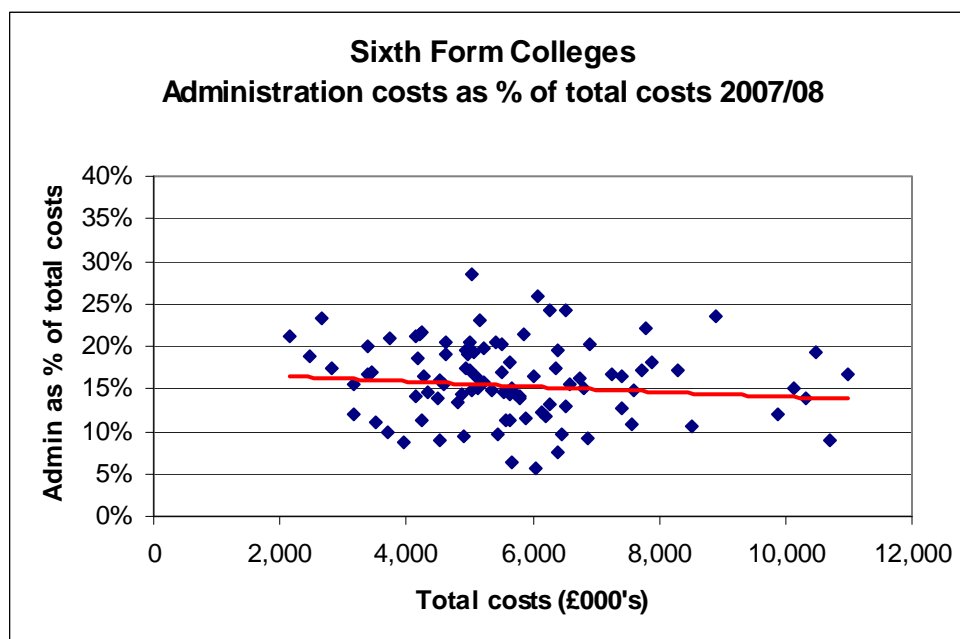


Figure 6: Administration costs as a percentage of total costs in Tertiary Colleges, 2007/08

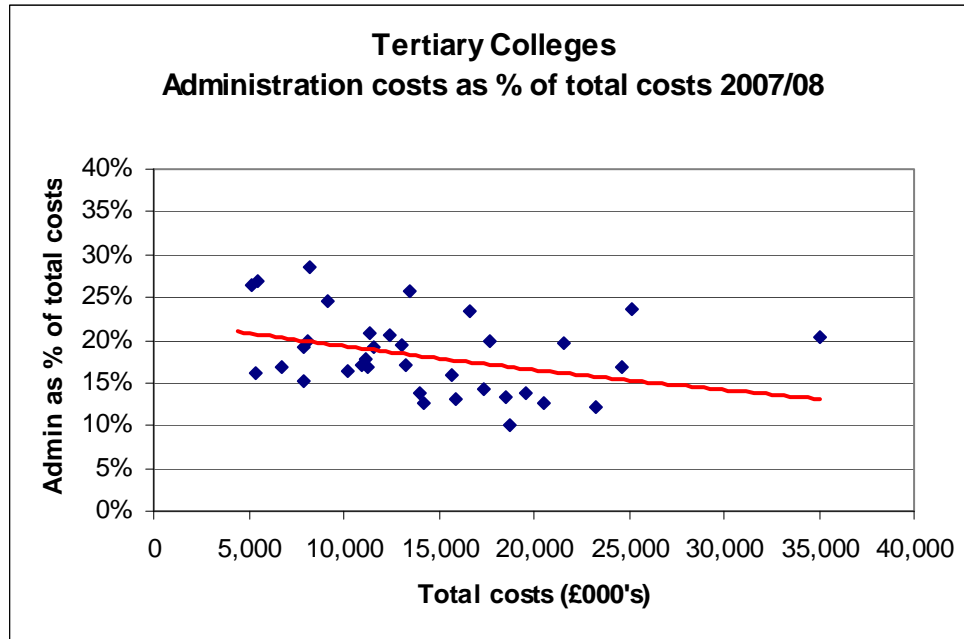
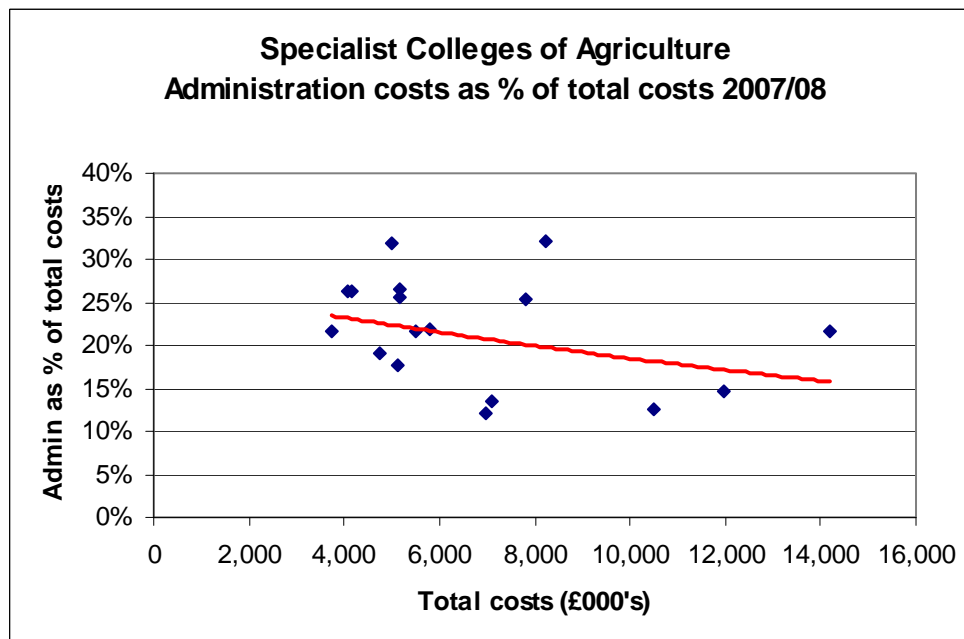


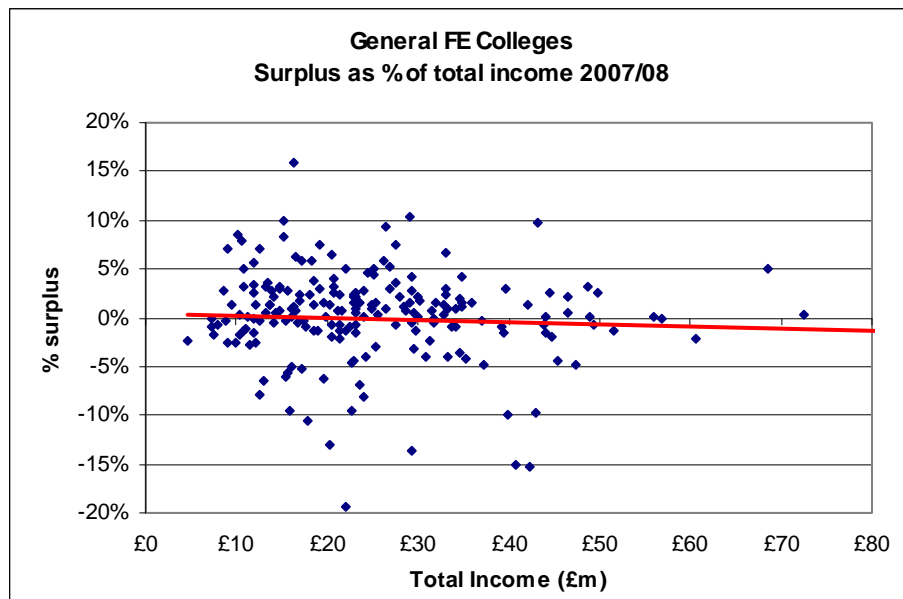
Figure 7: Administration costs as a percentage of total costs in Specialist Colleges, 2007/08



5.3.2 College income and surplus

The graph below shows the percentage of GFE colleges' surpluses against their total income. It shows a slight negative correlation between total income and surplus as a proportion of this. This is an emerging finding which we will be exploring further.

Figure 8: Surplus as percentage of total income, 2007/08



5.3.3 College size and funding allocations

The graphs below provide further evidence for the view that larger colleges provide, on average, greater levels of efficiency than smaller colleges. These graphs plot the level of base funding for each 16-18 year old full-time learner against the funding allocation (one indicator of how large a college is). The base funding per learner is directly related to the size of the learner's programme. **They show that in general FE and specialist colleges, although not in sixth form colleges, there is a trend towards larger colleges receiving less money per learner than smaller colleges as they are delivering leaner programmes.** This, combined with the graphs below which demonstrate that larger colleges also deliver higher success rates than smaller colleges, suggest that larger colleges are able to provide improved value for money – more for less.

Figure 9: Relationship between base spending per 16-18 year old learner and funding allocations in GFEs, 2006/07

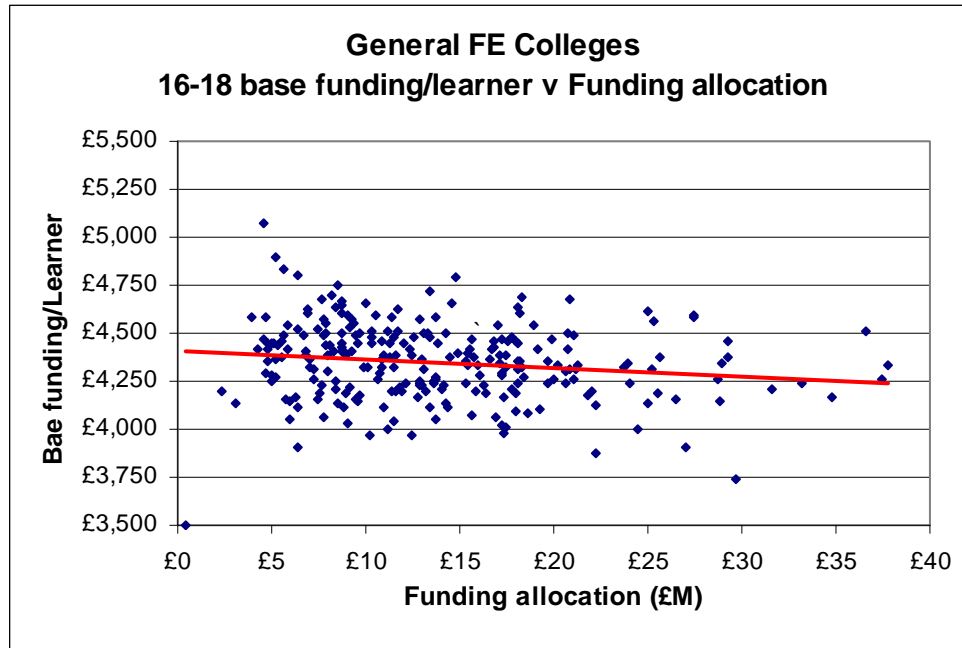


Figure 10: Relationship between base spending per 16-18 year old learner and funding allocations in Sixth Form Colleges, 2006/07

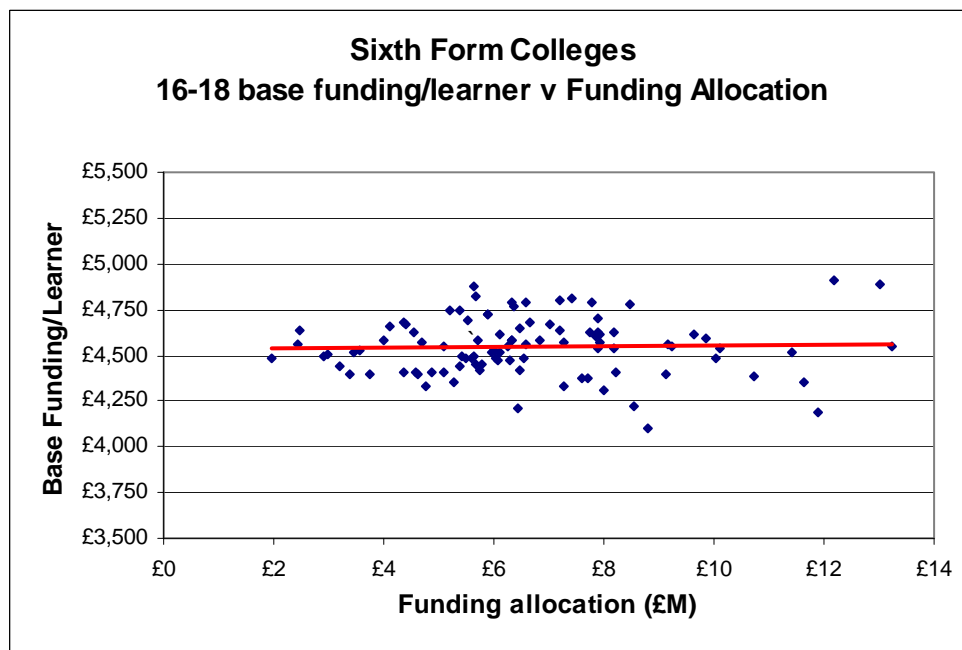
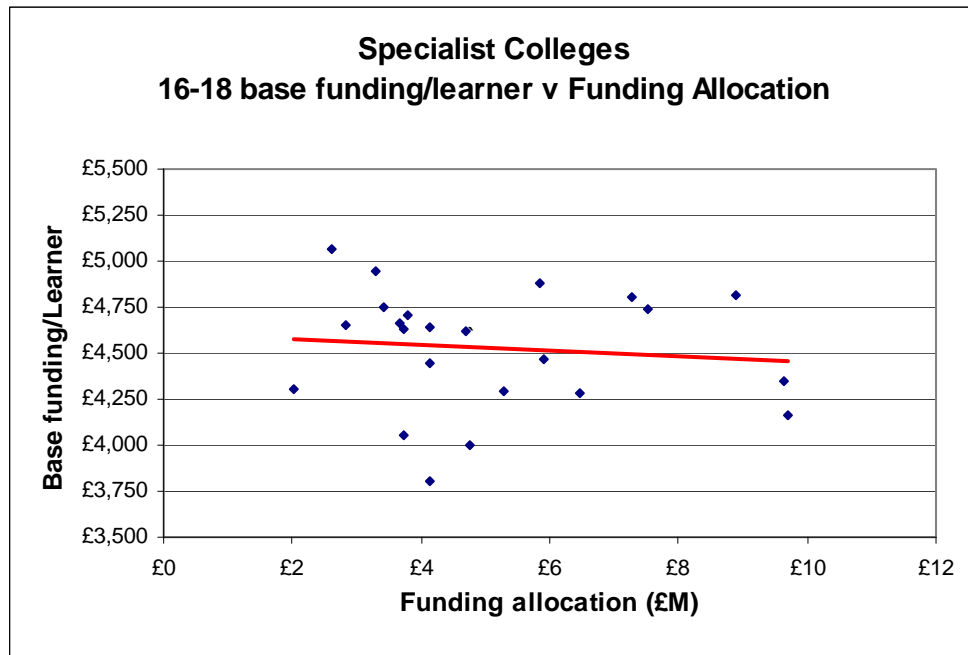


Figure 11: Relationship between base spending per 16-18 year old learner and funding allocations in Specialist Colleges, 2006/07



5.3.4 **College size and success rates**

The graphs below demonstrate a **positive correlation between a college's funding allocation and success rates (how well it is doing academically). This trend is consistent across GFEs, Sixth Form Colleges and Specialist Colleges.**

This analysis also matches research undertaken by Fletcher & Perry in 2008, which found that larger colleges have, on average, better Ofsted gradings than smaller colleges. While the authors note that various caveats such as differences in Ofsted inspections and mergers which were underway during the period analysed need to be taken account, the data does suggest large colleges are better for learners than smaller ones.

Figure 12: Relationship between success rates and funding allocations in GFEs, 2006/07

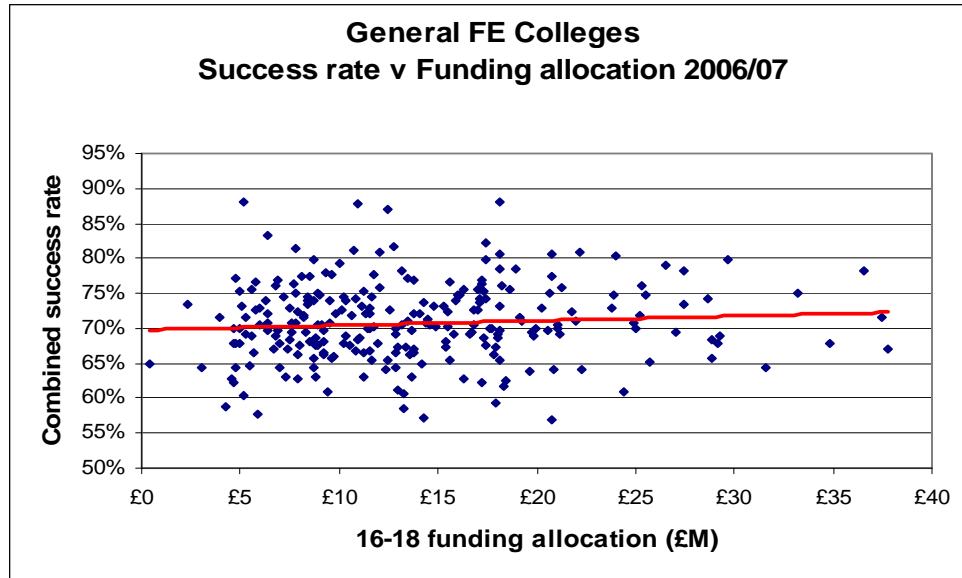
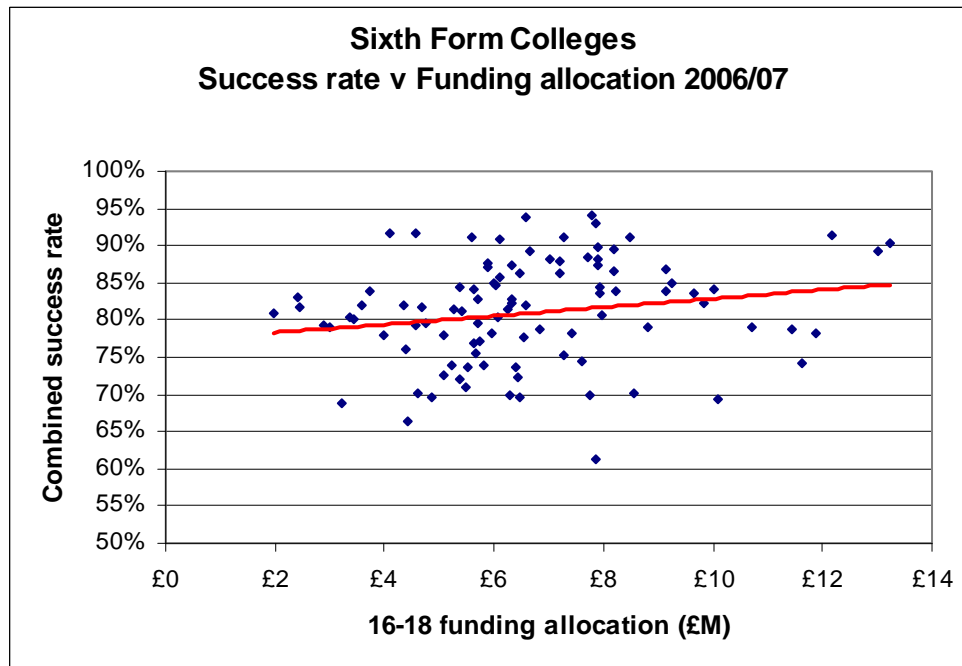
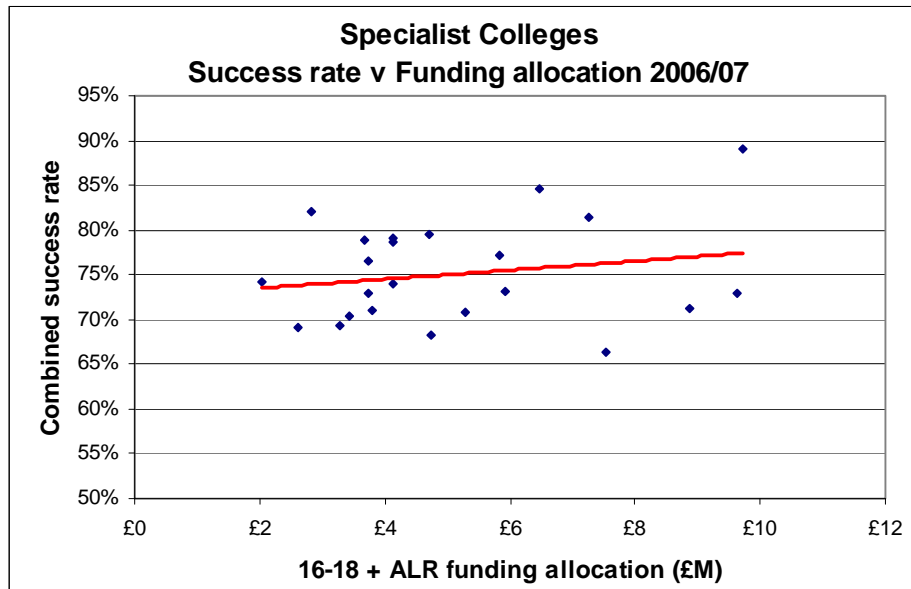


Figure 13: Relationship between success rates and funding allocations in Sixth Form Colleges, 2006/07





5.3.5 Evidence for the size of Sixth Form Colleges

The FE sector has seen a reduction in the number of stand-alone Sixth Form Colleges in the last decade, with the vast majority of this reduction the result of incorporating this provision within a GFE institution through merger. Recent analysis of A Level results achieved by students at maintained Sixth Form Colleges by the AoC has shown that, “*bigger is (generally) better*”.²⁵ The AoC’s research identifies:

- A difference of 241 points in level 3 examinations between the largest and smallest Sixth Form Colleges.
- Maintained school 6th Forms were far more likely than Sixth Form Colleges not to offer selected key subjects including English Literature, Mathematics and Chemistry.

The main reason given for this is the inability of smaller Sixth Form Colleges to offer specialist teaching and a choice of subjects to students. However, research published by the Sixth Form Colleges’ Forum (SFCF) shows that Sixth Form Colleges and comprehensive schools with larger 6th Forms “*seriously outperform FE Colleges and small 6th Forms.*”²⁶

The SFCF concur with the AoC that small 6th Forms are poor value for money, but concluded that the most effective performance – value-added and therefore ostensibly accounting for diversity of intake – is delivered by Sixth Form Colleges, the average size of which is 1,500, considerably smaller than the average GFE.

²⁵ ‘New research shows size matters in school 6th Forms’, AoC, 3 September 2009.

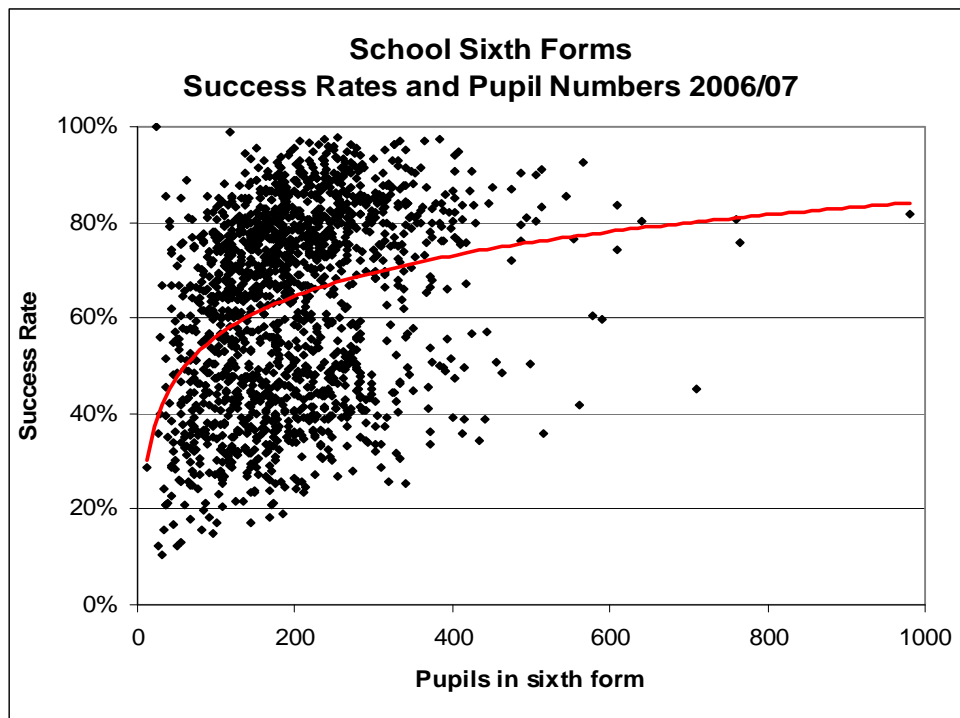
²⁶ SFCF, A Level Performance System (ALPS) – Briefing Paper 7 2008.

5.4 The evidence for the size of Sixth Forms in School

Given that a strong message from consultation was that the VfM for the sector could not be measured in isolation from a consideration of the impact that small sixth forms had upon the viability of some colleges in the FE sector, the LSC asked us to undertake some further analysis to compare the success rate for school sixth forms against their size measured in learner numbers.

The graph below shows the comparison and the exponential trend line appears to indicate that schools with less than around 150 learners tend to have poorer success rates.

Figure 14 Relationship between success rates and the size of school sixth forms.



This conclusion had been reached by other researchers much earlier. In 1985, the Audit Commission report “*Better Schools*” which considered the most cost effective size for schools, concluded that 150 learners was the minimum size for a sixth form to be able to offer a cost-effective and full range of course options. It recognised however, that this number could be achieved by co-operative sharing of learners between schools and/or colleges.

Again, in 1996, an Ofsted report *Effective sixth forms* indicated that a school sixth form may be educationally and financially viable with fewer than 150 pupils, if it focuses on a narrow range of provision. In 2002, further Audit Commission research for *Trading*

Places Update: A Review of Progress on the Supply and Allocation of School Places re-confirmed its view that effectiveness and efficiency is best achieved by a minimum sixth form size of 150-160.

5.5 Is there an optimum size of college?

Given the analysis which appears to show that bigger is better for each type of college, this gave rise to the question of whether there is an optimum size of college which every college should aspire to. This question elicited a wide range of answers from the sector, no two of which were the same. Some of proposed optimum college sizes are listed below to demonstrate the variety of opinion on this issue:

- *No smaller than £15m turnover p.a. (Webb Review of Post 14 Education in Wales)*
- *No smaller than £40m (Vice Principal, London)*
- *£25m-£40m (Principal, North-east)*
- *£100m (Principal, South-East)*

It is therefore true to say that there is absolutely no consensus on the optimum size for a college from consultees. We noted that the majority of principals we consulted seemed to think that the “ next size up” to their own college was the optimum size! Equally, **the quantitative analysis presented above and at Appendix 3 does not show a ‘sweet spot’ in terms of college size. This is equally true if one varies the question and asks whether there is a critical mass beneath which an institution is unable to offer high-quality FE provision.**

5.6 Does size affect a college’s strategy?

Our consultation showed that innovations such as acquiring companies, entering in to joint ventures and leading plans to merge with other colleges are more common in larger colleges. This evidence was largely anecdotal and drawn from consultation, but was a common theme amongst those interviewed, particularly college principals and other senior management.

Consultation also showed that this seems to be linked to confidence and ability to make these ‘business’ type decisions, and that larger colleges are more likely feel able to do this. This is linked to factors such as:

- Experienced, high-quality senior management (and the ability to invest in and attract such people).
- A sufficiently large organisation to make calculated financial risks without jeopardising the college’s financial position.

5.7 Does rural and urban FE provision have to be treated differently?

Our consultation with college principals and other senior managers revealed a broad view that the needs of employers, learners and the community, while based on common principles of accessibility and quality, were best served very differently in rural and urban

areas. Principals to whom we spoke from rural areas noted the importance of links to the local community.

FEFC undertook a study of whether rural and isolated colleges needed special treatment in the funding methodology as they often had to deliver a wide-ranging curriculum with small group sizes. At the time (late 90's) the evidence available suggested that the difference was not perhaps justified in additional funding. However, we note that a number of failing colleges have been in such areas (East Devon and Yorkshire Coast College for example) so consider that it may be useful to revisit this issue. Some of the County College type mergers have been in more rural areas e.g. Wiltshire, Staffordshire. It is interesting that the first tertiary college in the country was created in Exeter in order to create a greater critical mass.

Principals from colleges in the Greater London area put forward the view that large urban areas such as London would best be served through a co-ordinated system of FE institutions rather than a large number of similar, competing GFE colleges. In the words of one consultee, *“it makes sense for each college to offer GFE, but it doesn't make sense for the system as a whole”*.

Figure 15: Typical characteristics of rural/provincial and urban FE provision

Issue	Typical rural/provincial position	Typical urban position
Accessibility	Typically limited public transport and low population density so large travel-to-learn catchment area even for GFEs. Small group size	A large choice of FE options within
Quality	Need for high-quality FE provision	Need for high-quality FE provision
Identity	Fiercely protected by local community or a specialist sector which will see a college as 'theirs'.	Population keen to keep good quality colleges but more willing to travel past nearest college to access quality provision

6 How much strategic partnering is there?

England has a multi-institutional post 16 learning world. FE colleges co-exist with sixth form or tertiary colleges, school sixth forms, adult education services, private trainers and community charities. Collaboration between these various organisations seems sensible”²⁷

It is clear from the preceding chapter that although individual colleges may be able to become more efficient through adopting a range of performance improvement measures, collective action with a range of partners (other colleges, schools, local authorities, HE, vocational providers, the voluntary and the private sector) will be vital to increase the VfM of the FE college sector.

In this section, we focus primarily on two inter-related organisational developments short of merger that consultation and our own research indicates may have the greatest impact on the FE college’ sectors’ ability to deliver VfM over the next few years. These are: **Shared Services and Federation**

We explored the challenges and the opportunities that developing these particular strategic partnerships presents to FE colleges as they strive to stay within the current legal and regulatory framework. Our review indicates that the current legal and regulatory framework for FE colleges militates against the success of shared services and federations. These collaborative ventures will be essential in the current economic climate if colleges are to deliver improved VfM, individually and collectively. The present constraints on colleges often leave them with only the option of merger to achieve critical mass sufficient to achieve their ambitions in a cost effective way. Given that **merger** is the ultimate in strategic partnerships we also consider the issues this raises.

Appendices 4 and 5 provide a commentary and case studies of the wider range of collaborative practice presented to us. All these will undoubtedly remain valuable, but the approach to co-operative collaboration with a range of other public sector partners is already embedded in most college practices, and has been enabled by legislation, should colleges wish to use these. We discuss key aspects which may influence whether a particular collaborative partnership will deliver VfM and for which organisation, but this chapter focuses primarily on the strategic partnerships that colleges find most difficult.

6.1 The Government’s Vision of Collaborative Working in FE

The Government views greater collaborative working as a vital step towards transforming the public sector to deliver better VfM. The collaborative agenda is not solely aimed at

²⁷ Adrian Perry – *Delivering FE models* for the Foster Report.

FE, government policy references include – Co-Location, Cost sharing, Best Value, Total Place, Place Making – all are based on the concept of shared action across sectors and departments to deliver best VfM for public sector delivery.

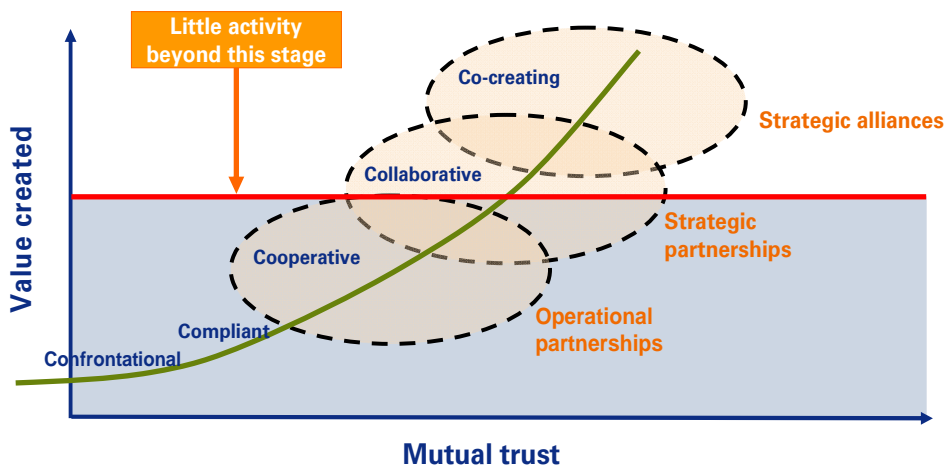
Efforts to join up different parts of the delivery chains in the Learning and Skills sector have been driven by the realisation that barriers to learner and employer participation must be removed. In the late 90’s, there was a collaboration fund to promote cross sector working and although the additional seed funding is not more, strategic partnership must be promoted so that scarce resources are maximised.

However, our review indicates that the current legal framework for FE colleges, outlined in Section 4 above, militates against certain types of strategic partnership which may be helpful in delivering improved VfM, in a variety of ways.

The diagram below presents a stylised conception of how collaborative working can evolve between organisations, and includes KPMG’s assessment – which has been validated in consultation with the FE sector – of the current level of activity.

This chapter considers a range of examples of strategic partnering that the sector has provided to us. These centre mainly around three key themes: collaboration; ‘federated’ arrangements; shared services. It explores the challenges and the opportunities that this agenda presents to FE colleges.

Figure 16: A model for strategic partnering



Source: Based on work by Tony Lendrum, *The Strategic Partnering Handbook*, 3rd ed., Sydney: McGraw-Hill, 2000

The vision set out for the FE sector in the DIUS document, *Models for Success*, (2008) is challenging.²⁸ The sector is expected to:

- Develop innovative and collaborative learning routes
- Listen and respond to the needs of employers

²⁸ *Models for success*, DIUS, 2008.

- Reach out to those that are least likely to engage in learning
- Offer a wide range of opportunities and resources to their local communities.

Colleges are exhorted to use the wide range of organisational options available to them in developing their business model to provide:

- Greater innovation
- Increased flexibility
- Yet more collaboration
- The forging of new and effective partnerships.

Models for Success recognises that colleges and other providers are autonomous bodies and confirms that there is no intention to specify or impose any particular model of organisation either pre or post 19. The document provides a list of strategic tasks for the FE college sector which is challenging:

- Meeting the growth in demand for 16-19 opportunities
- The successful delivery of diplomas
- Supporting Raising the Participation Age
- The expansion of Apprenticeships
- Reducing the number of young people not in education, employment or training
- Increasing the delivery of HE in FE – including through using the powers to award foundation degrees
- Working with employers – expanding their Train to Gain delivery and full cost work
- Developing specialist training to better meet the needs of employers
- Working with National Skills Academies and exploiting further opportunities for innovation and enterprise
- Helping the workless to acquire the skills, knowledge and confidence to succeed in the workplace
- Using their resources to respond to the needs of local communities, for example through supporting the delivery of informal adult learning,
- Ensuring equality of opportunity and supporting greater access to and choice in learning for individuals, through the introduction of Skills Accounts etc

- Supporting community cohesion.

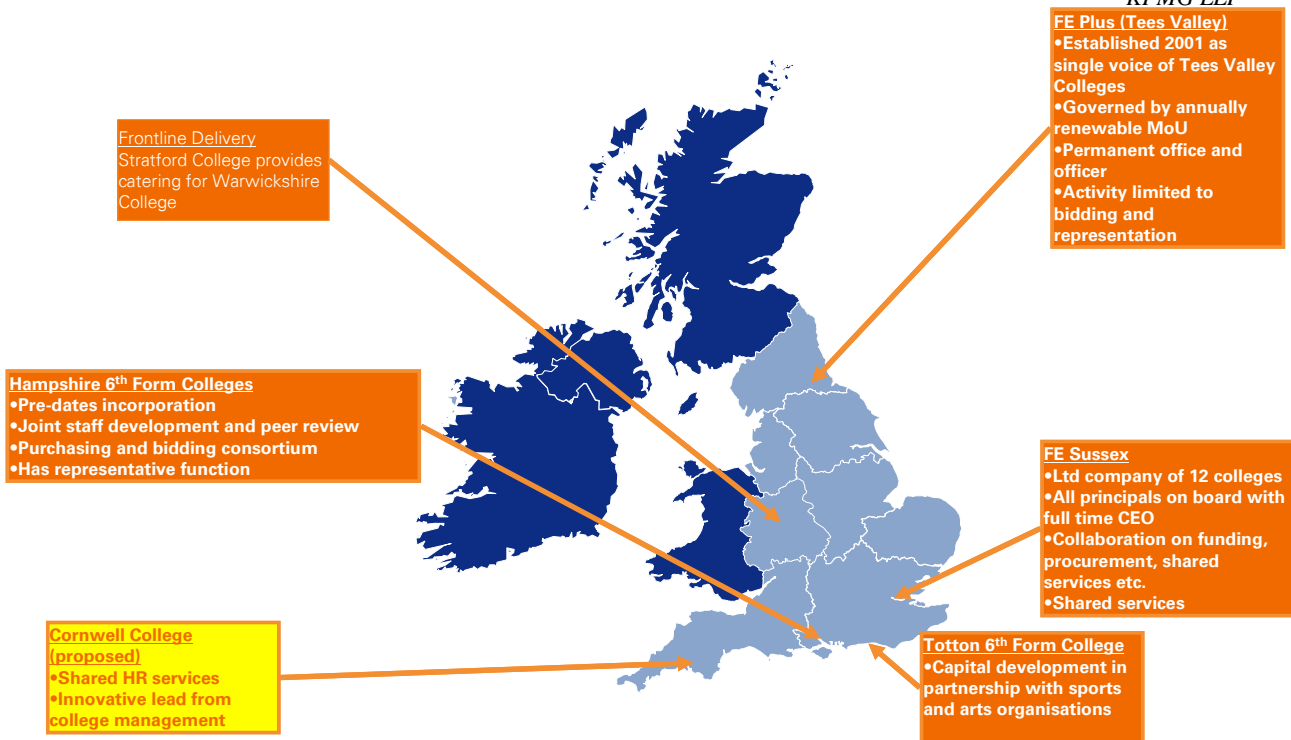
Government expects collaboration between organisations, and innovation in delivery models, in order to provide a rich and diverse offer to young people, adults and employers. It identifies that some of these models may require a wide range of stakeholders to come together to consider what is required for an area and to present proposals. Others, such as the use of joint committees or the formation of trusts, may require just two or more partners to come together to deliver an enhanced learning offer. While yet others may be internal to an institution, enabling it to provide a more flexible and tailored response to its customers.

6.1.1 **The range of collaborative options**

Within the restriction of the legal framework, many colleges have taken advantage of the minimal flexibility afforded them under legislation. This has resulted in colleges:

- Franchising (sub-contracting) and partnering a range of external organisations (now subsumed under the categorisation of “ partner providers”
- Establishing and/or acquiring companies
- Investing in Joint Ventures
- Collaborating with schools to provide sixth forms
- Collaborating with adult education providers;
- Collaborating with the independent specialist colleges sector;
- Colleges delivering HE
- Creating “shared services ”
- Creating “ federations”
- Merging – either through an ‘acquisition’ model in which a weaker college is incorporated, - the “deficit” merger or ‘tactically’ or strategically, which involves merging with another strong college to create a larger entity

Figure 17: Examples of formalised collaboration arrangements in the English FE sector



6.1.2 Key aspects in assessing the VfM of collaborative partnerships

Models for Success presents a range of strategic partnership options other than merger for the sector to use. Some collaborative ventures may be between two partners, or some of these models may require a wide range of stakeholders to come together to consider what is required for an area and to present proposals. Some options are formalised and legal partnerships (college companies, Joint Ventures, Joint Committees,) informal collaboration for a shared goal, (14-19 Diplomas, federations, the provision of Sixth Forms in schools or consortia between colleges and other providers to extend participation); some are semi-legal - undertaken according to strict guidance to keep within the FE legal framework (franchising and sub-contracting, Train to Gain etc).

In our view, colleges are skilled in utilising most of the collaborative options described above. In the context of delivering increased VfM, all the strategic partnerships that FE colleges take part in will undoubtedly have *some* potential to deliver this, but the extent to which they *actually* deliver VfM is variable and dependent on a number of factors. Key success factors for successful collaboration to increase VfM include:

- The quality of the governance and management arrangements within each member organisation;
- The effectiveness of the governance and management arrangements between each of the members:
- The robustness and efficiency of the financial arrangements for the partnership

The question must also be considered as to *which* organisation in a collaborative venture receives the benefit of the increased VfM i.e. the learner, the college, the partner, the funding body, the public purse etc. For example, the growth of franchising in the early 90's was of great financial benefit to the financial bottom line of a number of colleges,

but the huge volume overall represented poor value for the sector as a whole. Most importantly, the poor quality of provision often meant poor value for the learner. This led to stricter regulation which in turn reduced the volume of this type of collaboration. However, the funding model whereby some colleges retain up to 30% of the funding still raises the issue over the true VfM for this collaborative model in every circumstance.

Similarly, although there is an obvious VfM factor in schools and college collaborations to develop wider access, not all arrangements will represent VfM equally for all partners. For instance, the consortia approach for a shared 6th form between the schools and the college in Abingdon, appears to represent poor VfM for the college in that the college incurs a financial loss each year- although it gains in community participation terms.

However, even though improvements could be made to the operation of each of the collaborative options described in 6.1.2 above, the majority are already embedded and understood in the approach of most colleges. In the next paragraphs we turn our attention to the strategic partnerships that are *not* being fully exploited by FE colleges and consider the reasons why.

6.2 The FE approach to Shared Services

In considering the FE approach to shared services, it is important to distinguish between the opportunities and challenges of sharing **back office services** and the potential there is for FE colleges to bring together different parts of the delivery chain by working together to provide **better front line services** to learners. There are some limited examples of both in the FE College sector. We consider that the latter option offers much untapped potential to deliver increased VfM in a shorter timescale than the former.

Shared Services of back office services has long been recognised as way of driving efficiency, particularly within the private sector where they are increasingly used as a tool for driving corporate strategy and competitive advantage. One major provider of shared services to the public and private sector reports that “*successful shared services projects across both the public and private sectors are reporting operating cost savings of between 30 -50% on and critical reductions in the future cost of change, by removing duplication.*”²⁹ However, up-front investment is required and the timescale for pay-back is normally measured in years.

The 2004 Gershon Efficiency Review proposed shared procurement as one of the main sources of efficiency savings in the public sector. The report stated the LSC estimates that from an annual procurement expenditure of £1.6 billion, colleges could make savings of £75 million by March 2008. The savings made by colleges would be available to be redeployed into front-line services for learners. However, although some progress has been made with sharing procurement activity between colleges, there is less use made of other back office shared services per se. The barriers appear to relate to the impact of the SAF, a side effect of which contributes to a lack of trust between colleges, with a

²⁹ Steria

resultant unwillingness to share information and data in case their own individual position is undermined.

6.2.1 Government policy

Shared Services is a major theme within the Transformational Government Strategy which sets out the cabinet-approved strategy to transform public services through enabling technologies, launched in November 2005. This strategy identifies eight key areas that can be used as a basis to investigate the opportunities of a shared services approach: *Customer Services Centres, Corporate Services, Common Infrastructure, Data Sharing, Information Management, Information Assurance, Identity Management, Technology standards.*

The Transformational Government paper states that public sector organisations that are not sharing services cannot be said to be providing full value for money and standardisation across organisations. The strategy considers that a new shared services approach is needed to release efficiencies across the system and support delivery focused on customer needs.

“Shared services provide public service providers with the opportunities to reduce waste and inefficiency by re-using assets and sharing investments with others.”³⁰

In 2006, the Education and Skills Strategy Board of the DfES agreed the following vision for shared services:

‘The Education and skills sector will use the sharing of common services to release capacity for teaching, caring and managing and ensure that those common services meet customer needs for support at a significantly lower cost

The aims included:

- **Increased efficiency and effectiveness (value for money):** enabling resources to be diverted to priority areas so that every child or learner has the opportunity to maximise their benefit;
- **Improved service effectiveness:** reducing the burdens on frontline staff through maximising workforce improvement through shared services; and
- **Improved Procurement:** improving the effectiveness of procurement through consolidation of procurement expertise and scale of transactions.

Shared Services was included in the FE White Paper which talked of collaborating to share services and stated that the LSC would lead the development of a shared services strategy for the FE sector. Shared Services was part of the FE & Skills Bill (Clause 10) which was introduced in Parliament in November 2006. The Foster Report also noted that administrative services could be rationalised to reduce duplication and waste. **The Comprehensive Spending Review 2007 (CSR07)** required the identification of benefits that can be gained from sharing of services. It is clear from the documentation that has

³⁰ *Transformational Government*, Cabinet Office, 2005

been shared with us that there are expectations that the sharing of services will be a significant element of the Education and Skills Sector's delivery plans.

6.3 Progress towards shared services within the FE college sector

There are some well established examples of shared services in the FE sector. Two well known examples are the services provided by Joint Information Systems Committee (JISC)³¹ i.e. JANET³², and UCAS, the University Admissions Service. Significantly perhaps, these developments were in place before incorporation so were already embedded in the landscape of FE when colleges became independent. **They also share a common independent third party approach to shared services and do not require colleges to work together closely.**

However, we found that there is little evidence to date of other college services being shared right across such a diverse and complex environment.

Our research indicates that since independence, a large LSC project in partnership with the sector, to put in place a sector wide shared back office services infrastructure has not yet been successful, although the compelling need to make efficiency gains by sharing services in the FE sector is well known. We understand from comment provided by the AoC that a main contributory factor to the discontinuation of this project was the splitting of the DfES into DCSF and BIS

There has been more success with establishing shared procurement systems in FE in England, using a neutral third party "facilitator". By setting up Procurement networks and demonstrating that named colleges could save significant money, the LSC has persuaded an increasingly large number of colleges to join the *Crescent Purchasing Consortium* (CPC) This is managed by the Directors of Finance for nine further education colleges based in the Greater Manchester area and operated by the Purchasing Services Department at the University of Salford. The CPC now boasts 496 colleges in its membership, these being located in a number of different regions throughout England and Scotland. A significant number have signed up for the Government Procurement Card (GPC)³³

³¹ JISC is the only single, national institution responsible for providing strategic guidance, advice and opportunities to use ICT to support teaching, learning, research and administration for national tertiary education. Its remit covers FE and HE in the UK

³² JANET is the network dedicated to the needs of education and research in the UK. It connects the UK's education and research organisations to each other, as well as to the rest of the world through links to the global Internet. In addition, JANET includes a separate network that is available to the community for experimental activities in network development

³³ This a branded VISA Purchasing Card provided to the UK public sector through a framework agreement between OGC buying, solutions, VISA and six VISA-Issuing Banks. The LSC performed a mini competition between the banks to establish which bank work offer the most assistance to colleges adopting GPC cards. Barclays Bank was the winner of this exercise

6.3.1 Sharing the delivery of Front Line Services

A regional director at a Government Office told us that his ideal scenario was to have the best providers of each strand of provision that research indicated was required in a geographical area, delivered by the very best providers. This would require a high level of trust between providers to work, but could offer improved VfM for learners and employers in certain circumstances. Whether it would deliver VfM for individual colleges is more questionable and would depend on the arrangements within such an approach.

There are a few examples of two colleges collaborating to deliver provision for each other in order to improve the quality of the offer in a local area. Perhaps the best known is Warwickshire College which has asked Stratford College to deliver its catering provision. Catering in Warwickshire needed improving and Stratford College had a Grade 1. Another example is Capel Manor College which is delivering horticulture courses for some FE colleges in London.

In both cases, the college with the best provision is funded directly by the LSC for the delivery and the provider is inspected by OfSTED. The arrangement between the two colleges is governed by a memorandum of understanding (MOU) and is not subject to VAT. There is more information on these arrangements in the Appendices.

6.4 Federations in the FE Sector

Colleges are often urged to federate as a means of delivering VfM. Federations would appear to be an ideal vehicle for the development of a shared services approach. Our research indicates that the legal and regulatory framework for FE colleges in England only allows for a particular type of federation – a “soft” Federation.

In order to consider what may be possible, the definitions of “Federation” used in the maintained school sector are helpful to consider. Section 24 of the Education Act 2002 allows schools to federate. Further enabling legislation is contained in the Education and Inspections Act 2006.

- A **“hard” federation** in the school sector has a single governing body shared by all the schools. It has the potential for a single head teacher across the group.
- A **“soft” federation** is where member schools retain their governing body, but the federation has joint governance/strategic committee with delegated powers.

There are no examples in the FE sector of ‘hard federations’ – where one college can direct the activities of another college. Consequently, developments based on hard federations of the type seen in the maintained secondary school sector would not be possible in the FE sector under current legislation. **In FE, a “hard” federation between colleges is only possible through merger.**

We were provided with a number of examples of FE ‘Federations’ by respondents. Many of these come together initially for a specific purpose e.g. bidding for funds/improving

quality/ joint procurement. Some FE federations may be formalised by a company structure or semi-formalised by a written memorandum of understanding.

The examples included:

- The Hampshire Sixth Form College Partnership
- The S7 group of Sixth Form Colleges
- FE Plus – representing the 6 GFE’s in Tees Valley
- FE Sussex – representing all FE colleges in Sussex

All the above FE federations are “soft” – they depend upon each member’s agreement to act and each is concerned only with a limited range of activities. Whilst they certainly appear to provide some VfM for members from the joint activities each participate in, they do not fully exploit joint activity to maximise VfM. Each group of colleges states that the cost of maintaining the partnership does not exceed the costs of the additional resources brought in. In the timescale available to us, we were not able to validate the claims.

6.5 The ultimate strategic partnership - merger

Merger has been the most formalised way of colleges coming together to form larger entities and so, it is hoped, achieve economies of scale.

6.5.1 Government Policy on Mergers

Models for Success, DIUS August 2008, presented a very negative view of mergers as a last resort after a whole range of federal, collaborative or partnership approaches had been tried. This policy has changed now to one of *'each merger being considered on its own merits'*.

6.5.2 Types of merger

There remain two types of merger model as outlined on the LSC Website.

Type A involves all of the colleges involved in the merger agreeing to dissolution and forming a new FE Corporation. One of the most recent examples of this model is the creation of the South Staffordshire College by the agreed dissolution of Tamworth and Lichfield, Cannock and Rodbaston Colleges in 2008. A type A merger usually takes slightly longer to achieve as it requires the establishment of a completely new FE Corporation.

Type B involves the retention of one FE Corporation. This becomes the receiving body for the assets and liabilities of the college or colleges agreeing to dissolve. It is currently the most common FE merger type but is sometimes mistakenly referred to as the take-over model. The degree to which the dissolving college feels 'taken over' depends on the terms negotiated with the receiving college. For example, if continued provision on its

site(s) is agreed, together with local sub-branding and adequate representation on the Governing Body, the renewed financial prospects for that provision locally goes a long way to offsetting feelings of take-over, (especially if closure was the only other likely option.)

In 2009 most of the mergers agreed e.g Grimsby Institute of Further and Higher Education (GIFHE) and Yorkshire Coast College; Colchester Institute and Braintree College; Derby College and South East Derbyshire College for example- have been via type B.

6.5.3 **Reasons for Merger**

Current reasons for merger include the fact that some failing colleges have been reliant on exceptional support funding, or more recently, advances of funding from the LSC in order to remain viable. That funding is no longer available and is unlikely to be so from the successor bodies. Colleges have therefore chosen merger as a last resort rather than consider closure-Braintree and Yorkshire Coast Colleges, are examples in this context. Other colleges have decided at an earlier stage that if they do not merge with a stronger partner now they too may fail and HAVE to merge. East Devon College was an example of this context.

Currently these are the two most common reasons, but there has emerged a third reason over the last few years.. This is when two or more good colleges believe that by merging they can offer an even better deal for learners in the sub-region and at better value for money. These types of merger could perhaps best be referred to as “*tactical*” or “*strategic*” mergers. North Trafford and South Trafford Colleges which merged by model B to become Trafford College or the merger of the three Staffordshire Colleges to form one college are examples of this approach.

6.5.4 **Feedback from consultees on merger**

The implicit message from Models for Success is that merger may lead to the loss of a local college identity in an area. A particular concern about merger raised by a number of sixth form colleges was a feared loss of identity and the weakening of the sixth form college sector by more sixth form college mergers with GFE’s. Land-based and specialist colleges expressed similar concerns about losing the stand alone land based college into a GFE to detriment of the whole land based sector.

We have been provided with many examples where sensitive local branding and local collaboration have not led to this feared loss of either local or specialist identity. Colleges such as Guildford College, Sussex Downs College and The Manchester College have offered evidence that since they took on the responsibility for failing sixth form colleges, participation 16-19 has widened and success rates increased. Similarly, there are examples of GFE colleges taking on struggling land-based colleges, preserving their local identity and growing participation so that effectively the land-based industry in that particular geographic area is strengthened. Conversely, there is an example of a land-based college taking on a tertiary college with good results. Whilst good practice may not be universal, it does demonstrate that with good leadership and management and

supportive governance arrangements, it is possible to retain and strengthen local priorities within a larger merged college.

There is no doubt that the MOG changes may lead to increased difficulties as to how failing sixth form colleges may best be supported if merger is not an available option. These could be overcome by the co-operative working between SFA/YPLA/Local Authorities. The Government has committed to growing the Sixth Form College sector so it may be that merger and/or federations within types is the way for single focus colleges to explore if stand alone becomes impossible.

The view of many respondents was that in a demand-led system, colleges are going to have to compete regionally and nationally for business and need a large base from which to do so. Our desk work and analysis supports the view that there are economies of scale to be gained. In our local interviews, we heard the view that colleges below £35-100million turnover were vulnerable in this present fiscal crisis and MOG changes. That the vulnerability of already failing smaller colleges in the present fiscal crisis is likely to increase, was agreed by all. **At the moment, given the restrictions of the FE College legal and regulatory framework, for many in the FE sector, merger represents the only possibility for colleges to create the economies of scale required to deliver better VfM** The increased number of mergers in the second half of 2009 and the very strong growth in interest in mergers that we have observed in our practice in the final two months of 2009 suggest that more are likely to be proposed in 2010.

7 What are the ‘blue sky’ ideas from the sector?

7.1 Introduction

A large number of 'Blue Sky' ideas, have emerged from consultation and research. For ease of reference, we have set these out in terms of

- **Systemic change** - those changes that would require clear policy direction, enabling legislation and lead to major change in the infrastructure of the sector;
- **Radical Infrastructural Change** - those that would require some enabling legislation and clear partnership with the sector
- **Evolutionary Infrastructural Change**- changes that are entirely possible within current legislation and which can be determined by individual colleges.

7.2 Systemic Change

Our consultation indicates that the FE college sector shows an appetite for major change. Most respondents' ideas fell into the category of systemic change. Several commented that to do anything less was “tinkering at the edges”. Hence in this report we identify the ideas at this level of change first.

Those advocating systemic change did so on the basis that although individual colleges could be made even more efficient, such changes would only deliver limited savings and the fundamental factors inhibiting the response of the sector would remain

Implementing any of these options would require clear policy direction and equate to a large scale restructuring of the delivery infrastructure across more than the FE sector. In order to implement such far-reaching change, there could be at least a temporary reduction in the independence of individual institutions to determine their own infrastructure and direction. There would be an upfront cost which would have to be evaluated against the cost saving made. The timescale for consultation and implementation would be lengthy and decisions taken as to whether change would be instantaneous or incremental.

Many of the ideas put forward to this review for systematic change, were also put forward for consideration in the Foster Review of Further Education. Thus, suggestions were made that the FE sector could be systemically restructured via a number of alternative variables³⁴ The difference between the suggestions made for the Foster Review and those made now in a time of fiscal crisis is the level at which colleges would be able to “opt” for such a change, and what should be “imposed” by another authority.

³⁴ Mission, purpose and specialisation A paper for Sir Andrew Foster’s Review of Further Education Adrian Perry, Visiting Senior Fellow, University of Sheffield

However, the perception by some respondents was that it would be difficult in the light of the proposed MOG changes to find one authority which could deliver such far-reaching infrastructural change.

There was widespread agreement that the fiscal crisis would result in swingeing funding cuts which would inevitably lead to more failing colleges. Unless a new national blue print for the delivery of FE was produced to deliver “adequacy and sufficiency” of provision, the concern was that the result of leaving such change to market forces could be an even more chaotic infrastructure. The perception of many respondents was that systemic change would be driven by the larger and stronger colleges with accumulated surpluses, or with the ability to attract external investment. The fear of some was that they could simply take market advantage from their own strategic viewpoint - ***unless there was a clear over-arching local strategic planning and operating framework which put learners, the community and employers centre stage.***

The suggestions for the type of systemic change to FE infrastructure required to deliver significant VfM included the following which are listed in no particular order of priority. The suggestions have included:

- Split the sector by age range i.e. 14-19 Sixth Form colleges and schools. GFE’s to start at 19, to focus on skills and work for employers and to include more locally based higher education; a variation less well supported was to create a new “technical” 14-19 college which would bring together academic and vocational education;
- Reduce the number of colleges (but not necessarily delivery points) by creating larger merged college groups. Whilst the present mechanism for this is merger, it was considered that the ability to create Federations should be a priority as an alternative structure. The boundaries of these merged /federated colleges to be based on a formula linked to LA or sub regional LA boundaries, but the over-arching factors should be Travel to Learn and Skills demand patterns. The StARS could be a useful starting point;
- A related suggestion was to adopt a change in the age range of colleges and combine this with the reduction in number and effectively adopt the American Community College model / or the Netherlands ROC Model. This would mean funding one large FE College/federation in a defined area. Merged central back office functions would create a shared services centre. The College would in turn fund other providers in the area on a sub-contract basis. A network of regional and national specialist colleges would meet the needs of employers and industry. Once established this pattern would retain and utilise college independence in a cost effective manner. One respondent suggested that this model would negate the need for the YPLA and SFA or at least reduce them to very small centralised monitoring bodies. A means of monitoring the effectiveness of the arrangement by assessing the impact on a range of socio-economic measures was suggested.
- Move to a Tertiary system as standard across all LAs by removing all school sixth forms;

- As in Wales, require all local authorities to produce strategic plans for schools and all FE, including post 19 based on set national planning criteria

7.3 Radical Infrastructural Change

The changes at this level suggested by the sector may require enabling legislation for some aspects, but would retain college independence.

- Clarify the position that a Principal can apparently only be Accounting Officer for the employing institution – this would recognise fundamental shifts in the way colleges are now managed and open the way for “hard” federations in FE;
- Reform the regulatory system to reward those that drive forward efficiencies by sharing front line and back office services to deliver VfM, and take part in other collaborative ventures which deliver VfM.
- Bring in the schools National Challenge Model and some of the school interventions such as suspension of the governing body and establishment of an Interim Executive Board. to better identify and deal with failing colleges
- There are a range of VAT and tax reforms which could be implemented by HMRC to allow colleges to claim back VAT for shared services and which would encourage closer partnership involvement of colleges with the private sector
- Related to the above - “Market test” failing colleges by opening these to bids from other FE colleges and the private sector - in the same way that failing NHS Trusts and Prisons are tested. However, for this to work across the public and private sector it is essential to address the range of governance, regulatory, tax, pensions and other similar barriers which currently exist;
- Develop an “Academy” model for colleges whereby private sector/other sponsors can “buy” a share in colleges and have a greater influence on the curriculum and the management model;

7.4 Evolutionary Infrastructural Change

This is change that is entirely possible under present legislation, much of which is in the hands of colleges themselves. Colleges recognised that within their own internal structure, they need to better address VfM issues, but tended to lack specific ideas as to how this could best be achieved without cutting front line services. Many considered that they were already stretched to the limit. Those that did address this point supported the following ideas:

- Better financial and other benchmarking data to enable each college to monitor its own performance against sector “norms”.
- There was a great emphasis on shared services as a means of increasing VfM, but little expertise in how this should/could be achieved.

8 What are the current barriers to innovation?

This section identifies current barriers to innovation, first looking at those experienced by colleges reacting individually to increase VfM, and then collaboratively with other colleges. We also consider the obstacles to the private and voluntary sector contributing to innovative approaches to increasing VfM in FE.

Our desk research and the consultation process identified a number of barriers. A fundamental cause of many of them is the impact of the legal and regulatory framework for colleges which defines the limit of strategic partnerships between colleges. The influence of this, exacerbated by an implicit tendency towards competition between colleges, has created less tangible but equally, in some cases, impenetrable cultural barriers which discourage innovation. In addition, there are acknowledged factual barriers, such as the current tax rules which are a particular disincentive to involving private and voluntary sector providers in FE provision.

8.1 The types of barriers

Whether these barriers are real or perceived, all can be separated into two distinct categories from the perspective of an individual college:

- **Internal barriers** – those over which the college has direct control; e.g., governors and management team improving systems and taking out cost.
- **External barriers** – those over which the college has no, or limited, control e.g. legal and regulatory framework for colleges, and OJEU, and the UK tax and pension regime.

While many barriers were identified none are considered insurmountable; each could be addressed by legislative change, or concerted ‘hearts and minds’-type change management. Equally, our research has found an appetite for innovation and many ideas were suggested by colleges ideas about how to achieve better VfM.

8.1.1 Internal process-based barriers

These include:

- Management Information Systems (MIS) are fundamental to college processes and there are major opportunities for efficiency in this area. However, there is no uniform MIS across FE – this adds to the cost and complexity of collaboration. Good MIS and good Systems integration within a single institution, (which can be seen as achieving internal shared services,) is a critical prerequisite to a shared services agenda, for instance.
- Most colleges are not using their existing accounting systems to generate basic analyses such as the volume of business they do with a particular supplier. The

National Audit Office report *Improving Procurement in Further Education Colleges in England (2006)* found that three-quarters of colleges could not readily provide a breakdown of the amount they spent on basic categories such as water, energy and catering supplies. In most cases, colleges do have accounting information about how much they have spent, but the systems are not designed in a way that allows them easily to itemise the value and volume of individual categories of expenditure and contracts. As a result, many colleges' contract and supplier management is at a basic level, this inhibiting the development of effective procurement at an individual college level, let alone on the basis of making the most of shared procurement across partners.

- Space utilisation - Recent capital issues can divert attention from the fact that space utilisation in colleges across the sector is poor. Best practice in space utilisation includes tracking of how often each teaching area is used, at what times of day and even the percentage of its capacity being used, based on the size of a teaching group. This is still a new science to many colleges.
- Overall, colleges lack benchmarks to assess performance. Key indicators such as utilisation (of teachers and of estate) and the ratio of staff costs to budget are central to monitoring and improving efficiency. KPMG has undertaken a scoping exercise for the LSC on identifying a series of financial benchmarks which could be used by English FE colleges as in Scotland. Wales is developing cross –sector benchmarks across schools, FE and HE.

8.1.2 **Internal cultural-based barriers which colleges can control**

Cultural barriers are equally pervasive and can prevent colleges pushing through innovations which could improve VfM. The lack of a 'burning bridge' has been a key factor i.e. an urgent need to reform the status quo.

There is a strong element of frustration across the sector against other *perceived* rather than *real* barriers. Two main stakeholder groups were cited by consultees:

- Governing bodies: it is entirely understandable that governors should scrutinise and, where appropriate, act to stop, proposals which could jeopardise their college's best interests. However, innovation involves an inherent degree of risk which could be managed;
- Regional LSCs: some consultees, particularly those representing senior management within colleges, saw these bodies as too slow to respond to proposals for change and inconsistent in their treatment of such proposals. As with governing bodies, there is clearly a duty on LSCs to safeguard FE provision in the region. Equally, LSCs have the power to lend their weight to innovative proposals which stand up to robust scrutiny and to help steer them through the approval process which follows. It was felt by many that this did not happen often enough, sometime with the consequence that the action needed to address poor levels of FE provision in an area was delayed or made almost impossible to achieve.
- Where colleges have proposed merger as an innovative measure to deliver VfM , there may be opposition to merger – from learners, parents and politicians – which

centres around a *perceived* ‘loss’ of a specific college identity, but when managed well, need not present an insurmountable *real* barrier, as demonstrated previously

We also identified other cultural barriers. To date, most public services have been focussed on increasing productivity – often by increasing the size of the organisation or in the form of non-cashable improvements which have been measured in ‘more for the same’ terms. Cutting budgets without reducing the quality of provision has not been a major imperative. For instance, where a college has considered taking part in a collaborative project with others, the main driver may be meeting the agenda of others e.g, the regional agenda, rather than considering the impact on VfM for the individual college.

Historically in the FE college sector, the immediate response to a financial crisis has often been to seek to *increase* the budget available to the individual institution rather than to make efficiencies. So where business re-engineering has taken place in colleges, it has often begun by identifying how the college may “*optimise*” its share of the national funding “pot”, rather than to consider ways to “*minimise*” expenditure by introducing performance improvement processes such as LEAN Six Sigma³⁵ to streamline processes and eliminate waste and duplication, or to share services.

So for instance, in some colleges, in order to “*optimise*” funding claims, the qualification which generates the most funding has been preferred over one which is “*cheaper*” to the public purse, although in curriculum terms both are equally valid. Similarly, in some colleges, additional qualifications have been added to individual learning programmes to increase the funding flowing into the college. Whilst in some cases, these developments may be justified on curriculum and quality grounds, this has not always been the case. It is a mindset which must change as it is unsustainable given the reduced funding available to everyone.

8.1.3 External barriers over which colleges have no control

These are few, but their impact is great.

- **The size of the sector** - Success stories in shared services in the private sector and elsewhere in the public sector are *frequently on a much larger scale* than that achievable in tertiary education.
- **The Legal and Regulatory framework** - the inflexibility of the SAF, the focus of Ofsted inspection regime and the audit regime on single institution practice– are not supportive of “*hard federations*” and contribute to a lack of incentive to share information and services
- **Tax, OJEU regulations and Pensions** - specifically VAT and corporation tax, have emerged as major barriers to innovation. This is particularly true of potential private

³⁵ Applying LEAN principles to key processes such as reporting and recruitment could create efficiencies – in other sectors LEAN has drastically reduced the length and cost of processes. A pilot project to trial using LEAN for Apprenticeships is being trialled by World Class Skills for LSIS

sector involvement in the FE sector, with any commercial activity attracting to 17.5% value-add tax. The Tax regime has been cited as a disincentive to Joint Ventures with the private or voluntary sector by a number of principals and by consultees from these sectors.

There was some disquiet from those consulted that the ‘Power to Innovate’ vested in the Secretary of State by Clause 161 of the 2006 Education Act has not yet been used to trial change. Even if this was to be the case, this power is limited to education legislation and does not extend to areas such as tax and employment where more fundamental governmental barriers are found, nor can it address other fundamental issues.

8.2 Barriers for private and voluntary sector involvement in FE

For the purpose of this element of our work, we assumed greater use of private and voluntary sector providers to be a goal to increase VfM for the sector and identified factors which may be preventing this from being achieved. We have consulted extensively with private and voluntary sector training providers (PVTPs) and professional bodies which represent them to identify the barriers – real and perceived – which currently exist for their greater involvement in the Further Education sector either as partners of colleges, or to fill gaps which FE colleges have failed to address.

We found **extensive market demand** for greater involvement in FE provision – ‘latent’ or ‘pent up’ demand was evident amongst PVTPs, with many noting that they would like to become more involved in delivering FE services. At present there are no PVTPs responsible for delivering FE on a college-wide scale. The barriers identified in this element of consultation are seen by the PVTPs to which we spoke as the main reasons for them not focusing on FE more thoroughly. The over-whelming response was that until competitive neutrality can be developed, then the potential for VfM that greater competition for whole or part provision that the PVTP may bring to the FE sector will not be realised.

8.2.1 Barriers to market entry

The involvement of private sector companies in education has increased over recent years from the more formal involvement of private companies through the sponsorship of EAZs, EiC, specialist schools and Academies to local education authority services being outsourced or contracted out to private companies. Increasingly, however, local authorities and local education authorities are entering into voluntary contracts or partnerships with private companies to deliver services. Mostly these contracts are for "back office" functions, like IT support, personnel or payroll services, but occasionally they can be for core education services, such as advisory services, when LEA personnel are transferred to the employment of the private company

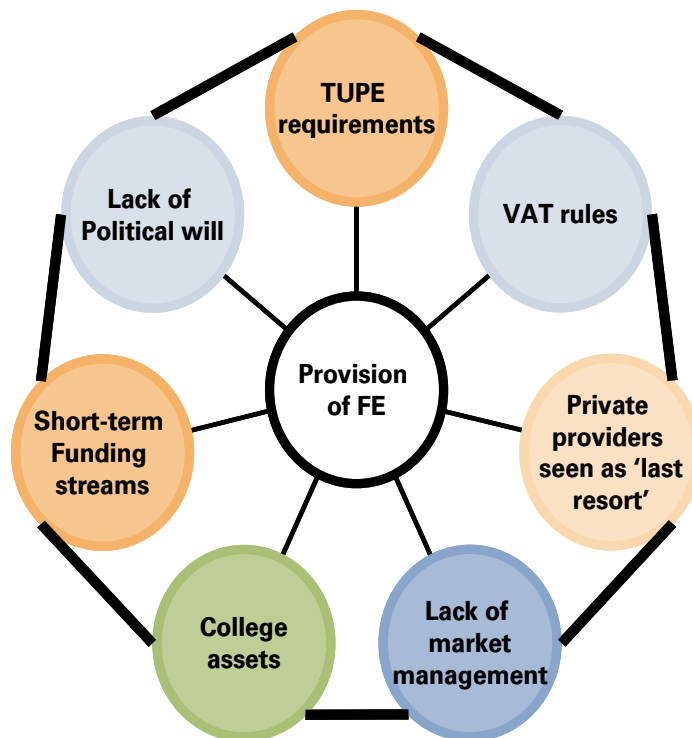
We found a perception that **FE is ‘a tough nut to crack’**. Demand from PVTPs to become involved in FE provision is largely latent due, in part, to a widely-held view that the FE sector is a difficult one in which to build up a commercially viable offering. To date, the major involvement of the PTVP sector is via provider partner arrangements or directly as work-based learning providers.

Our consultation has shown that some PVTPs are actively interested in a more high profile role by delivering FE provision at a whole college level – i.e. taking over delivery from a college. While this would be most likely as a solution to poor quality existing provision, PVTPs noted that the chance to do so would be less appealing than the opportunity to take over, or become a significant partner in, delivering provision which could be taken ‘from good to great’.

As well as the more political barriers cited above, there are also **regulatory barriers** to entry and potential innovation. By far the most important of these are the rules governing VAT and TUPE (the transfer of undertakings, ie. the requirement to offer ‘broadly comparable’ terms and conditions to staff on taking over a service previously run by another organisations), particularly pensions. For many private sector providers, pensions are the ultimate barrier to them becoming more involved in FE.

The CBI, which represents PVTPs, has raised these issues in their work on competitive neutrality. They cite a lack of consistency in pension costs and VAT treatment between the public, private and third sectors as, “*barriers to better quality public services and better value for the taxpayer.*”³⁶

Figure 18: Barriers to market entry cited by private and voluntary sector training providers during consultation



³⁶ *Counting the cost*, CBI, 2008

9 What have we learnt from elsewhere?

9.1 Global examples of FE structures and change

Comparable further education systems have undergone systemic change. We have researched recent, current and future trends in further education globally, using a combination of desk research and interviews with KPMG and/or college senior staff in the respective countries. We would especially like to thank Geoff Hall Principal of New College Nottingham who took a version of our talk book prompt to an international conference of colleges in Calgary, Canada and persuaded **a group of Canadian and American principals** to spend a considerable time describing at first hand the systems in their countries for the review.

We have consulted with officials and/or colleges in **Northern Ireland, Wales and Scotland**. In these countries, larger colleges have already undergone systemic change by the merger of smaller entities, or, in the case of Wales about to do so.

Over the last twenty years there has been a clear global trend towards systemic change towards larger delivery units for education below the level of Higher Education i.e. the phase equivalent to our FE. The same trend is observable in Canada, USA, Australia and The Netherlands and closer to home in Scotland, Wales Northern Ireland and the Irish Republic.

These countries have changed the way the sector works, as opposed to the ways in which organisations within the sector can be instituted. Large single delivery units serving whole regions or large administrative areas have either been established from the inception of the FE service, or are being formed by merger of smaller organisations. This is not at the loss of local identity as smaller delivery centres continue to exist.

9.2 Organisational structure

There are two main trends to the formation of larger units to deliver further education across the globe. These can be characterised as “vertical integration” and “horizontal integration”

9.2.1 Vertical integration

In this system, institutions offer education across more than one age range and education stage – in some cases providing ‘end to end’ education from school to higher education. Examples of this include:

- School, further and higher education (some parts of Canada)
- Further and higher education post 18 (Canada and the USA)

- The proposed delivery pattern for schools and colleges proposed by Welsh LAs where by 2015 there will be one FE college in each LA ³⁷

9.2.2 **Horizontal integration**

In this model, smaller colleges serving the same age range are merged together to form larger organisations capable of delivering education to larger communities eg:

- Regional Vocational Colleges (ROCs) - The Netherlands)
- Rationalisation of colleges (some parts of the USA, Australia, Scotland, Wales, Northern Ireland).

9.3 **Larger delivery units- the view from abroad**

As the international respondents to our survey were already in or using larger institutions it is not surprising that they were of the view that larger delivery units had significant advantages over smaller entities. The advantages they identified included:

- A more visible presence to learners and employers;
- An ability to lead the education agenda in the region or large area
- Can be funded directly by government thus avoiding “middle” agencies;
- Financially more stable and able to deliver economies of scale including ability to deliver internal “shared” services;
- More choice for learners ;
- The flexibility to “segment” and establish “specialities” so local identity and niche provision was not lost but was supported by the economies of scale of the larger entity
- Need for fewer principals and governors – who can therefore be of higher calibre

There was no consensus as to the definition of “large”. Where figures were provided, these were not against consistent measures. Figures provided included a description of one college in Australia with 42,000 learners; a monetary figure provided of 160m Euros annual allocation in the Netherlands for a ROC; to £140m annually for the size of the FE budget for all Northern Ireland.

The Webb Review in Wales identified £15m as the smallest viable size for an FE delivery unit, but the evidence for this figure and no other is not provided in the report.

However, direct comparisons between the pattern for FE in other countries and England is difficult as colleges operate in different environments. The level of independence of the sector in each country varies. For instance, in Canada, colleges are not able to form companies and have more direct federal and central control. In Canada and Australia the colleges are “Government owned”. In the USA they have similar freedoms to innovate as

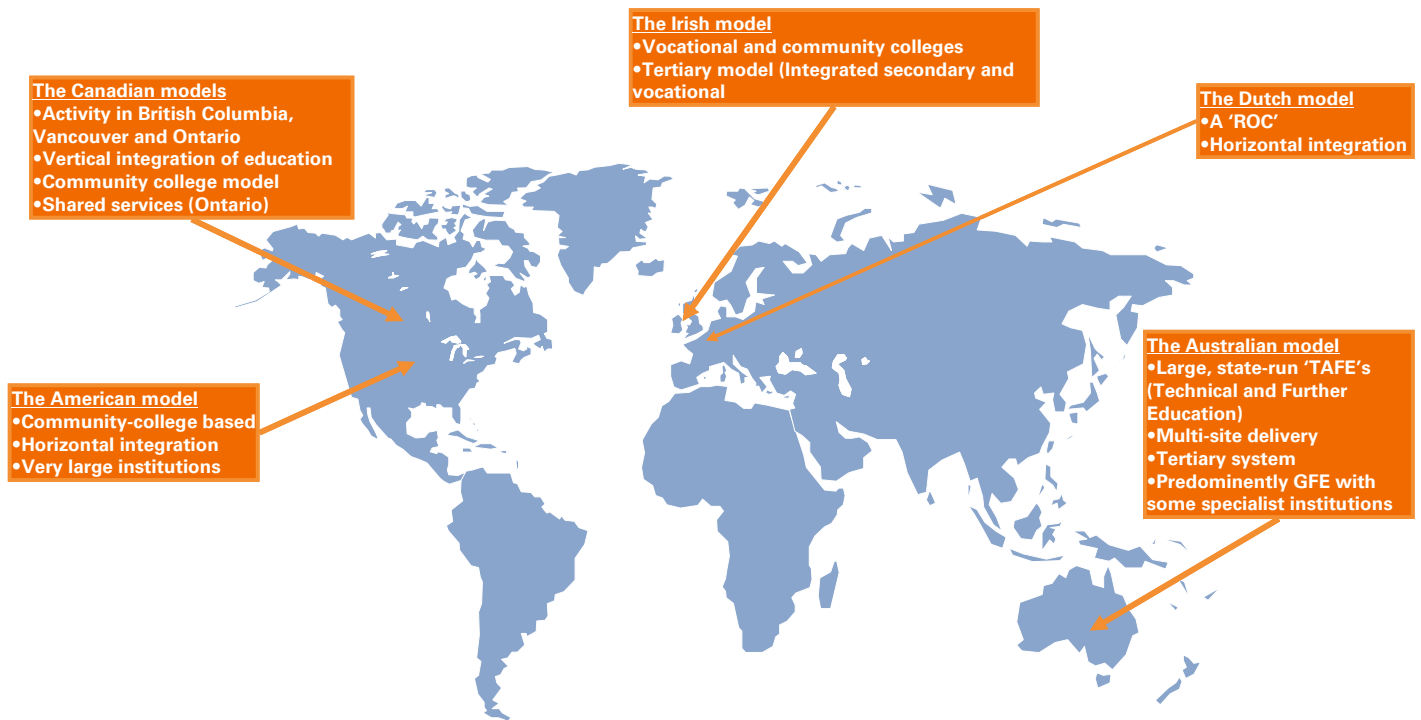
³⁷ Currently 23 further education (FE) colleges and two FE institutions in Wales

in the UK, but also face strict federal and central control. It is interesting to note that where change to create larger units is proposed for economies of scale, the same sort of concerns about loss of local identity etc arise.³⁸

The age range for FE varies – from 16 in the Netherlands to 18 in Canada and the USA. In the USA, Canada and Australia, the Technical and Further Education Institutions (TAFE's) offer both vocational training and higher education. In the USA and Australia there is also a strong private sector to provide market challenge. In Australia, large private providers may offer similar facilities to universities and TAFE institutes, while small specialist institutes may also offer some purpose-built learning facilities. Private providers in Australia are divided into registered training organisations (RTO-offering vocational training) and private higher education provider.

We have found many studies of how effectiveness and efficiency may be measured within the various systems but little consensus and little that is directly related to VfM. We have concluded that the most compelling lesson from abroad and the wider UK is the **universal global trend towards the establishment of larger delivery units which are perceived as more efficient and effective.** This appears not to be at the expense of a local focus and mission which is implicitly integrated into the design of the systems we reviewed.

Figure 19: Map showing key features of FE systems in selected countries



³⁸ The College of Eastern Utah merger into the Utah Regional system -Salt Lake Tribune 14/07/09

9.4 Transferability from other sectors in the UK

9.4.1 The Schools Sector

We think that there are a number of lessons to be learnt from some developments in the Schools sector. These are the ones that received the most support in consultation with the sector:

- The use of “hard” as opposed to “soft” Federations in order to allow schools to form larger units for the purpose of quality improvement and to share resources. We think that if this was transported to the FE College sector, it would offer an alternative to merger and support the development of a range of shared services- including sharing front line delivery within the federated area;
- The open and transparent approach to identifying, and then supporting schools which fail to reach national benchmarks. The National Challenge model is now well-established in the secondary education sector. Schools which fail to achieve 30% 5 A*-C GCSEs including English and Maths are deemed ‘National Challenge’ schools and required to enter in to the programme. If the 30% minimum is not reached within 3 years, despite a range of interventions, schools are closed. Closure is not a threat but a reality.
- Some of the range of interventions in the school sector are interesting. For instance, the School Improvement Partner Service (SIPS), and the band of “super-heads” which the DCSF can mobilise to support failing school. Overall, we and consultees liked the concept of stronger schools coming to the aid of struggling schools.
- The ability of the Local Authority to suspend a school governing body and to establish an Interim Executive Board (IEB) could offer an additional power to deal with failing Governing Bodies for the successor bodies to the LSC to use.

9.4.1.1 *Innovative partnerships between education providers*

Joint Ventures between colleges and private sector companies are difficult by virtue of the different regulatory frameworks. The availability of investment vehicles such as Academy Trusts, Specialist and Trust Schools in the schools sector seems to open the way for more private sector involvement in the management of education than the present framework for FE colleges does.

We have come across an innovative Joint Venture Collaboration between a Private Training Provider, a Local Authority, a school and college in Southend which may provide lessons for others. Despite significant barriers, including Governance, VAT etc, Prospects Learning Foundation (PLF) has become a significantly involved in delivery mainstream secondary education - but it has required lateral thinking and tenacity.

Prospects Learning Foundation is a charity. It came forward with an exciting scheme to combine a school and a work based learning provider, on a single site, as an innovative new educational establishment. The proposal was that the school would be rebuilt as a new Trust school with Prospects, who are committed to using their funds for

educational/charitable purposes and not for commercial gain. When Prospects came forward to Southend LA with their proposal, they had secured funding to relocate to another site, but they proposed to change their plans and transfer their vocational provision to be part of a larger new education provision on the Thorpe Bay site. Both Prospects and the LA agreed that the proposal represented an exciting development to help improve the life chances of young people in Southend. This proposal was strongly supported by the (then) Department for Education and Skills as a Trust School pathfinder.

PLF has contributed £20m to the building of a new Upper college building with specialist vocational facilities and provided a vocational and commercial influence and ethos to the school. However, it became concerned that the present governance framework for Trust Schools does not recognise its significant contribution and commitment. Therefore, in order for more formal recognition and influence, it entered into an agreement with Southend-on-sea Borough Council for the transfer of the freehold interest of 6.9 acres of land on the Futures College site. This land will be used to erect a new Upper college building with specialist vocational facilities to be owned by PLF.

9.4.2 **Lessons from other sectors – market testing**

In the early 1990s, the UK government introduced a policy of market testing public services in central government, testing their efficiency by exposing them to competition from external providers. It was less relevant whether the service was actually contracted to the private sector, but rather that it was subjected to competitive challenge. Market Testing is one of the strands being introduced by Government, to effect change to try and manage the reduced budgets imposed by Treasury Public Sector services.

For instance, in September 2009, the Justice Secretary announced plans to market test poorly performing public sector prisons with bids invited from the public, private and third sectors

Similarly, the Dept of Health has a policy that while NHS organisations are the government's preferred provider of NHS services, services can still be tendered where they have proved financially unsustainable.

In a recent example, an NHS District Hospital, complete with accident and emergency services is being offered up for takeover by the private sector for the first time, alongside bids from other NHS organisations. But according to the Financial Times ³⁹the conditions attached to the 7 year franchise are so stringent that it is thought that few if any private sector companies may be interested. A further disincentive is the timescale to conclude the deal which is said to be 18 months.

9.4.3 **Lessons from other sectors – Shared Services**

The major barriers identified to us as preventing the development of a shared services approach included the requirement for significant up front investment before any gains were realised and a reluctance by FE colleges to share information. Primary Care Trusts

³⁹ 30th October 2009

in the NHS have similar characteristics. However, there are examples of effective shared services operating in this sector. Steria and the Department of Health (DH), established the NHS Shared Business Services (NHS SBS) as a unique joint venture. It leads the way in developing and providing Finance & Accounting, Payroll, e-Procurement and Family Health Services to all types of NHS organisations. More than 21 million people in the UK have NHS healthcare delivered by NHS SBS clients. It provides a range of value added services to enable NHS trusts to focus on strategic decision making and business improvement activities whilst benefiting from operational efficiencies. It delivers annualised cost savings of around £3million, resulting from improvements made to the accounts payable process. In addition, the growing popularity of NHS SBS helped drive an increase in the volume of invoices processed from 3.1 million to 4.1 million. Finally the number of directors of finance who said they, “would recommend SBS” leapt from 39% in 2007 to 86% in 2009.

However, a major advantage that the NHS Trusts have over Colleges is that they can claim back the VAT expenditure. This makes a significant difference to attracting private sector investment, and the payback time for both parties.

9.4.4 **Lessons from other sectors – promoting competitive neutrality**

The **Welfare to Work market**, which is currently dominated by a number of large, long-term contracts under the Flexible New Deal (fND), was cited by more than one consultee as an example of a well-managed public service market in which there was more of a ‘level playing field’ between providers from different sectors. The same combination of complex legal issues and high-profile, socially vital public services is found in this area but the Department of Work & Pensions (DWP) have, over time, moved to a managed market in which providers from the public, private and voluntary sectors are able to bid for service delivery contracts on similar terms. The DWP’s website states that:

*“Under this principle of “competitive neutrality” competition must be fair between different classes of market participants so that there is a level playing field between public, private, and voluntary sector providers of goods and services”.*⁴⁰

One crucial difference between the welfare to work and FE sectors is the extent to which provision is controlled and directed by central government. The DWP plays an active market management role through its administration of fND contracts in a way which the BIS (nor the LSC) does in the FE sector. The recent trend in the FE sector has been towards increasing decentralisation and self-regulation – the appetite for reversing this and the potential opposition to so doing would have to be considered before adopting any elements of the DWP approach.

⁴⁰ DWP guidance. Quoted in *DWP’s Commissioning Strategy and the Flexible New Deal*, Work & Pensions Select Committee, 2009

10 Conclusions and Recommendations (1)

A recent KPMG global survey of top-level public sector professionals found that many predict a smaller public sector within the next 10 years.⁴¹ The challenge is to achieve this without cutting front line services. For the FE college sector, the challenge will be how to influence the shape of the sector going forward.

To date, achieving VfM has never been the key *raison d'être* of FE colleges in England. Neither has it been a key driver for the funding and inspection agencies in discharging their duties. Instead it has been a “peripheral” by product of a) widening participation and b) delivering high quality provision which have been the key drivers for colleges. Similarly, whilst Ofsted inspection reports categorise a college’s provision as being ‘good value-for-money’, this is not on the basis of a comparative analysis of unit costs, but a softer interpretation of whether success rates are broadly in line with the level of public investment into the institution.

There is no doubt that up to now the FE sector as a whole, has outperformed schools and universities and with fewer resources than those sectors. It has met and exceeded all the targets set for it. Since incorporation, colleges have diversified and expanded the opportunities for thousands of learners in a way that local authority control did not allow. The independence of the sector has made this possible. However, there are failing colleges and it is likely that the number of these will increase as funding reduces. Failing colleges consume huge quantities of additional public funding – sometimes over several years. The view of many in the sector is that the money could be put to better use by supporting the strongest colleges which do deliver high quality provision and which are making efficiencies.

Unlike the pattern of provision in several other countries, it seems that the current shape of the post 16 infrastructure in England has not been consciously planned on other than an ad hoc basis since incorporation in 1993, despite the intention of the LSC’s Strategic Area Reviews (StAR). In many Local Authorities, the determining factors behind the present pattern of provision i.e. whether sixth form colleges, tertiary colleges, a separate adult education service or integrated into FE, or the size of schools sixth forms, are a result of decisions taken in the 1980’s by Local Authorities in response to policy drivers at that time. The infrastructural changes made by LA’s in the 80’s were in response to their budgetary pressures which occurred with the introduction of Local Management of Schools (LMS). The change process at that time was almost exclusively to create larger FE units, sometimes joining together smaller FE colleges and/or integrating formerly free standing adult education services within them, (in other LA’s, adult education remained a separate service, but was often created as a “county” rather than local service.) Where sixth form or tertiary colleges were formed, this was by moving the age range of schools or by vertical integration between schools and colleges.

⁴¹ *The Wolf at the Door: KPMG Global Survey*, KPMG, 2009

Where more radical change since has occurred within an area, it has mostly been driven by larger colleges, or those with principals and corporations with strategic vision, rather than as fundamental response to change for better local provision and value for money, - although the rules on mergers means that this has been the by product of the change.

We have not discovered any definitive evidence about which type of local delivery structure works best to deliver VfM, although several respondents we spoke to had their own views – which was usually that the system they worked in was best.

Strategic Area Reviews (StARs) came out of the “*Success For All*” strategy (DfES 2002b) and were intended to be the drivers for change. These mapped provision across localities and regions thoroughly (in most cases) and with the intention of creating a blueprint for future post 14 development. Generally, it seems as though the Joint Area Reviews (JARs) have been more a catalyst for change within a locality, than StARs, the results of which seem to languish in a filing cabinet somewhere. One commentator has commented that perhaps StARs should have suggested roles rather than capacity.⁴²

If StARs have not been the driver for the infrastructural change to deliver better VfM, neither has the commissioning process. The LSC, as FEFC before it, has not used price as a determining factor when deciding which provision to commission. Rather, the “pot” of funding has been divided up on the basis of the relative value of a range of provision, and the drivers of meeting government targets, locally, regionally and nationally.

10.1 The Present State of the Sector

The general consensus from stakeholders is that FE is already an efficient and effective sector in the way that it meets and exceeds the targets set for it compared to other educational sectors. This does not mean however, that every college could not be more efficient. There was unanimous agreement amongst all the colleges we consulted that they must take action NOW to increase efficiency and their effectiveness if they were to survive into the future. Our research identifies the evidence that larger colleges may be more efficient and have the advantage of economies of scale, but even they will not be immune to the impact of the current fiscal crisis. A principal of one such large college predicted that if either his 14-19 income or his Adult provision income fell by only 3%, he would be in some difficulty. As he recognises that the most optimistic forecast is for a 5% cut in funding he is already making plans to reduce expenditure.

Based on an extensive sector experience, our view is that a significant number of colleges will struggle to remain viable in the next three years. GFE’s are the most vulnerable, although no college is exempt. The number of GFE colleges will decline naturally. Some colleges have stagnated through the rising funding levels in the last 7 years so there is room for efficiency gains and quality uplift – lower levels of funding will be, to a degree, an impetus to innovate for these colleges.

⁴² Adrian Perry *Delivery Models think piece for the Foster Report*

There now needs to be collective buy in by the FE college sector to the notion that cuts do NOT necessarily mean poorer provision or reduced quality. Innovative solutions and structural changes will occur. Chapter 9 confirms the appetite there is for change; however, it may be significant that a number of respondents looked first for *systematic change* i.e. imposed from above, rather than first considering what could be done at the *infrastructural level* – where they are responsible and which they can control. In our view, it is possible to absorb the projected reductions in funding in the next three years. Ironically many of the currently most efficient colleges are already positioning themselves to do so. There are efficiency tools available for colleges to review their efficiency levels without abandoning quality, and in our view, every college should be taking advantage of these, although we agree that they may require guidance as to how best to do this.

As we finalise this report, it is becoming clear that the reduction in Adult funding allocations is exceeding the sector's worst estimates in many colleges so the numbers in the top categories may increase. The combination of the cuts in public spending with the MOG changes, indicate a systematic change in the landscape of FE in the next few years. This may be particularly acute for GFE colleges, although no type of college is immune. However we consider that it is imperative that the sector must help itself. Collaboration and sector driven action will be essential.

10.2 Recommendations

In the face of the scenario above, it is imperative that prompt action is taken to accelerate the change process. Systemic change is now more likely to be needed to ensure the long term health of the public sector. The result is likely to be more creative, cost effective business practice in the medium to longer term. But change at the first and second level must be the priority for immediate action in response to the fiscal crisis.

10.2.1 Systemic infrastructural change

There is a danger that systemic change will be driven by circumstance rather than planned and coherent. Given the apparent appetite within the sector for fundamental change, now is a good time to begin looking to the future. At this level, Government would take the lead in establishing a new, slimmed down and re-organised delivery structure of FE colleges. This would require revisiting and re-defining the role of other educational sectors and re-allocating age responsibilities. The permutations of such radical infrastructural change are many. The danger when choosing this route however, as attempts to impose order from above, at a time of fiscal crisis could lead to the worst of both worlds – local inflexibility and reduced funding. It has been noted by many that good institutions do well, whatever the local infrastructure and, there is no evidence to date that any of the existing delivery patterns of post 16 are any better than any other.

However, Multi-million pound savings are only possible by far-reaching and permanent systemic change; such fundamental change takes time – in which more colleges will have failed.

Lead responsibility: BIS/DCSF/SFA

10.2.2 **The challenges for Radical Infrastructural Change**

Change at this level should be driven by colleges working with the Government to make more radical changes. At this level of change, a fundamental issue for the sector and the Government to address is the extent to which colleges are *delivery bodies for the plans laid down by other agencies*, and how much they *themselves become strategic planning organisations*.

10.2.2.1 **Provide wider freedom of action for the sector to collaborate**

This requires a re-thinking of some aspects of legislation and guidance, including the Instrument and Articles of Government to free up the sector to make further change. These changes would;

- allow a Principal of the second decade of the 21st century, to be the Accounting Officer for more than one college in certain specified circumstances;
- re-define the role of the Corporation in such cases
- enable colleges to form “hard” federations. These would provide a firm basis for
 - Supporting weaker colleges
 - Shared services – both back office and front line delivery
 - As an alternative to merger
 - Support the development of further innovative collaborative options

BIS working with SFA, YPLA and sector bodies would take the lead.

10.2.2.2 **A more open and transparent framework**

If colleges are to be given more freedom to innovate, it has to be within a more transparent framework which assesses their contribution to VfM. It would also enable colleges and potential investors from the private and voluntary sector to identify which colleges within the sector needed support. So we suggest that:

- A framework for colleges along the lines of National Challenge Schools is established with a transparent benchmark(s) against which colleges can be viewed as “good” at delivering VfM or “failing” in which case, there would be a range of interventions for a time-limited period before closure and/or market testing.

This would encompass and not replace the Framework for Excellence, and interventions such as Notices to Improve. It should incorporate a more focused business- like approach akin to that of the private sector Corporate Recovery Service and signal that failure is not to be supported. Closure should not be shirked where the evidence suggests over-supply or chronic failure.

The Lead responsibility for this development would be BIS/DCSF

10.2.2.3 ***Remove tax barriers for the whole of the education sector***

The current VAT and corporation tax regime is not equitable across the public sector or even across the wider education sector. We consider that opening up the education market to the private sector to provide competitive neutrality would drive forward VfM by:

- Encouraging more private and voluntary sector involvement and investment
- Allowing colleges to work more closely with the private sector in innovative Joint Ventures
- Support the development of shared services
- Allow for true market testing of failing colleges

For true competitive neutrality it will be essential to address the issue of pensions which are a huge deterrent to the entry of private sector providers into the market. Related to the latter point is a consideration of how investment vehicles such as Academy Trusts, Specialist and Trust Schools in the schools sector could be opened up more private sector involvement in the management of education than the present framework for FE colleges does.

Lead responsibility: BIS/DCSF

10.2.3 **The challenges for Evolutionary Infrastructural Change**

At the elemental level, there is an onus on every college improve its efficiency levels, whilst at the same time continuing to improve its effectiveness in delivering high quality provision. Although colleges are in the lead for implementing change at this level, this should be accelerated by:

- improved guidance on *where and how* to implement efficiency changes within individual colleges, and between colleges and other partners;
- Development of improved VfM financial benchmarks to support the process so colleges can identify and assess their weak areas;
- Development of new quick to implement options for Sector driven support for failing, struggling and vulnerable colleges as an alternative to merger

1. Given the MOG changes, and the need for speed, BIS should take the lead responsibility for issuing improved guidance.

2 LSC/SFA/YPLA should immediately commission work to develop improved financial benchmarks for the sector

3. We provide a thought leadership piece in the next chapter on new options for sector driven support within the existing legal frameworks

10.3 Summary diagram

Below we summarise the level of change required to respond to sector ideas, and assign a high level value to the level of saving it may generate, identify the potential primary risk, assign overall responsibility and an indicative timescale.

Level of change	Benefit	Projected order of saving	Risk	Responsibility	Timescale
Third Level - Systemic Change	A leaner, fitter sector delivering best VFM across the country	Multi-million pound savings	Disruptive beyond the FE sector	Government	5-10 years depending on political will
Second level - Radical Infrastructural Change	The FE sector assumes collective responsibility for all colleges becoming more cost effective.	Savings at least in order of present budget for supporting in year 1, but significantly more within 2 years as National FE Challenge impacts, colleges share responsibility and, work together.	Sector is not cohesive enough to effect change; insufficient talent in the sector to deliver leadership required; lack of strategic planning leads to strong colleges dominating and inequitable FE service across the country	FE sector and Government	Some immediate savings in Year 1, but significant savings across the sector from year 2 onwards. More 5 years down the line as other developments deliver results.
First level - Evolutionary Infrastructural	All colleges become more cost effective and improve	Average across the sector of 5 %	Savings will not be sufficient at this level	Colleges and Sector Bodies but accelerated	Significant savings across the whole sector will not

Level of change	Benefit	Projected order of saving	Risk	Responsibility	Timescale
Change	their VfM	per college	College response will be patchy. More colleges will fail affecting the VfM of the whole sector	by guidance from BIS	be apparent for minimum of 5 years

In the next chapter we put forward our suggestions for **immediate next steps** which the LSC/SFA/YPLA sector can take to accelerate VfM.

11 Recommendations (2)-Immediate Opportunities

11.1 Introduction

We do not think that the sector has fully exploited the potential it has to *lead* change. Chapter 9 identified a range of actions which Government will need to lead. This chapter provides two KPMG Thought Pieces which put forward some practical models for action by colleges which will show how the sector could seize the initiative *now* within the existing legal and regulatory framework. The role of Government policy going forward needs to be clear about the wider options it will support and the tools which it will make available to support the sector in this endeavour. Quality provision in FE must be maintained as the sector down-sizes the number of GFE college providers, possibly by up to 50 colleges.

11.2 The new options

For many failing, struggling and vulnerable colleges, merger may either a) take too long – 10 months minimum in our experience or b) represent the last resort. We therefore think that there should be another option which would be speedy to implement, and could be cheaper than long term interim management. It would use the strengths of the sector in support of weaker colleges, and it would retain college independence at a time when turn round may still be possible, or if some time is required to properly prepare for merger.

This model has a current working title of “*College Improvement Partner Service*” (*CIPS*) (but that may change) It has arisen from consideration of what has worked in the schools sector, but it has been adapted for the FE sector, and in our view should work under present legal, regulatory and tax frameworks, although we recommend that it should be trialled further, perhaps through discussion workshops with the sector and outside the sector.

We provide a detailed description of how we think it could work. We have added a number of variations which have been suggested in consultation, and we think there may be more.

Secondly, we supply our thoughts on how a “*modern merger*” may look in the future. There remain a further range of collaborative options which colleges may pursue as outlined in previous chapters, but we think that the reality is that as the impact of the funding cuts hits, merger will be at the forefront of many college deliberations. In some instances, this will be the most appropriate way in which to preserve access to essential provision, but the decision to merge **MUST** be taken on the basis of the likely future merger context in mind and should **NOT** be based on memories of mergers which have taken place in the last 5 years.

Both these thought pieces have been reviewed by a number of representatives of the sector (from a variety of types of college, strong and weak), the LSC and the private

sector and their comments have been incorporated into the working drafts. We invite further comments – this is still work in progress.

11.3 KPMG Thought Piece 1 - Delivering a College Improvement Partner Service (CIPS)

A College Improvement Partner (CIP) Service involves a College with Good to Outstanding quality grades and strong financial health, agreeing a contract with a ‘failing’ a ‘struggling’ or in some circumstances, a “vulnerable” college to deliver strategic and operational performance improvement.

It is differentiated from merger in that the college in receipt of the service retains its Corporation and its independence (although at the end of the process it may choose to merge).

The primary aim of the service is to return the failing/struggling college to financial stability and to improve quality in an agreed timescale. The CIP Service is therefore for a specified period of time – a minimum of one year is suggested as is a maximum of 3 years, although in theory it could be renewable. If recovery cannot be achieved in a time agreed between the funding body, and the governors, the CIP service may be used to prepare the failing/struggling college for merger or closure.

The contract between the colleges would contain clear timescales and milestones. Each milestone would contain SMART objectives for performance improvement in order to justify the contract.

In tax terms, a formally contracted CIP Service is a new development for the Further Education sector. There are VAT implications, but these need not form an impenetrable barrier. The advantages of a CIP Service are potentially so great that VAT implications (which have been identified as an obstacle in the past) should not be seen as a deal-breaker; the advice of KPMG’s VAT specialist advisers is that they can be overcome. The current advice is that following model will not attract VAT. It is however, vital that a VAT tax specialist is employed from the beginning to ensure the process and its detail. There may be pension and/or national insurance implication for some employees which will need to be explored on an individual basis.

11.3.1 The Core Model

11.3.1.1 *Stage 1 - Establishing the CIP service*

If the College is failing, the LSC or its successor body will take the lead in instigating a competition for a CIP Service. A sufficiently proactive College Governing body, possibly led by a new Chair, may also instigate this action as long as the ‘denial’ stage has been passed.

The LSC and its successor bodies may wish to appoint two governors to the failing college’s Corporation to strengthen it so the contract can be effectively constituted, tested for realism and then monitored by the governors. In addition, permission may be sought

from BIS to extend the Governing Body up to 25 for a two-year period through a temporary modification of Instruments and Articles. This is a common procedure for mergers, as an alternative or additional safeguard.

If the College is under-performing, the governors of the college may instigate a competition for a CIP. We recommend that the preferred supplier (College B) to College A (the failing/struggling college), is identified through an open and transparent competition⁴³ to ensure due process, but this process should be held within a tight timescale.

The service required would be clearly specified in the contract and monitoring milestones would be identified. The detail should be agreed by senior leaders and Boards of both Colleges. In the case of a “failing” college, the LSC or its successor bodies will have to be involved although with ‘struggling colleges’ a funding body presence is also advisable. There will be a series of break points built into the contract to allow for revision or re-negotiation of the contract by either party. Close monitoring of progress will be a regular feature of the process (an independent facilitator/moderator⁴⁴ will be needed in this context as members of either college would be conflicted).

No funds are now available for Exceptional Support for failing colleges which is why the CIP Service is such an attractive option. No funds will be available from the LSC to pay for the service. Costs will be met at the failing college by improvements generated with the providing college (College B). High-quality leadership and management is provided and the ‘struggling/failing’ college retains an option over time to retain its independent status.

11.3.1.2 *Stage 2 - Employment Arrangements*

The principal of College B – the good to outstanding college – is formally employed for 50% of his/her time by the governing body of College A to become the Accounting Officer of College A. They remain employed 50% of the time by College B and thus retain the Accounting Officer role for this college as well. This arrangement is made possible because the Instrument and Articles:

- do not specify a restriction on a Principal being Accounting Officer for more than one college
- [allow that] the Principal may delegate all functions save for budgeting and resources

Additional staff from College B can be employed at College A under the same arrangements. In this example, up to two further members of College B (e.g. the Vice-Principal and a third tier member of staff, precise functions to be determined by the nature

⁴³ Perhaps based on that used by colleges to seek a merger partner

⁴⁴ This could be provided by the SFA/YPLA, Local Authority, OfSTED, perhaps one of the Sector bodies or an external company. The external facilitator/moderator service is likely to involve payment of VAT unless within the remit of the appointed body.

of the issues) are also appointed and directly employed for 50% of their time at College B.

11.3.2 Table of Financial arrangements - example costings

College original salaries	B	Increased additional duties managed service	to of	Each College pays	Each College receives per post
Principal £125k		£140k		£70k	£70k
VP £90k		£120k		£60k	£ 60k
Third Tier £70k		£90k		£45k	£45k
Total	£285	£350		£175	£175

11.3.2.1 *Variations on the Core Model*

In some circumstance, it may be desirable to modify the core model. Variations which have been suggested to us, and which would seem to be possible within the basic principles of the core model include:

1. The Principal of College B to be appointed Accounting Officer of College A to carry out those responsibilities which the Instrument and Articles identify cannot be delegated. A “local site” or campus Principal could be appointed full time to manage local provision and relationships.
2. The Principal of College B to be appointed Accounting Officer of College A as above. Supporting staff to be identified from a consortia of other colleges on the basis of selecting the best staff available and on the same payment arrangements.

Care must be taken with Variation 2 which has an added risk element in that the consortia arrangement may lead to a less focussed approach. There are advantages to a consortia approach though e.g. a larger pool of potential talent available without the risk of de-stabilising one college.

3. It may be possible to use the employment model to deliver a “part service” i.e. a replacement financial function, or management of a particular strand of provision (although for the latter there are well established routes already) which would not require the college providing the service to assume Accounting Officer status. We think it is essential that the service is provided by a college to a college.

11.3.2.2 *Other issues for discussion at individual college level*

There may be a number of individual issues to be taken into account in arranging a CIP depending on the circumstances in which it is required. The following are suggestions of issues which may need to be explored.

- The role of the existing senior staff at College A should be clarified and employment law should be followed;
- Concerns for staff at College A about the future viability of the college should be addressed
- Should the LSC or its successor bodies fund College A through College B? Will there be any issue about funding routes if College A and B are in different regions?
- If College A has an MLP and has had provision taken away as a result, does the better quality of provision at College B over-ride this restriction? If so, is College A able to deliver the provision as this flexibility may impact on the potential for recovery and economies
- Concerns amongst staff and local stakeholders that the college providing the CIP service may not be taking decisions in the interests of College A (e.g. if College B is nearby, it may be seen as predatory)
- There could be reduced transparency for external stakeholders in who is running College A – which could impact on recruitment and hence recovery
- Concerns that College B will be less successful as the Principal has less time to manage it

11.3.2.3 *What are the advantages of the CIP Service?*

The advantages possible from this option include:

- The college’s performance improves but it retains the option of its own separate and distinct identity
- It would harness proven expertise as an input over a timescale where a real improvement can (and must) be made. For good colleges (and particularly Beacon colleges,) it provides a practical opportunity to spread good practice.
- It is likely to bring more immediate learner benefits within a familiar environment
- It is less disruptive for the majority of staff than a traditional merger
- It is good for the sector as a whole as it would involve peer support for effective turnaround
- It is likely to be more cost effective than the present commercial interim arrangements and appears to represent better VFM than the simple donating advance of funding to maintain staff responsible for a already weak position. The injection of high quality and proven successful leadership and management is key;

- It can be implemented within a very short timescale, subject to a willingness to gain contract agreement quickly (hence the recommended use of an independent facilitator). This differs from a traditional merger which typically takes at least 10 months to effect and often longer (note that ‘modern’ mergers are likely to be much speedier)
- It is likely to be more cost effective than other commercial solutions as it will not incur VAT – as long as a VAT specialist is used at appropriate stages to ensure compliance
- It provides a personal and professional incentive for individual staff and opportunities to invest in career growth.

We are currently exploring other aspects of this concept. For instance, will such a service be viewed sympathetically by banks etc and so open up the way for a strong college to manage capital investment on behalf of a weaker College.

11.4 KPMG Thought Piece 2 - Future Features of a “Modern Merger”

Present Government policy is that each merger proposal is to be considered on its own merits. We anticipate that this will continue. It is certain that the fundamental reason for merger will remain the same- the wholly educational, learner-driven justification- to improve access, choice, progression, retention, success and overall quality of learners, to engage more learners and to do so at lower unit cost, given the likely levels of resources available in the next 3-5 years. The seven criteria outlined in Models for Success will therefore remain of paramount primary importance.

Taking the educational justification as the core reason for merger going forward, other subsidiary reasons may include

- Financial affordability
- avoidance of closure of provision on economic grounds
- capital pressures;

11.4.1 Drivers for merger

Smaller colleges (below £20m for a GFE) will continue to provide a local service and have a strong local attachment. However, with cuts of up to 20%- 25% over the next three years, a distinct possibility is that many of the struggling and vulnerable colleges may merge to survive, and be quite proactive about the required strategic decisions. It is also likely that a growing number in these categories may choose to explore the College Improvement Partner Service (or a variation of this) to see whether viability and sustainability can be achieved without merger. Struggling colleges (of any size) may opt for merger following a 1, 2 or 3 year CIP partnership where the relationship between the two colleges has developed to the point where there is a strong mutual desire to merge.

Larger colleges (above £50m for a GFE) are likely to aim to increase turnover to near the £100m 'optimum' which many of them see as necessary to achieve the economies of scale they see as necessary for survival. We are aware of a number of such colleges, six at least currently, who are in the early stages of wooing potential merger partners so they can

achieve growth through acquisitions.

11.4.2 The Financial Aspects of a Modern Merger

As we have noted earlier 'the public sector merger' since Incorporation has been relatively financially generous. This is especially so in model B mergers which usually involving seriously 'failing colleges' which have continued to fail despite receiving, in many cases, multi-million pounds of additional funding from the LSC in the form of exceptional support, or latterly, as advances of funding. As part of the merger process the LSC has also traditionally provided additional funding to meet some or all of the following costs:

- Write-off of net current liabilities;
- Merger harmonisation costs
- Funds to cover urgent health and safety needs
- Costs of the merger process itself
- Occasional specific one-off needs

This 'gifting' of money by the LSC for these needs has now ceased (as some mergers currently going through are discovering.) It is likely that advance of funding with a clear timescale for a full repayment may be possible, but there is likely to be nothing more. In other words a college wishing to merge with a college where the Corporation is willing to dissolve and have the assets and liabilities transfer, will have to bear the cost and manage the risk. In the private sector this is normal practice; the cost is borne in year 1 with the 'downstream benefits' emerging from year 2 onwards. The minimal cost FE merger is no more.

11.4.3 Compliance steps in the Merger Process

Currently, these are clearly outlined and available on the LSC website. The main steps usually require:

- College Corporation decision- by large majority, preferably unanimous, to consider the full range of strategic options. With good governance this should be automatic every two or three years at least.
- College Corporation decides that because of poor financial performance, poor Ofsted inspection outcome, falling learner numbers and other similar factors that a formal Strategic Options Review (SOR) is carried out by an independent body.
- Governor response to the SOR is the decision to merge - establish an initial timescale for the overall process.
- Governors agree the conditions they would want safeguarding by the chosen merger partner.
- Undertake an open and transparent process to select the best merger partner.
- Feasibility study- a White File requirement
- Formally involve BIS to outline the proposition and gain permission to proceed to Consultation stage and to the Initial Outline Proposal Stage (IOP)
- Proceed to Consultation stage with sub-regional stakeholders
- Write the IOP for consideration by the LSC's Regional Council. If positive outcome is achieved formal harmonisation between the two colleges usually begins.

- Due diligences carried out on each college- financial and legal.
- Write the Full Merger Proposal (FMP) and submit to the LSC Regional Council. If positive outcome achieved proceed to writing of White File and accelerate the harmonisation work.
- Write and submit the White File to BIS.
- Secretary of State approval is given

11.4.4 **Changes that may occur**

The steps in the process outlined above will need to be modified as the LSC will cease to exist and its successor bodies are not required to exactly follow the steps outlined. The precise changes may not become clear until after the General Election but what should be borne in mind is the White File. This is essentially a check that due process has been followed- therefore in the interim any changes agreed for a particular merger, such as no need to go to Regional Council (because there is none planned) should be received from BIS in writing to show a clear tracking of any modification. After the large amount of time and effort put into the merger process it would be pointless to be turned down on a process technicality.

11.4.4.1 *Should the sector pay for failure?*

Finally, as a challenge to the sector, we throw in a further “blue sky” idea. This would:

- Require the sector to set up its own “insurance scheme” along the lines of the Association of British Travel Agents (ABTA) scheme used to address failure of one of its members.

In essence, college budgets have been top-sliced for years as the LSC retained a centralised budget to support failing colleges. To introduce such a scheme at this time of stretched budgets would not be popular and could send more colleges into decline. But it would emphasise and preserve the independence of the sector.