KordaMentha Higher Education Annual Report

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KordaMentha

Australia’s higher education sector is experiencing its most significant shake-up and greatest challenges in 30 years.

The Dawkins reforms of the early 1990s are giving way to a new, more managed system of growth aligned with national priorities for participation and skills. At the same time, the higher education sector is having to manage new legislative requirements relating to workforce decasualisation as well as huge pressure on costs and revenue, alongside many aspects of their business model being challenged.

The inaugural KordaMentha Higher Education Annual report highlights three key challenges facing the sector and considers what actions providers can take to best position for the turbulent environment.

Background | From Dawkins to the Accord

For the last 30 years, higher education across Australia has been on a growth trajectory. Total student numbers, domestic and international, have expanded and research expenditure has increased. Australian higher education has been a huge success story on almost any measure. The sector has created a world-class export industry which has enabled individual universities to ascend global rankings, resulting in Australia punching well above its weight on the global stage.

All of this has taken place within the settings created by the Dawkins reforms of the early 90s - hybrid government and student contributions and a free market for international students.

Underfunding of research has forced universities to rely on international student revenue to subsidise research, while government policies like the 2020 Job Ready Graduates legislation have attempted to influence student degree choices through differential contribution rates. The Dawkins settings have also produced a sector with little differentiation between universities either by discipline or function.

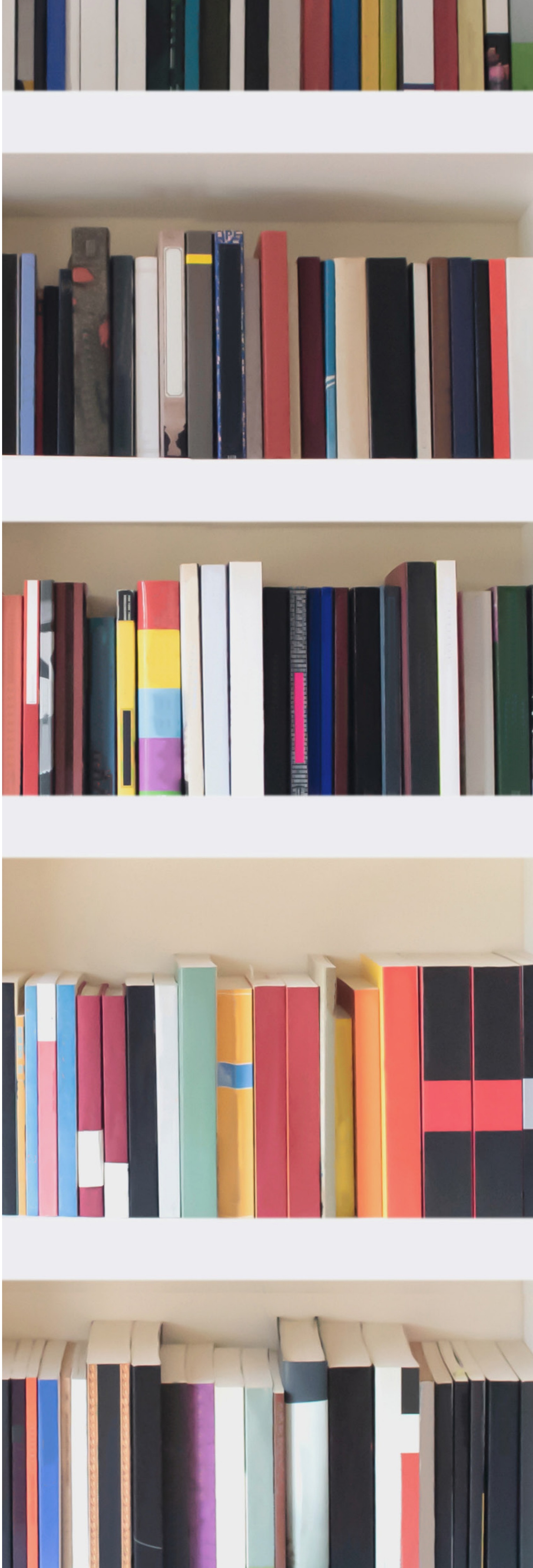
The Dawkins model was overdue for review. The report of the Universities Accord Panel, published early in 2024, represents a blueprint for a very different kind of system – one that will become much larger over time, that will be more planned and managed in ways that will see tighter alignment between national skills needs and higher education provision. The Accord blueprint outlines a scenario where the boundaries between different types of post-secondary education will become blurred. The Accord will address and acknowledge the different needs of different students and institutions, and will work towards an education environment that could see the emergence of more specialised institutions.

These changes will create important strategic choices for universities. In the meantime though, universities must address pressing challenges arising from concerning patterns in both their revenue and costs.

In this report we identify three key challenges in the current landscape that will require universities to address their strategy and operating models as a matter of urgency:

- Rising costs
- Limited revenue from international students
- A more managed and directed system.

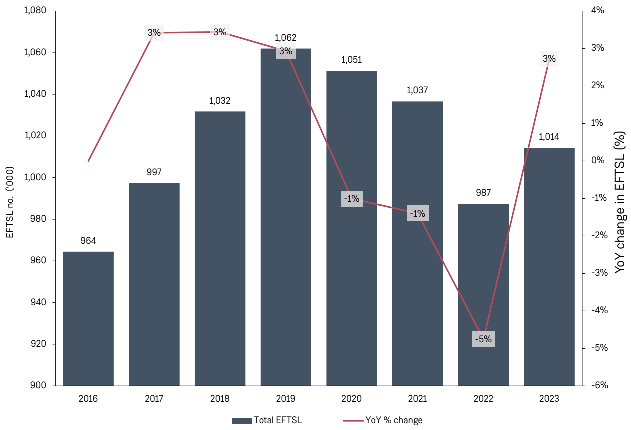
In this report we consider the likely impact of each of these challenges, and how universities should respond.



Challenge 1 | Revenue pressure and rising costs

Our analysis of 2023 university financial statements from Victoria, NSW and Queensland shows universities are facing significant revenue and cost challenges in the aftermath of COVID.

Fig. 1: Despite slight improvements, total student (EFTSL) numbers have not returned to pre-COVID levels



Total EFTSL ('000) and year-on-year change (%) across the 40 Australian universities between 2016-2023.

Source: Higher Education Statistics, Department of Education.

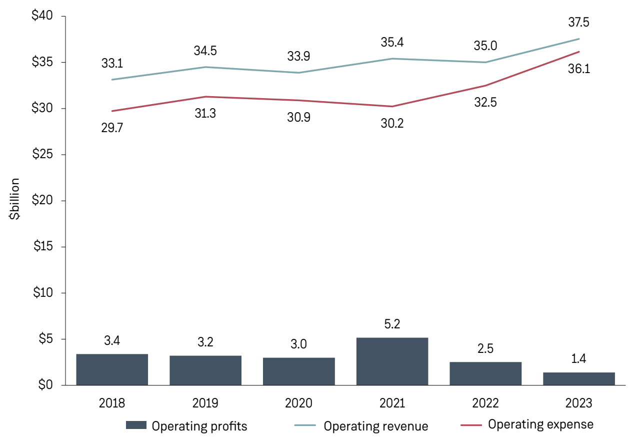
International student numbers recovered slightly in 2023, as government sought to adjust visa settings to kick start the international education sector after the lean years of 2020-2022. However, universities were still rebuilding their international pipeline.

Many school leavers deferred or chose not to enrol in university, while others reduced subject loads and became part-time students. Consequently, Equivalent full-time student load 'EFTSL' figures (the basis of university funding) are significantly lower than actual student numbers, adding an additional revenue/cost imbalance for universities to deal with.

In addition, the funding changes introduced by the Coalition's Job Ready Graduates legislation started to kick in, which meant the real value of Commonwealth funding for students started to decline.

While universities are grappling with revenue, their expenditure has significantly increased over the same period. Using a simple 'cost to serve' measure (i.e., total operating expense divided by total EFTSL) university costs rose by 22% between 2018 and 2022, driven mainly by rising staff costs.

Fig. 2: In 2023, sector operating profit margins reached their lowest levels in the last five years, as increases in costs outpaced revenues.

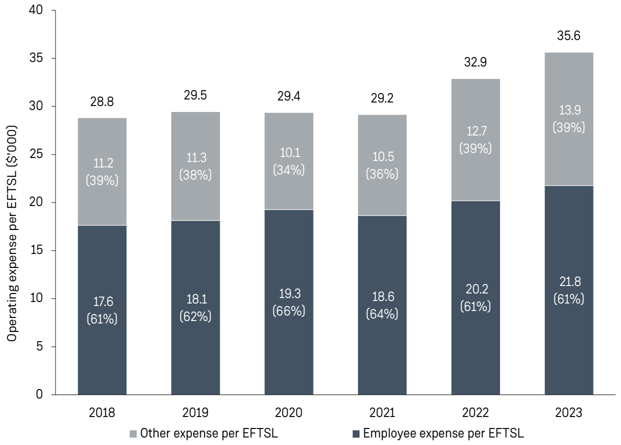


Operating Revenue and Operating Expense ($billion) across the 40 Australian universities between 2018–2023.*

**Operating revenue and expense exclude accounts that relate to income or expense from investment activities, gain or loss from valuation, amortisation, depreciation and borrowing costs.*

Source: Higher Education Statistics, Department of Education (2018–2022); University Annual Reports (2023).

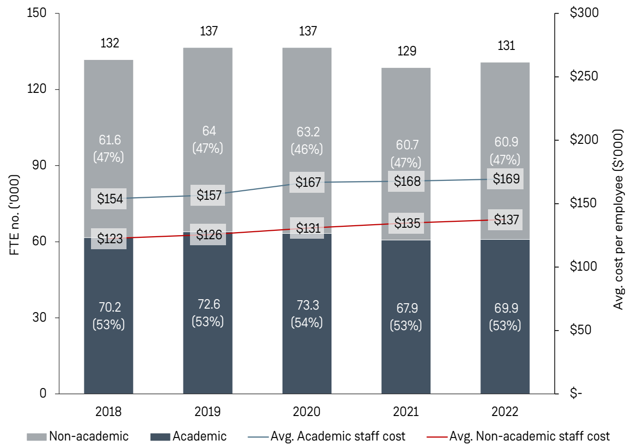
Fig. 3: Cost to serve per EFTSL surged in the post-COVID years of 2022 and 2023.



Employee and other expense per EFTSL ($'000) across the 40 Australian universities between 2018 – 2023.

Source: Higher Education Statistics, Department of Education.

Fig. 4: Average cost per employee* increased by 10% for academic staff and 12% for non-academic staff over the total five-year period between 2018 to 2022.



FTE employee count ('000) and average cost per employee ($'000) across the 40 Australian universities between 2018–2022.

**Average cost per employee is calculated by dividing employee by number of employee FTE.*

Source: Higher Education Statistics, Department of Education.

Many factors have contributed to this increase in costs, some of which are directly attributable to COVID, others have been accelerated through broader market forces:

1. Increased staff wages under new Enterprise Bargaining Agreements (EBAs) coming into effect in 2023.
2. Increased number of part time students create a 'cost to serve' imbalance for universities.
3. Hybrid models of delivery which are more complex to support and have led to higher student expectations of flexibility
4. Universities assumed a faster return of student revenue than was actually the case and sought to rebuild capability lost during COVID.

It's clear universities face immense pressures on both their revenue and their costs. Historically, universities have been able to manage their way through similar periods by increasing international student revenues. But that avenue may soon be closed.

Challenge 2 | Limited international numbers

During 2023, the government made several changes to the student visa regime that were designed to support the return of international students to Australian universities. International student enrolments reached a four-year peak, almost returning to pre-COVID levels because of these enabling policies, coupled with a backlog of demand from students who had been unable to locate to Australia during COVID.

However, this enabling environment for international education was thrown into reverse towards the end of 2023 as political concerns about the cost of living, housing shortages and levels of net overseas migration started to increase. International students were (wrongly) identified as a major contributor to these problems. To address these concerns, the federal government rapidly and significantly reduced the number of student visas granted to international students.

At the start of 2024 universities had a healthy international student application pipeline which, assuming historic conversion rates, would have ensured gradual return to pre-COVID performance and university surplus. Then, in early 2024, for many Universities, visa approvals started to decline to unprecedented low levels. It became apparent the Department of Home Affairs, applying a Ministerial Direction, was using a system of risk classification assessment levels, devised for a completely different purpose, as the basis for prioritising visa applicants to some 'low risk' institutions over others perceived as higher risk. This severely disadvantaged many universities, while funelling students into others, depending on their assessment level.

Australian universities then had an additional challenge presented: the introduction of the Education Services for Overseas Students (ESOS) amending legislation. Coalition has now abandoned plans to support the legislation but it has certainly destabilised broader efforts and momentum to attract international students. The legislation gave Ministerial power to decide how many students each university would be allowed to enrol. The intent of the legislation was to ensure a more even distribution of international students across the sector than is the case under Ministerial Directive 107.

The fall out of this proposed legislative change will be felt for sometime and universities will likely experience a drop in international revenue in 2025 against forecasts. Any further debate regarding student visas caps will erode and curtail universities' licence to recruit international students, negatively impacting the sector and Australia broadly.

For Australia, international students have contributed significantly to filling skills gaps in our economy and to GDP growth. International revenue has enabled universities to build a global reputation as amongst the best in the world while making relatively modest calls (by OECD standards) on public funding. Universities have used international fee revenue to cross-subsidise research such that universities have been the most significant contributors to Australian R&D spending, far exceeding the contributions of government and industry.

For universities, the changes that were recently proposed by government represent a reversal of almost 20 years of consistent government policy supportive of student migration and has created a sense of apprehension and diluted short and long-term confidence for many universities in their ability to attract, and compete globally, for international students. It was based on a largely false premise that international students are the cause of the housing crisis, yet led to an increase in students enrolling at universities in Australia's large cities where the housing crisis is at its most severe. For all universities, international students now account for a very significant proportion of all revenue.

[1]The Group of Eight (Go8) comprises Australia's leading eight research-intensive universities. These are the University of Melbourne, the Australian National University, the University of Sydney, the University of Queensland, the University of Western Australia, the University of Adelaide, Monash University and UNSW Sydney.

What are the potential consequences for individual universities?

The most obvious is that it further adds to the imperative to manage costs far more aggressively than has been the case historically. The steady growth in international revenue over the last 20 years has cushioned universities from this need, but no longer. Improving efficiency, removing unnecessary cost, and maximising returns on investment in people and infrastructure is now more important than ever.

Second, there is likely to be increased interest in exploring various forms of transnational education (TNE), whether through third party delivery, offshore campuses or online, to avoid the need to bring students into the country at all. Those universities already with physical offshore campuses are likely to be best placed to take advantage of this new environment. There are challenges associated with TNE, such as quality assurance, lower rates of return, difficulties repatriating revenues, and the possible loss of distinctiveness for Australia's universities in a global marketplace. Each university will need to consider its options in this new environment.

Third, universities will need to reconsider their research strategies. Research is well known to be a loss-making activity (whether externally funded or supported through workload allocations), and has been sustained for the last two decades by cross-subsidy from international revenue. With the likely reduction in cross-subsidy, remaining funds will need to be targeted more carefully. This means all universities, including the GO8, will need to give serious consideration to focusing their research effort through strategies of specialisation and differentiation.

Fourth, the government's new policy framework links expanding international enrolments with providing additional student accommodation, which means universities may need to reconsider their investment priorities. Much will depend on whether the costs incurred to build new accommodation can be offset by increases in future revenue, or whether other investments will be more productive.

Finally, it may be that the financial stress on universities will lead to discussions about mergers as a way of assuring financial sustainability.

We are entering a new era of university funding with profound implications, comparable to the changes from the Accord.

Fig. 5: Sector profitability has declined since 2021, despite a rise in income from overseas students*.

Total EFTSL ('000) and income from overseas students ($billion) and total operating profit across the 40 Australian universities between 2018–2023.

**'Overseas student income' = 'Fee-paying onshore overseas students' + 'Fee-paying offshore overseas students.*

Source: Higher Education Statistics, Department of Education (2018–2022); University Annual Reports (2023).

Challenge 3 | A managed system

The federal government has announced it intends to establish an Australian Tertiary Education commission (ATEC) from the middle of 2025. At that point we will enter a phase of higher education policy and funding unlike anything seen in 30 years.

ATEC will have an explicit mandate to develop a long-term plan for the sector, to evolve funding models, and make mission-based compacts with individual institutions. It will be charged with creating a more diverse and differentiated system, and with ushering in new provider types.

Some are forecasting ATEC will become an intrusive and coercive bureaucracy, creating no more than onerous compliance busy work while adding little to the overall quality or coherence of the sector.

However, an alternative view is that ATEC's mandate will create genuine strategic choices for universities for the first time since the Dawkins reforms in the early 1990s; and that fortune (and ATEC) will favour institutions with a clear idea of how they want to respond to those choices.

We believe there are six significant choices that can help universities chart a way forward in a post-Accord world.

Choice 1 | Grow, or not?

In its final report, the Universities Accord panel recommends ambitious growth targets in student numbers and participation rates.

The choice of how much an individual university will want to participate in this growth (assuming demand returns) needs to be made. It is not inevitable that growth will come from all universities or indeed from within the university sector.

From a government point of view, universities are costly places to deliver higher education compared to more teaching focused institutions. From a university point of view, many universities are already very large and may not want to grow further. Additionally, significant growth would require commensurate investment in systems to support disadvantaged students, and not all universities may wish to undertake this investment.

Choice 2 | Where to specialise?

ATEC's remit to drive greater diversity and differentiation should increase the likelihood of support for individual institutions to specialise in particular disciplines, or become more teaching or research focused. Once again, individual universities will need to decide how to respond.

Choice 3 | Competitive landscape

If there is to be greater diversity of provider types, and especially more non-university providers of higher education, how should universities position themselves relative to these new providers? Should they collaborate and partner with them, ignore them, or perhaps create their own as subsidiaries?

Choice 4 | University/TAFE engagement

The harmonisation of the vocational education and training and higher education sectors over time will be another theme of ATEC's work. Underpinning this will be significant policy reform designed to grow the 'connective tissue' between the sectors, such as a reformed Australian Qualifications Framework, a common skills taxonomy and integrated reporting.

This means the choice facing universities will be how to respond to this 'skills imperative' or, as Peter Dawkins put it, 'the growth in the importance of skills relative to knowledge' in university curricula and organisational arrangements. How universities approach their relationships with the TAFE sector will be particularly important.

Choice 5 | Qualifications universe

The universities Accord Panel refers explicitly to two new types of credentials; microcredentials and degree apprenticeships, and generically to 'modular, stackable and transferable qualifications'. It asks universities to establish exit pathways at diploma and associate degree level. A post-ATEC world would require universities to decide whether they want to participate in this newly expanded qualifications universe, or not.

Choice 6 | Research focus

Finally, with research, universities will need to decide whether they can continue to support research in all areas in which they teach. The proposal to raise the rate at which the indirect costs of research are funded is likely to reduce the range and quantity of publicly funded research at most universities. If they haven't already, universities should be deciding where to excel at research and what to let go.

How should universities respond?

Universities excel at developing long-term, multi-year strategies; however, in such a turbulent environment, it's imperative they 'control the controllables'.

The choices outlined in this report have significant financial and operational consequences. Therefore, when universities make their choices, expert understanding and analysis of the financial and operational consequences will be essential.

Similarly, designing and implementing pedagogical operating and business models that can weather this uncertainty will be critical.

In the meantime, universities will be well served by a stronger and clearer line of slght of their increasingly complex cost structures and costs to serve. This insight and understanding will allow universities to operate more effectivly in the short to medium term, while giving them an essential foundation for the strategic choices ahead. Waiting, without this depth of insight, until choices need to be made, will leave universities and their councils slow to understand the full implications of their choices and less able to make tough choices and embrace new growth opportunities.

However individual universities approach the short term challenges and medium term decisions, it is clear that the longer term for the whole university sector will not be 'business as usual'.

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