

Commercial Risks and Opportunities in the New Zealand Tertiary Education Sector

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Abstract

The purpose of this paper is to use an historical approach to examine the changing nature, size and diversification of education and training in New Zealand. In particular attention will be concentrated on the emergence of the private training providers and tertiary institutions that made up a very large proportion of the New Zealand tertiary education system. After making a negligible contribution to New Zealand's education system in 1990 the private sector now makes up around 16 per cent of tertiary enrolments. It will examine the relationship between the private tertiary education sector as well as the relationship between these institutions and demands of both students and industry.

Introduction

Prior to 1989 the government owned polytechnics, colleges of education and universities in New Zealand in the provision of tertiary education did not compete directly with each other, nor was there any substantial competition to the state sector from private providers. Overall the competitive climate in which New Zealand's tertiary education providers operate has been intensified throughout the 1990s. This has come in the form both from the advent of competition between government providers and between private and government providers. At the same time the government tertiary education providers have become more reliant on private sources of income; including student fees. These two aspects – competition and private sourced funding – have meant that have been compelled to become more commercial in the manner in which they operate.

The purpose of the paper is to identify the rationale for the introduction of intensified competition and commercialisation into the New Zealand tertiary education system and the role of the private education providers in relation to the state sector. Further it will analyse the commercial risks involved both for private and government providers in participating in a more competitive climate. Finally it will look at the role played by the regulators of the private and government providers in enforcing quality standards and alternatively ameliorate some of the risks of a more commercialised tertiary education sector.⁷

The Reform Process

Education and training are today recognised as having an important part to play in the creation of economic growth, not just in New Zealand but internationally (Organisation for Economic Cooperation and Development 2002). The creation of human capital through the efficient provision of education and training is regarded as being an important part of the development of the national New Zealand economy. In New Zealand the present structure of the tertiary education sector was formally created during the reform period of the late 1980s. During the 1980s a wide range of government bodies undertook investigations of New Zealand's tertiary education system.¹ The final outcome of the reports and investigations were the two Department of Education policy documents *Learning for Life* and *Learning for Life II*. The policy documents made a number of main recommendations – subsequently largely implemented. The first was that there should be a substantial increase in the number of New Zealanders undertaking tertiary education study in order to raise the general skill-level of the workforce. Since 1989 this has substantially been achieved

¹ The reports on education and training were the Probine-Fargher report on polytechnics (New Zealand, Office of the Minister of Education 1987), the Shallcrass Report on non-formal education (New Zealand, Interim Advisory Group on Non-Formal Education, 1987), the Treasury briefing paper (New Zealand, Treasury 1987), the Watts report on Universities (New Zealand Universities Review Committee, 1987), the Tertiary Review (New Zealand, Department of Education, Tertiary Review Project Team, 1988), and the Picot Report on educational administration (New Zealand, taskforce to Review Education Administration 1988).

as the number of student formally enrolled in the tertiary education sector has grown from 169,924 in 1990 to 319,886 in 2002 (*Education statistics*). The second main recommendation was that a greater level of competition should be brought into the system. One way in which this has been achieved was by giving the government owned polytechnics and colleges of education much greater autonomy, which has meant that they have been able to compete directly with universities in the delivering of degree programmes. As well they have been allowed to establish campuses in centres outside their 'home' locality in direct competition with other government tertiary education providers and in many cases have begun to attract overseas students. The final main recommendation was that government tertiary education providers should derive a much greater proportion of their funding from non-government sources including student fees. This last recommendation is closely linked to the first two in that the additional revenue raised from private sources has helped to enable the government to expand the number of tertiary education enrolments as well as led to an intensification of the pressures on the providers to respond more fully to the demands of students, employers and local communities.

As part of the process of creating more autonomy for the polytechnics and colleges of education the *Education Act 1989* provided for an annual allocation of funds to each provider which then paid its own staff, owned its own buildings and within the limit of its Charter and the funds available, planned its own destiny. A pool of contestable funds was also established which the providers could apply for. The purpose of the changes was that it was hoped that by making them autonomous institutions and funding them according to the students they attracted, the government providers would become more market orientated and more responsive to the needs of students and industry. At the same time private tertiary education providers in New Zealand were given greater opportunities to compete with the government providers in the education and training market (Abbott 2000; McKenzie 1996).

In terms of efficiency it would appear that the major concern on the part of the government was to achieve a more efficient allocation of resources as well as promote dynamic efficiency. This means that it was envisaged that the introduction of enhanced competition would lead to the allocation of resources into the delivery of courses that were in greater demand by students and also the dynamic development of new courses (Hawke 1988). There seems to have been less concern about achieving efficiencies in the operation of the providers themselves although there is some evidence that this has occurred.¹

At a regulatory level the Department of Education, which had previously been responsible for the administration of tertiary education in New Zealand, was abolished and replaced by a Ministry whose job it was to be responsible only for overall policy. The distribution of government funds to the various education providers became the responsibility of the Ministry but in the late 1990s this passed to a newly established Tertiary Education Commission. As part of the reform process a national qualifications authority (the New Zealand Qualifications Authority) was also established and it replaced the government funded bodies like the Trades Certification Board, the Authority for Advanced Vocational Awards and Vocational Training Board, which had previously been responsible for controlling standards, analysing

¹ See Tables 3 and 4 as well as Appendix)

training needs and conducting examinations. Under the old system the boards were comprised of representatives of professional and technical bodies together with educational professionals and they prescribed courses and set and marked examinations. The polytechnics for instance conducted the teaching of many courses, and successful graduates from each course received New Zealand Certificates. From June 1990 the government and private providers were free to develop their own courses subject to accreditation and validation by the NZQA although it also retained responsibility for prescribing some courses, which providers, both government and private, could choose to deliver. The regulation of the tertiary education sector by NZQA, therefore, spreads across the activities of both government and private providers and even to the universities when they deliver national qualifications. The universities' degrees and higher degree programmes however are not the subject of NZQA regulation but instead are overseen by the New Zealand Vice-Chancellor's Committee.

National and International Trends

The reform of the tertiary education sector in New Zealand can only be fully understood by appreciating the context of both national trends in the New Zealand economy more generally and international trends in tertiary education provision. The New Zealand economy went through a process of extensive macroeconomic and microeconomic reform during the period 1984 to 1993. This involved the deregulation of financial markets, lowering of trade barriers, abolition of many industry subsidies, corporatisation and privatisation of government businesses and labour market reform. The whole general trend involved the opening up of the various sectors of the New Zealand economy to intensified competition and use of the market mechanism to allocate resources (Brash 1997). To some degree the reforms of the tertiary education sector in the late 1980s reflects this emphasis. The Hawke Report (1988) which attempted to draw the conclusions of the previous government reports on tertiary education together for instance emphasised that the introduction of intensified competition and by effectively decentralising decision making to the various educational providers these would become more responsive to the demands of students, employers and local communities and led to a more efficient allocation of resources. Similar arguments were made about the corporatisation and deregulation of New Zealand's government owned businesses such as the railways, postal services, and telecommunications industry.

The increased use of market forces to allocate resources during the 1990s was one that followed similar trends in other countries. The notion that there are benefits from the raising of levels of competition in the tertiary education sector is based on the view that allowing market pressures to influence providers will create incentives for institutions to improve the quality of education, improve productivity and efficiency, encourage innovation in the development of new programmes, and in general improve the services provided by the tertiary education sector (Dill 1997). A number of international agencies have advocated the further introduction of competition into tertiary education as they feel it is the best way by which a mass education system can meet the extensive demands upon it (World Bank 1994; OECD 1990). In most cases however where greater autonomy has been given to education institutions government intervention has remained in some form; and for a variety of reasons.

The most important continuing involvement in tertiary education both in New Zealand and internationally is the subsidisation of tertiary education. Despite the increase in the dependence of tertiary education providers on private sources of funding government subsidies to tertiary education and research are still substantial mainly because of the government's desire to promote both economic and social development through education provision. Although education is fundamentally a privately consumed good it may be considered a quasi-publically consumer good if a significant amount of benefits (externalities) flow from its production and consumption such that they assist third parties. In the past the possible existence of positive externalities that flow from education has been used to justify the subsidisation of both government and private providers of tertiary education and training. The continued government subsidisation of tertiary education further means that governments are also concerned that the institutions receiving government funding are kept accountable for the funds expended.

Finally if there are information asymmetries in education markets; that is if students lack the ability to make rational choices about which qualifications they would like to enrol and study in it would be thought necessary for them to have sufficient information about the quality of the alternative courses available to them. Although it may be possible that they have some information about the general reputation of providers like the older universities in New Zealand in general students would not be expected to have a very substantial knowledge about the standards of many of the other tertiary education providers in New Zealand. It is quite possible that students might even like to undertake shorter and even lower quality courses if the cost was less than higher quality qualifications. At times the distinction between the quality of the various courses at different providers may be hard to distinguish. Another area where information may be deficient is in the case of risk. Often students undertake qualifications that can extend over a number of years. In New Zealand, for instance, most degree qualifications take three or four years of study to complete. Students who commit their funds and time to courses of study of this length might be concerned if there is some degree of risk associated with the financial viability of a provider.

This process of giving tertiary education institutions greater institutional autonomy and then subjecting them to external formal regulatory structures that report on quality assurance processes in order to ensure educational standards has become a feature of number of countries during the 1990s (Dill 1997, 2000; Jose-Gines Mora 2001). In countries such as the United Kingdom, Australia, the United States and New Zealand where tertiary institution such as universities have traditionally been fairly autonomous bodies there has been an increase in the degree to which they are formally 'audited' by statutory bodies. In New Zealand in recent times there have been regular audits of the universities by the New Zealand Vice-Chancellors' Committee as well as attempts by the Tertiary Education Commission to more strictly associate research funding with research output. Similar processes have been undertaken in the United Kingdom and Australia.

In those countries such as those in continental Europe where the universities have a strong history of state control there has been a movement toward greater university autonomy. In both cases, therefore, there has been a tendency for universities to have a degree of autonomy from the government and be influenced by market pressures

while at the same time be subjected to quality assessment and assurance systems. In the New Zealand tertiary education sector both trends have occurred. The rigid control of the Education Department of the polytechnics and colleges of education were replaced with a system of them being given greater autonomy but also the subject of regulation while the autonomy of the universities has been eroded by the implementation of greater oversight by the New Zealand Vice Chancellors Committee and the Tertiary Education Commission.

Changes during the 1990s

Figures 1 to 3 and Tables 1 to 3 provide further information on the manner in which the tertiary education sector has changed during the 1990s. From Figure 1 it can be seen that the total number of formally enrolled students in tertiary education has grown from around 175,000 students in 1991 to approximately 320,000 in 2002. These figures have been boosted by a substantial increase in the number of formally enrolled students from overseas. The proportion of students enrolled in tertiary education in New Zealand who were from overseas has risen from under two percent in 1991 to over eight percent in 2002. Despite this growth in the number of international students in New Zealand there has also been a marked increase in the numbers of New Zealanders enrolled in tertiary education; both in absolute terms and as a proportion of the total New Zealand population. From Figure 2 it can be seen that the proportion of the total New Zealand population formally enrolled in tertiary education rose from approximately 5 per cent in 1991 to 7.4 percent in 2002.

This expansion of student numbers would ordinarily have been thought to have placed a substantial burden on the finances of the New Zealand government. The reintroduction of fees for domestic students and greater numbers of international students clearly has opened up new sources of funding for the operation of tertiary education providers in New Zealand. Throughout the 1990s the real level of total government funding of tertiary education providers has not fallen but it is true that these funds are now spread over a greater number of students.² This has meant that the real funding level per equivalent full time student has declined. Figure 3 shows that there has been a consistent decline in the real funding per student since 1991.

Looking at Tables 1 and 2 it is possible to get an indication of the difference in character of the various tertiary education providers in New Zealand. New Zealand in 2002 had eight universities, four colleges of education, 20 polytechnics and over 500 private education and training providers. The largest sub-sector of the tertiary sector in New Zealand is clearly the universities, which account for around forty per cent of formal enrolments. The universities concentrate predominately on degree and post-graduate programmes and have the largest proportion of students from overseas. At the other extreme are the private providers which on average are much smaller in size and concentrate far more of certificate and diploma level studies. One notable aspect of the polytechnics and colleges of education are the sizable proportions of students in

² Real government funding of government tertiary institutions (including bulk, research and EFTS funding) rose from \$1075 million (\$1999) in 1991 to \$1143 million in 2002. Per EFTS funding has fallen from \$8,017 in \$1995 in \$1991 to \$5,828 in 2002 (Tertiary Education Commission 2003).

both are enrolled in degree or post-graduate programmes whereas in 1991 these types of institutions did not offer degree programmes at all.

Table 2 provides data on the sources of funding of the government owned tertiary education providers. Around one half of funding overall is granted from the government in the form of academic or research related funding. With the exception of the colleges of education and the wānanga international fees are an important source of funding, as are domestic fees for all institutions.

The character of many of the tertiary education providers has changed considerably over the course of the 1990s. The granting of greater autonomy to the colleges of education and polytechnics has meant that a number have changed greatly in terms of the programmes they offer. In particular the granting of the opportunity to deliver degree programmes has meant that the process of academic drift in a few of the larger polytechnics has occurred at a rapid rate. At the Auckland based UNITEC Institute of Technology and Auckland Institute of Technology (now known as the Auckland University of Technology) degree students quickly outnumbered sub-degree student numbers. Across the polytechnic sector the proportion of students studying for degrees rose markedly and part-time student numbers plummeted. This strong movement of the polytechnics in particular into degree level courses would seem to indicate that there was indeed a fair amount of demand for degree level courses that before 1989 was not being met by the universities. The abrupt change in the nature of a number of polytechnics would indicate that a more optimal allocation of resources away from sub-degree programmes and into degree programmes was met by the reforms.

One characteristic of the New Zealand education and training sector in the 1990s has been the growth of private tertiary education providers who have moved very substantially into the vocational education and training sector. By 2002 there were 53,385 formally enrolled students in this sector, constituting 17 per cent of total enrolments. This has created a degree of competition to the government providers that they did not experience prior to 1989. Again, the growth of the private providers was presumably in response to demand by students that was not being met by the government providers. The tertiary education sector in the 1990s, therefore, could be said to be more dynamic in its response to changes in student demand than it had been before 1989. This can be shown simply just by looking at Table 5, which shows the fees for the various business degree and MBA programmes in Auckland. In 1991 the only provider of either of these two qualifications was the University of Auckland. By 2002 there were six separate institutions providing business degrees in Auckland and five MBAs. As can be seen from the table fees vary between the different institutions as do entrance standards. In this one case students obviously have a greater choice of provider as well as variance of programmes, fees and standards.³

This increase in competition and reduced government per student funding has had the affect of intensifying pressure tertiary institutions to improve their levels of efficiency. Table 3 and 4 provide partial and total productivity measures for the New

³ From 2004 the government has set maximum fees that can be charged for domestic students. There is scope for variance in fees beneath the maximum. One potential problem with this approach is that tertiary education providers will respond by creating more places for the uncapped international students and begin restricting places for the capped domestic students.

Zealand universities and polytechnics for the years 1994 to 1995.⁴ In the case of the universities none of the measures (partial indicators like EFTS/General staff, EFTS/Capital or total factor productivity) show any significant improvement. At the polytechnic level the situation is quite different. Over the years 1995 to 2002 the productivity of this sector improved by an average 2.4 per cent per annum. A significant part of this increase was brought about by an increase in the ratio of students to academic staff – which may mean an increase in class sizes – but it is notable that there were also slight improvements in the use of general staff and capital facilities.

Overall the competitive climate in which New Zealand's tertiary education providers operate has been intensified throughout the 1990s. This has meant that they have been brought under more intensified pressure both to directly meet the demands of students and operate at a greater level of efficiency. Even with these changes, however, it should be recalled that the process has been a partial one and therefore the process should probably be seen as being a partial deregulation of the tertiary sector rather than a full deregulatory reform. The major tertiary education providers in New Zealand are still the government owned universities and polytechnics and approximately one half of the funding for tertiary education comes from government subsidies. Finally the polytechnics, colleges of education, wānanga and the private providers are the subjects of regulation by the NZQA.

New Zealand Tertiary Education Regulation

The main regulator of the New Zealand tertiary education market is the NZQA; a central government statutory authority established under the *Education Act 1989*. The role of the NZQA is to provide a framework for the development of quality assured qualifications. This means that the NZQA both develops national qualifications and oversees the providers that deliver them and gives accreditation to the qualifications developed by the providers themselves. As well as registering qualifications of the private and government providers it gives approval to them and audits their delivery. The NZQA does not deal in the funding of providers, which is the responsibility of the Tertiary Education Commission, and it is accountable through the Minister of Education to Parliament. The NZQA in addition has other functions such as the evaluation of overseas qualifications for immigration and employment purposes.

As part of its functions the NZQA has established a Register of Quality Assured Qualifications which provides information for students about the quality assured qualifications that exist in New Zealand, both under its own jurisdiction but also conducted in the universities. The creation of the Register would appear to go some way to providing students with a degree of information about the range of qualifications in New Zealand as well as the degree to which these qualifications meet pre-set standards.

By developing a national system of qualifications students are able to ascertain the nature of courses offered by the various providers. The New Zealand Diploma of

⁴ For a description of the methodology used for the estimations of productivity growth for the universities and polytechnics see the Appendix.

Business for instance is a qualification developed by the NZQA but delivered by a range of universities, polytechnics, wanganu and private providers. These providers are monitored and audited by the NZQA when they undertake these qualifications. Students therefore have an idea about the content and nature of the qualifications regardless of where it is offered. This process helps to reduce the problems of information asymmetry, but it is after all only ever a minimum requirement and provides no more information than that. It for instance provides no information on the relative standing of providers such as a number of international higher education rankings do for overseas institutions and provides students with little information on the basis by which the regulator judges accreditation standards.⁵ As previously mentioned students are given an indication that any accredited provider meets a regulated minimum standard but gives no indication of what that minimum might be.

Licensing and an insistence on a minimum degree of competence is a common response on the part of governments in situations where it is difficult for members of the public to gain reliable independent information about the quality of a product or service. In New Zealand for instance electricians, plumbers, doctors and dentists all have to be registered with a legislated registration board. The general purpose of this approach is to ensure that consumers are able to be certain that professional service providers meet certain standards. The difficulty with this type of regulation is that it can often either impose a significant burden on providers which is then passed onto consumers in the form of added costs and prices or can even be used by providers to exclude entry into the market. This can occur in the cases where the cost of meeting the licensing requirements are too burdensome, which then can have the effect of restricting competition by making new entry too difficult. With the NZQA developed qualifications this does not appear to be the case given that there is now a large number of providers of them, both private and government owned, which implies that entry requirements are not too high. In the case of government and private provider developed qualifications the situation is a little unclear although it should be noted that over the past ten years there has been a very strong development of new degree programmes on the part of the polytechnics and colleges of education which at the very least implies that the entry of new government providers into these under graduate level qualifications is not impossible.

Turning now to the problem the financial viability of institutions the regulations of NZQA would not appear to give students any additional knowledge about providers. In the case of the polytechnics, colleges of education, wanganu and universities it would be expected that the government would bail out any of these that get into financial difficulties, as was the case with the Taranaki Polytechnic in 2001. In the case of the private providers there is no particular regulation imposed by the NZQA that ensures the prudent commercial behaviour on the part of a provider in the way that prudential supervision of the financial sector does. NZQA's regulation instead concentrates more on establishing and maintaining the quality of programmes rather than giving students any knowledge about the degree of risk involved in enrolling

⁵ Examples of ranking include those by Asiaweek (www.asiaweek.com/asiaweek/features/universities2000/) for the Asia-Pacific region, German University Rankings (www.university-ranking.org) for Germany, the Good University Guide (www.times-archive.co.uk/news/pages/tim/2000/04/14/timguggag01002.html) for the United Kingdom, McLean's (www.macleans.ca/universities/index.jsp) for Canada and *Princeton' Review* (www.princetonreview.com/college/research/rankings/rankings.asp) for the United States.

with any particular institution. There is however some provisions in the regulations of private providers that provides students with some protection.

The NZQA has two requirements within its quality assurance standards for private providers that relate to the protection of student fees. The first requirement protects students who choose to withdraw from a course within seven days of it beginning. Private providers must place fees in an independent trust fund for this period. More importantly is the NZQA provision that private providers arrange protection of student fees in the event of insolvency, regulatory or voluntary closure of the provider. NZQA allows for a range of different alternative provisions to be acceptable. These measures include: that students pay their fees after they receive tuition, that fees are paid into an independent trust fund, that insurance policies that protect against the loss of education fees be paid, that providers use fees to purchases guarantees and bonds, or finally that the private provider have a collaborative arrangement with other providers such that students can complete their education elsewhere. None of these arrangements strictly speaking eliminates the possibility of instability occurring. Instead the measures are designed to protect students in the event of institutional failure. They do not make institutional failure any less likely.

In a more market orientated, competitive system commercial failure on the part of private or even government education providers is a possibility. The failure of an institution is not necessarily a bad thing. After all one of the generally accepted benefits of a market is that there is a tendency for inefficient operators to be either forced from the market or taken over by more efficient operators. Resources can then be reallocated to providers, which achieve a greater level of productive efficiency. Difficulties can arise however if the failure of one institution leads to a loss in confidence by students in other, financial sound, institutions. A regulator needs to ensure that institutional failure not spread to other providers. At the same time it must avoid committing itself to the financial support of institutions in that this can lead to the added difficulty of 'moral hazard'. That is the possibility that by promising to financially support institutions in difficulty it might make this more likely by encouraging commercially risky activity.

In the past the NZQA has acted to facilitate the transfer of students from failed providers to others so that they could complete their qualifications at no extra cost. This process is greatly assisted if the provider's qualifications mainly consisted of National Qualifications that other providers deliver. What this does is effectively eliminates the risk to students of attending a provider. Theoretically then instability should not exist if students perceive that the qualifications they are studying for are not tied entirely to the financial success or failure of the provider they attend. If students have this perception then they should not feel as threatened by the collapse of another provider besides their own.

A problem might arise however with the development of qualifications by the providers themselves. Although it might be expected for most programmes to have equivalents at other providers to which students could be transferred in the case of institutional failure this might not always be the case if a private provider engages in the development of innovative programmes. Any statutory provision that providers maintain transfer arrangements might safeguard the interests of students and in most circumstances would be welcomed but might be at the expense of the dynamic

creation of new courses where this could not be established. If the role of the private providers is to create a more dynamic, innovative and competitive tertiary education sector then it would probably not be advisable to impose such a standard on all qualifications even if in most cases it would be of direct benefit to students and to the prevention of instability.

Conclusion

The intensifying of competition in the New Zealand tertiary education market and commercialisation of the New Zealand tertiary education providers would appear to have enabled the creation of a more diversified tertiary education sector. The sector is now more responsive to the demands of students, innovative in terms of programmes provided and better able to cater for a substantially higher number of students; both domestic and international. As well there is an indication that the polytechnics at least have improved their level of productivity over the course of the 1990s. On the down side there is no doubt that the degree of commercial risk has been intensified, not just for the private providers but also for the government providers of tertiary education. Creating a regulatory regime that both reduces the risk to students and provides them with greater information of the various programmes - while at the same time not increasing costs too far and reducing the dynamism of the sector - would seem to be the major concern that needs to be tackled by policy makers in New Zealand. Research on these aspects still needs to be undertaken so that the major benefits of a more competitive tertiary education sector can be achieved while at the same time mitigating the adverse affect of commercialisation. Further research into the impact of the greater levels of commercialisation and competition is also necessary if it is going to be possible to ascertain the degree to which these changes have affected the behaviour of these organisations.