



SCHOOL OF HARD KNOCKS

The Outlook for Demand for Higher Education in the UK

The higher education sector in the UK has witnessed significant growth over the past three decades, with a combination of demographic, economic and policy drivers fuelling demand (as measured by the number of applications) since the 1980s. However the sector seems to be at an inflexion point. Indeed, pressures on state funding coupled with an increasing need for a highly qualified workforce has driven the government to push a reform agenda, with the almost trebling of allowable tuition fees to £9,000 per annum being the centrepiece of the new policy. But what impact will this have on demand for higher education?

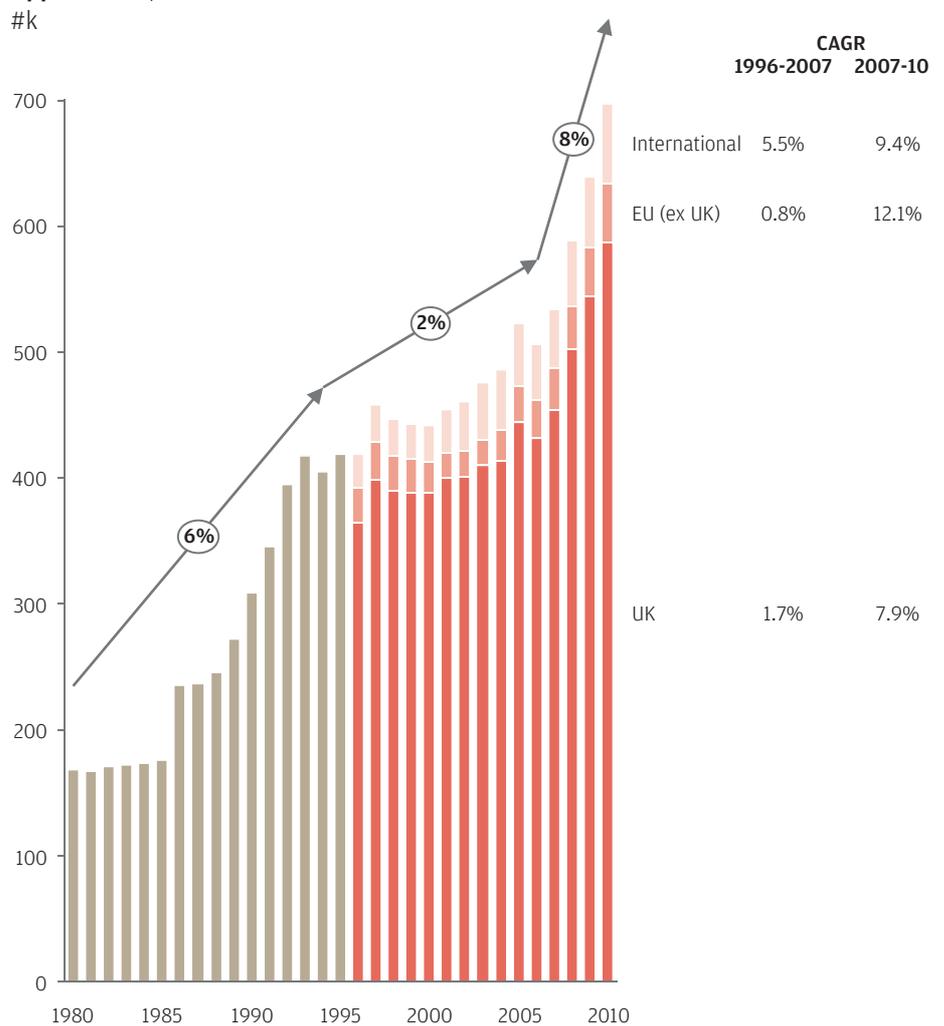
UK Government Policy Has Historically Been a Key Driver of Demand

Demand for higher education in the UK comes from UK and EU students, and international (non EU) students. Demand is driven by the absolute population of potential applicants and the application rate.

For all potential applicants, the application rate is a product of how much it costs to enter higher education including the opportunity cost of doing so and the likely benefits. Policy decisions and macroeconomic factors are the key drivers here. For students outside the EU, there is the added complication of immigration requirements which can limit the number of places available.

Although applications have grown significantly over the last twenty years, growth has been due solely to increases in the application rate, with the 17-20 year old population cohort in the UK declining over the same period. As the UK economy has increasingly required a higher skilled workforce, the government has encouraged young people to go to university, with the incoming Labour government in 1997 setting a target of 50% of 17 to 30 year olds participating in higher education by 2010. The nature of employment has also changed, with more jobs now requiring a degree or other form of higher education and so demand has increased accordingly.

Applications, 1980 to 2010



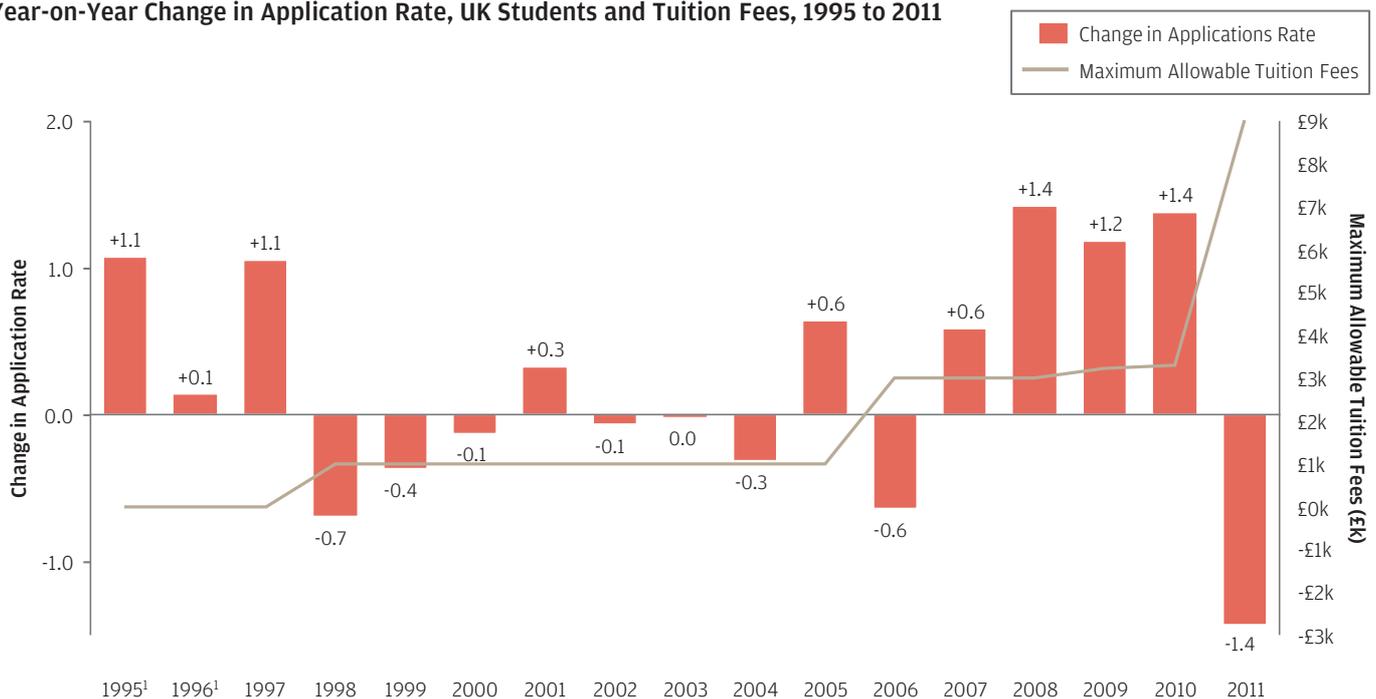
Source: UCAS

History Repeating Itself with Tuition Fee Increases

Historically, increases in tuition fees have motivated a surge in applications in the year before the tuition fee increases are introduced, followed by a correction the following year and a reversion to the long term trend thereafter. The figures on 2011

applications (for entry in September 2012 when the new tuition fees were introduced) do seem to corroborate the thesis that history repeats itself: 2010 witnessed a surge in applications followed by a significant decline in 2011.

Year-on-Year Change in Application Rate, UK Students and Tuition Fees, 1995 to 2011



1. Change in applications in 1995 and 1996 represents total students (including EU and International)
Source: UCAS, OC&C analysis

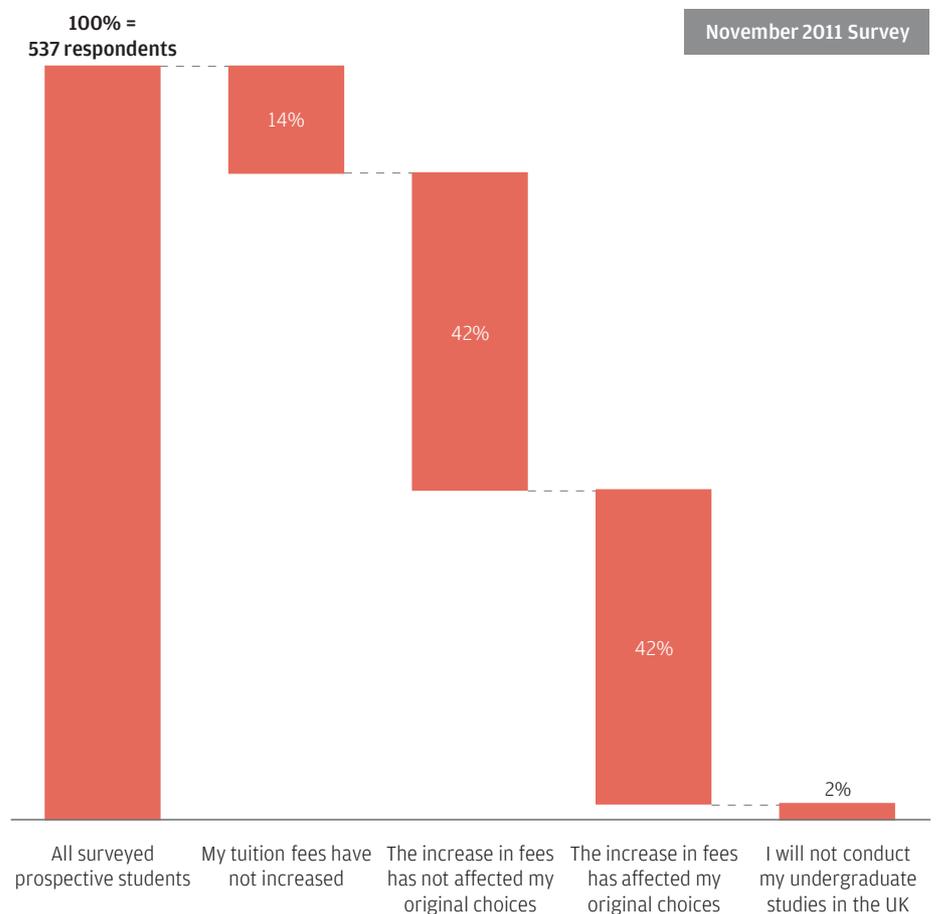
A survey of prospective students carried out by OC&C backs up these findings, with 42% of respondents saying that the increase in tuition fees impacted their original choices. Respondents also indicated that they may choose to attend a different institution which charges lower fees or offers financial assistance, or they may choose not to apply to a UK higher education institution at all. Additionally students will think harder about whether the qualification their chosen course and university or other higher education institution will confer on them will be worth the substantial investment they will need to make.

Unemployment also a Significant Driver of Applications

In terms of other factors, pre 1996, macroeconomic and demographic drivers had a large impact on applications, with applications in line with the GDP per capita trend. These drivers appear to have played out now, with unemployment being a significant driver of applications. Unemployment has an impact on applications as when there are fewer jobs available, the opportunity cost of entering or continuing in higher education is lower and so applications increase.

Impact of Tuition Fee Increases on Original Course Decision

“Have the tuition fee increases had any impact on your undergraduate enrolment choices?”



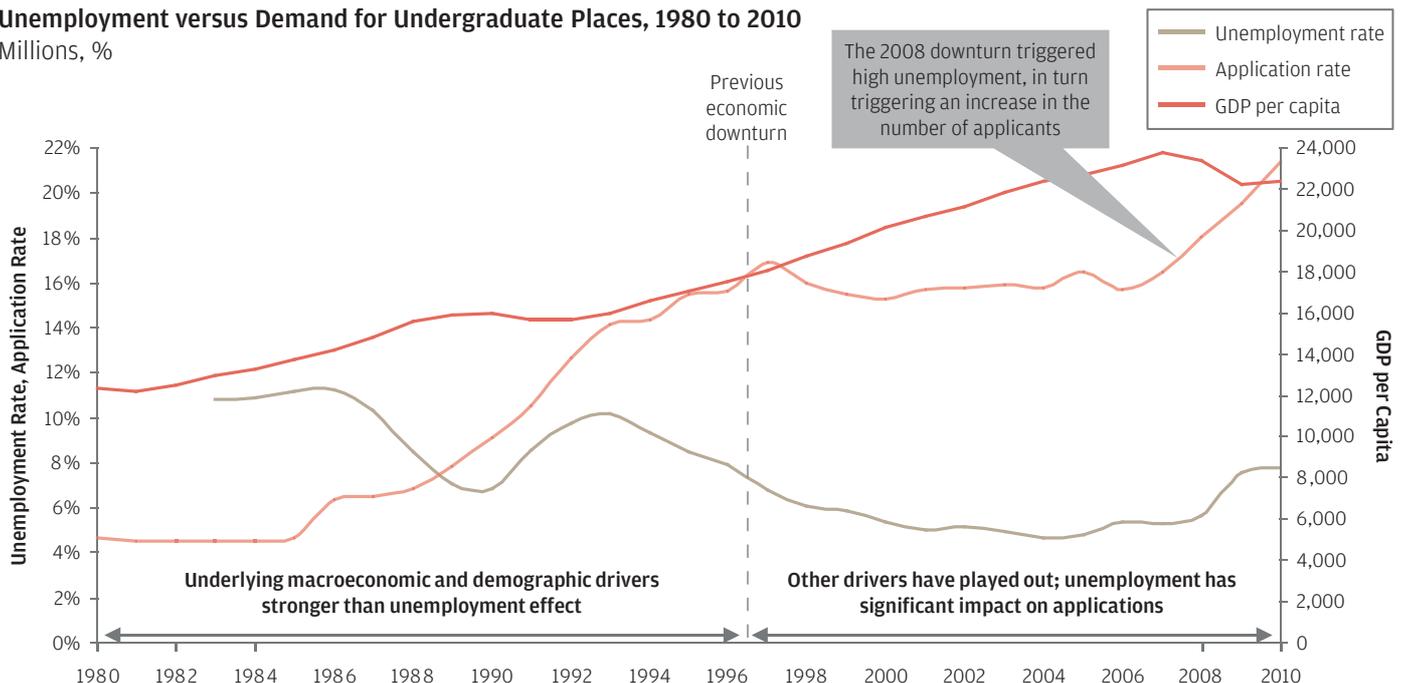
Source: OC&C Survey

In terms of EU and international (non EU) students, UK universities are now less attractive to EU students, with tuition fees of £9,000 per annum being the highest in Europe. Students from outside the EU can be charged a much higher price and are also impacted by the need to obtain a student visa. The government's new policies

make obtaining a student visa more difficult and in addition, there is no guarantee of a work visa on completion of studies. Whilst non-EU demand (as measured by the number of applications) was 11% higher in 2011 over the previous year, the recent adverse publicity associated with London Met suggests a more challenging outlook.

Unemployment versus Demand for Undergraduate Places, 1980 to 2010

Millions, %



Source: OC&C analysis

Future Market Growth Likely to be Challenging

Looking forward, the outlook for historical drivers of demand suggests a more challenging environment ahead:

- In the UK, the 17-20 age cohort is forecast to decline by 1.4% per annum to 2017
- GDP and disposable income growth are likely to be more modest than that witnessed before the financial crisis...
- ...albeit this may be moderated by sustained levels of high unemployment (as economic recovery progresses at a slow pace), thus reducing the opportunity costs of continuing in formal education
- Restrictive immigration policies are likely to negatively impact growth in applications from international (non EU) students

This view informs our base scenario of a 0.6% per annum decline in applications to 2017. However, given uncertainty in the market it is prudent to consider different scenarios contemplating different speeds of recovery post tuition fee increases and long term growth trends. Even in our upside scenario, we predict modest growth of only 1.5% per annum (mostly due to declining demographics in the 17-20 age cohort) with the downside scenario (longer recovery period and more restrictive immigration laws) predicting a decline of 2.2% per annum to 2017 (refer chart below). Nevertheless the more negative outlook on demand needs to be balanced against supply where we continue to predict constraints even if the downside demand scenario materialises.

What Does This Mean for Higher Education Institutions?

Slower growth and reduced demand will present challenges for higher education institutions, but the market reforms also create a number of potential opportunities that more innovative higher education institutions can exploit. In a more constrained funding environment creating cost efficient, nimble organisations will be key to achieving long term sustainability.

With a reduced pool of demand, smaller institutions may find it fruitful to explore JVs and potentially mergers with other institutions. By the same token, larger players may look to consolidate their position with acquisitions. Reduced funding will also lead to an increased focus on costs by higher education institutions. In this environment it may be profitable for a number of institutions to share administrative and “back office” costs.

Additionally a more sophisticated approach to customer (student) segmentation and pricing will be increasingly important to win share of a potentially diminishing applicant pool or indeed, to unlock latent demand for higher education. Understanding the thought processes of potential students and demonstrating clear value for money will be crucial in setting appropriate prices and communicating those prices most effectively. Offering courses at different price points using different delivery methods (eg. online, hybrid) will appeal to specific segments of the student population that currently have their choice limited to institutions that intend to charge the same amount (i.e., the maximum allowable tuition fee of £9,000) regardless of

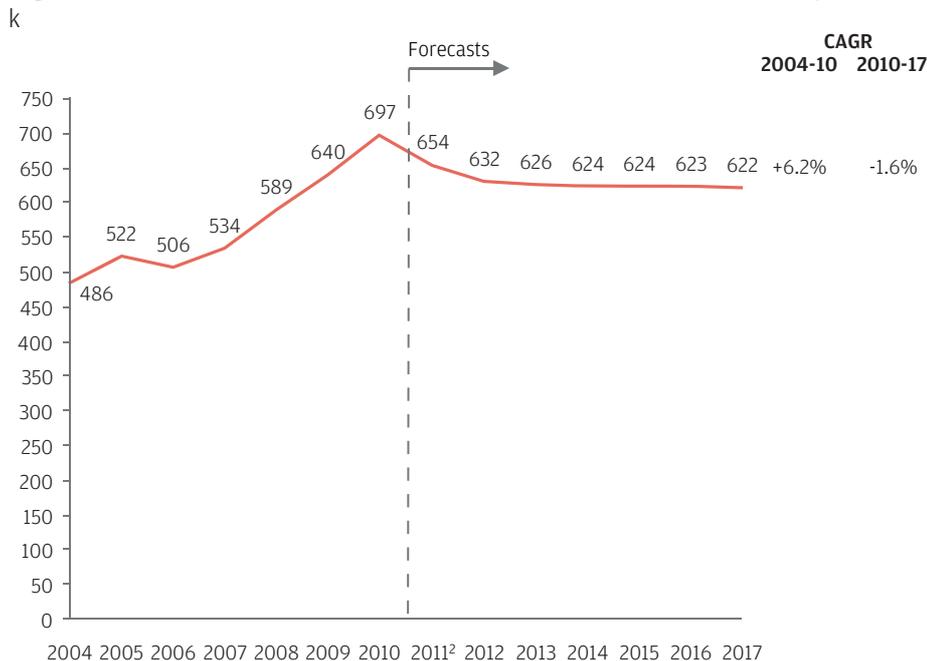
degree offered. Institutions will also need to think hard about which courses are going to be most attractive to students given the investment that students will be making.

As students increasingly take the burden of the direct cost of their education, value for money will take prominence and will be a key driver of student choice. Higher education institutions will need to build a strong “business case” for their course offerings and market their propositions aggressively. Developing closer links with business to help students gain a job after graduation and realise the benefit of that investment could be one way in which institutions show they are providing value for money.

Private institutions, freed from the history and tradition of public higher education institutions are in a good position to be catalysts for change and innovation in the system - building credibility and awareness will be essential. We might also expect to see a greater amount of sponsorship through more vocational qualifications by private companies, as they take proactive measures to ensuring suitable labour is available.

Out of all the unknowns the future holds, one thing is certain: to be sustainable higher education institutions will need to change.

Higher Education Historic and Forecast Demand, 2004 to 2017¹ - All Subjects



1. Years displayed are years of potential intake - applications in 2011 will lead to an intake in September 2012

2. Based on April 2012 statistics released by UCAS

Source: OC&C analysis

METHODOLOGY

OC&C's proprietary model of higher education demand was developed by utilising publicly available data from UCAS, HESA and other sources, including the EIU and HM Treasury. In addition, we performed more than 20 in-depth interviews with universities and also interviewed more than 30 experts, including representatives from the Higher Education Policy Institute and the Department for Business Innovation & Skills.

We also conducted an online survey of c.550 prospective undergraduate students, namely students in Year 11 (final year GCSE) through to students on a gap year. The sample of prospective higher education students also included 52 mature students. Respondents were from across the UK. The survey was used to assess the impact of tuition fee increases and to understand the likelihood of switching subject, location (university) or format choice.

UCAS applications and acceptances respectively were used as proxy for demand and the supply of higher education seats.

ABOUT OC&C

Established in 1987, OC&C Strategy Consultants is a global strategy consulting firm, headquartered in London. OC&C is a recognised leading advisor to the retail and consumer sectors, where we have deep experience advising clients on issues associated with pricing, price perception and customer segmentation.

In education, we work with a variety of education industry participants and investors in the sector. Our clients include many of the leading European and global players operating in the academic publishing, education technology and education support services market segments, as well as education and

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