



# The Reasonableness of Fees for Other Widely Used Qualifications

Final Report

1 June 2009

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# 1 Executive Summary

## This report

The Office of the Qualifications and Examinations Regulator (Ofqual) commissioned Grant Thornton to undertake a study to review the reasonableness of fees charged for 'other widely used' qualifications.

The output of this study will inform a number of stakeholders including the Department for Children, Schools and Families (DCSF), the Department of Innovation, Universities and Skills (DIUS), the Learning and Skills Council (LSC), partner regulatory bodies in Wales and Northern Ireland, awarding organisations and a host of interested parties in the education sector including schools, colleges and training providers.

## Background

The March 2006 White Paper 'Further Education: Raising Skills, Improving Life Chances'<sup>1</sup> set out a requirement for the Qualifications and Curriculum Authority (QCA) to lead a review of fees charged by awarding organisations, starting with the fees for GCSEs and A levels, and then progressing to look at the fees for 'other widely used' qualifications.

A firm of accountants was contracted to carry out the first strand of the remit (the 'A levels and GCSEs study') and reported to QCA in December 2006. This study considers the second strand of the remit: the reasonableness of the fees charged for 'other widely used' qualifications.<sup>2</sup> The definition of 'other' qualifications is set in the context of the A levels and GCSE study, namely qualifications 'other than A levels and GCSEs'.

The key objectives of this study are to:

- assess the reasonableness of the fees charged by the awarding organisations for 'other widely used' qualifications
- consider the appropriateness of cost allocation as a method of testing the reasonableness of the fees charged by the awarding organisations for 'other widely used' qualifications
- increase the transparency of fees charged by awarding organisations.

In meeting these objectives, different approaches to assessing reasonableness in the future have also been considered, plus the implications these have for Ofqual.

A range of factors have been used to assess reasonableness including:

- demand side analysis, via an e-survey and through meetings with centres
- supply side analysis, including analysis of how fees are set by awarding organisations and the importance of quality of service

<sup>1</sup> Published 27 March 2006. For further information see: <http://www.dfes.gov.uk/publications/furthereducation/>

<sup>2</sup> The remit covers England only. Nevertheless, Ofqual invited its regulatory partners in Wales and Northern Ireland to participate in the study, and they chose to do so.

- detailed analysis of 33 case study qualifications across 15 awarding organisations. Appendix D lists the case study qualifications, awarding organisations and how they were selected
- assessing the wider characteristics of the market, such as market definition, market shares and concentration and the qualifications landscape.

### The qualifications market

The market for other widely used qualifications is comprised of several thousand qualifications offered by over 130 recognised awarding organisations, suggesting that the market is highly competitive. However, this competition is reduced by factors such as:

- the dominance of a few key players in parts of the market (eg certain qualification types)
- the limited purchasing or buying power of individual centres, evidenced by the large number of centres that on their own represent only a small part of each awarding organisation's business
- the content of qualifications, which can sometimes be different across awarding organisations, making it more difficult for examination centres to switch suppliers
- the disadvantages of examination centres having a high number of awarding organisations (including higher costs such as centre registration costs and external verifier visit costs).

### Factors influencing fees

Awarding organisations tend to consider profitability<sup>3</sup> across the whole of their organisation rather than on a qualification-by-qualification basis, and they set fees accordingly. The process for setting fees differs according to the awarding organisation, with a diverse and complex set of factors influencing the level and structure of fees. Among the most important factors are:

- **Portfolio range:** awarding organisations provide a variety of profitable, less profitable and even unprofitable qualifications. Such cross-subsidy occurs for both educational and commercial reasons (including learner choice and product range)
- **The competition:** the awarding organisations consulted overwhelmingly stated that they consider the fees charged by other awarding organisations offering similar qualifications in order to remain competitive
- **Upfront development costs:** awarding organisations intend to recoup these (and the ongoing running costs) over the lifespan of the qualification and ideally generate a profitable qualification
- **External factors:** generating a profitable qualification is by no means assured as the demand for qualifications is inherently uncertain and subject to changes in public policy. Therefore the profits from successful qualifications are diverted to the development of new qualifications or the subsidising of other, less profitable qualifications.

Several of the case study awarding organisations specifically cited the impact of changes in public policy and an increase in 'regulatory burden' as a significant factor that was likely to influence fees. For example, complying with the National Qualifications Framework (NQF)

<sup>3</sup> The status and business objectives of awarding organisations differ. It should not be assumed that all awarding organisations are profit maximising. For example, many awarding organisations are registered charities.

and, more recently, the Qualifications and Credit Framework (QCF) requires upfront investment and introduces additional risks for awarding organisations. This impact of policy churn should therefore be considered as regulatory options are assessed going forward.

The complexity of fees varies greatly with a number of different fees set, such as registration fees, certificate fees and late fees. Late fees are especially unpopular among the centres responding to the demand side survey, but awarding organisations view them as instrumental in reducing late entries and costs to the overall system. Whilst unpopular with centres, some awarding organisations have commented that the revenue they receive from late fees accounts for only a nominal amount of their overall profit.

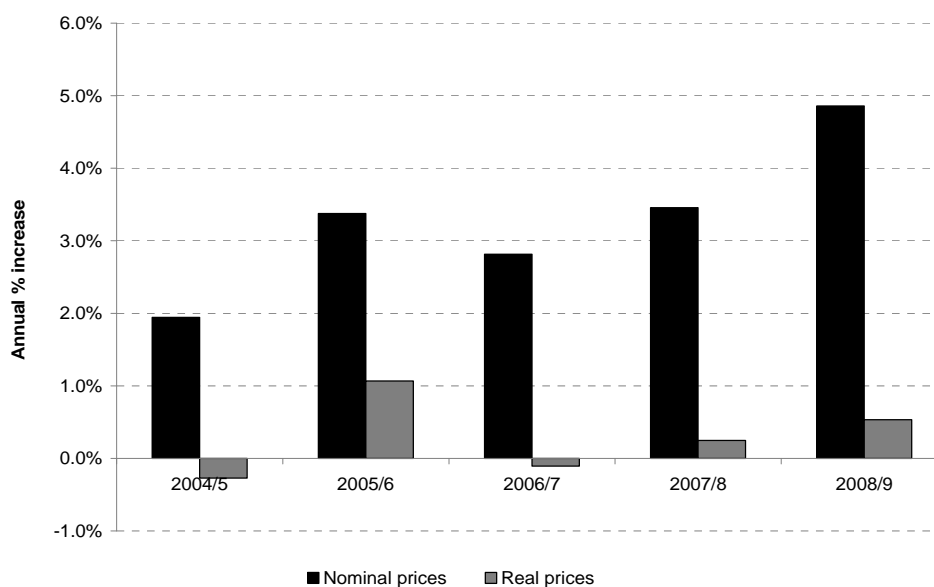
### Trends in fees

Our analysis found that the average increase in fee rates for the 33 case study qualifications was only just above inflation at 3.5% between 2003/4 and 2008/9 (see figure below).

However, the centres perceived this very differently. In our survey, the majority of centres (65%) reported that over the past three years they had perceived an increase (above inflation) in the fees charged by awarding organisations and that the impact of such an increase was an overspend on exam budgets and less funding on resources.

This difference may be due to centres' perception of rising fees based on volumes rather than prices, although it could also be that our 33 case studies – which are typically high-volume qualifications – have fee increases that are lower than the overall market average.

### Annual percentage increase in fee, real and nominal<sup>4</sup>



While the overall picture shows increases in fees of slightly above inflation, the changes in fees for individual products do differ considerably.

Some qualifications decreased in price, others remained static, some showed significant year-on-year increases greater than inflation and others showed one-off jumps rather than a constant incline. The fees charged for the same/similar qualification across different awarding organisations tend to be closely aligned so that there is minimal price differential.

<sup>4</sup> Change from 2007/8 to 2008/9 excludes NVQs due to the influence on fees of the abolition of the NVQ levy.

### Removal of the £10 NVQ levy

The NVQ levy was a £10 charge applied to each NVQ certificate issued by awarding organisations. The levy was intended to support the development of National Occupational Standards. However, the levy was withdrawn with effect from 30 September 2008 when legislation relating to it was revoked.

Removing the NVQ levy has resulted in a decline in fees for NVQs, with fees offered by our case study awarding organisations falling by 3.3% in nominal terms in 2008/9 compared to the previous year (or 7.6% in real terms).

However, the full benefit of the removal of the levy has not yet been felt. We estimate that NVQ fees should fall by 11.0% in real terms, if the removal of NVQ levy is passed on in full. It may be that the abolition of the levy and the associated fall in costs may take more than one year to fully feed through to fees, or that awarding organisations did not pass on the levy to centres in the first place, so its abolition has not impacted on fees.

Much of the demand side was unaware of both the existence and the removal of the £10 NVQ levy. In our demand side survey, 47% of the respondents were not aware that the levy existed and, of those that were aware of the levy, 52% of the respondents did not know that the levy had been removed.

Centres were also asked about the action taken by the awarding organisations used by the centre to supply NVQs:

- For 90% of awarding organisations, centres either did not know what action had been taken (61%) or the awarding organisation had not informed the centres about the removal of the levy (29%).
- Of the remaining 10% of awarding organisations, the respondents reported that 7% had informed the centre that the removal of the levy would result in savings for the centre and 3% had informed the centre that the removal of the levy would not result in savings for the centre.

Note that the results for this question reflect the individual respondent's *knowledge* of the action taken by awarding organisations. The results do not necessarily reflect the action *actually taken* by awarding organisations. That is, the awarding organisations in question could have informed the centre but the individual respondent may not have been aware of this.

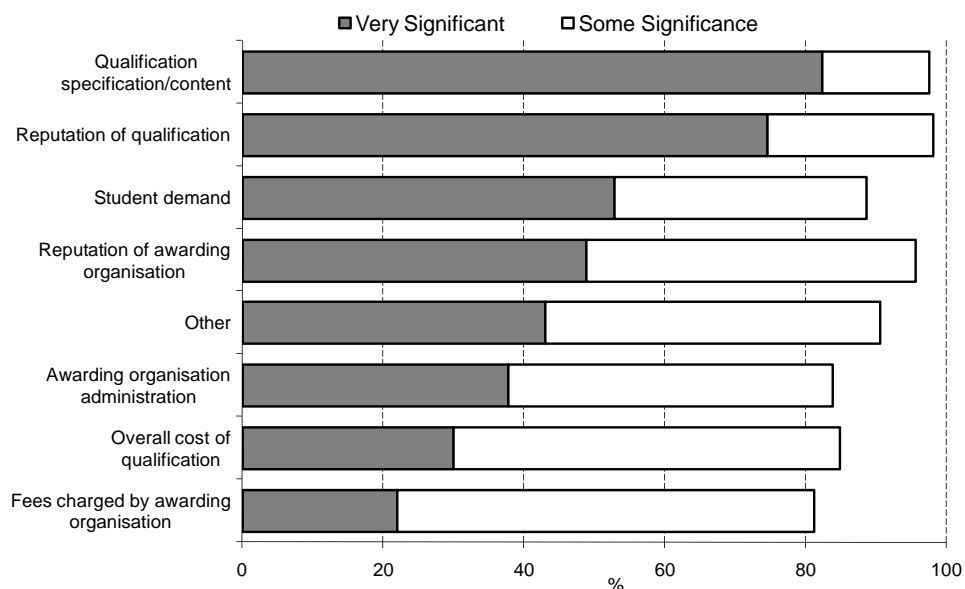
### Quality of service

Perhaps unsurprisingly, the survey results show that 'qualification specification/content' and 'reputation of qualification' were the most significant factors for respondents when choosing a qualification. Over 80% of respondents cited 'qualification specification/content' as being 'very significant' when choosing a qualification.

The fees charged by awarding organisations are also a factor for examination centres when choosing qualifications but to a lesser degree than the other factors. Only 20% of centres cited it as being 'very significant'.

According to the demand side survey, quality of service is the most important factor when changing awarding organisation with over 28% of centres citing it as a reason for the change.

### Factors affecting the choice of qualifications that the centre offers



The demand side survey also highlighted that the majority of centres are satisfied with the service and product they are receiving for the fee they are paying. Nonetheless several concerns with the quality of service were highlighted. These mainly related to the use of call centres and the lack of one-to-one contact with someone at the awarding organisations who could assist efficiently and responsively.

### Financial analysis

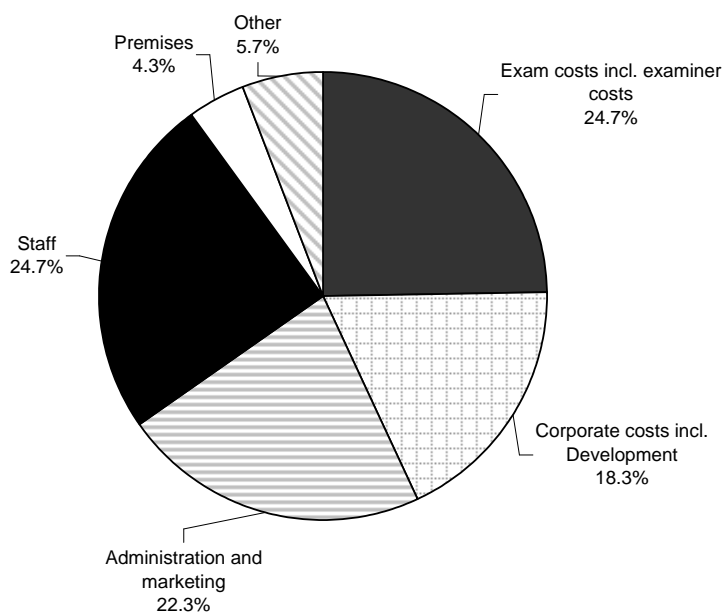
The case study awarding organisations tend to consider profitability across the whole range of their qualifications, and offer profitable, less profitable and even unprofitable qualifications to meet the demand from centres for broad learner choice and clear learner progression routes. Both high and low volume qualifications are also offered to the market for similar strategic reasons around choice and depth (eg one awarding organisation stated that, out of approximately 2,000 subject titles offered, around 1,000 are awarded to less than 50 candidates).

Awarding organisations therefore do not tend to allocate their costs and income to individual qualifications. Rather, information is held in one of three ways:

- direct income and costs are not reported on by any discernable division or profit centre that is directly responsible for the provision of qualifications
- direct income and costs are held for a suite of similar qualifications or considered across the whole examinations business and not necessarily split out for other widely used qualifications
- income and cost allocation exercises have been performed in house (for both direct and indirect costs) previously or in response to this project to establish a contribution for a specific qualification.

The cost breakdown of a typical qualification can be segmented into direct and indirect costs. Examination costs can usually be directly allocated to individual or small groups of qualifications. The remaining proportion are all indirect or overhead costs which are generally not attributed to individual qualifications.

### Cost breakdown of a typical qualification



Using cost allocation techniques, we assessed the profitability of each of the case study qualifications, considering the direct income received for the qualifications, the direct costs incurred for the qualifications and an apportionment of the indirect costs occurred across all the activities of the awarding organisation. \*\*\*\*\*

#### Wider issues on future regulation

Some of the case study awarding organisations raised concerns about the method of using cost allocation to assess reasonableness and said that it should not be used in future. Awarding organisations argued that cost allocation is not a business need, does not accurately reflect how an awarding organisation is run and is difficult and problematic, most notably because:

- a high proportion of fixed costs (property, marketing, corporate costs etc) cannot be accurately allocated to individual qualifications
- the strategy of offering a portfolio of qualifications, means that high volume profitable qualifications typically cross-subsidise low volume uneconomical qualifications.

Going forward, a number of options for future regulation were raised during the course of this study, either by awarding organisations, centres or other interested parties. In particular that:

- the qualifications market(s) should be formally defined and then only investigated in areas where competition concerns are identified. Awarding organisations differ in their views of just how competitive the market(s) is, from a belief that the market is highly competitive, to a belief that there probably are issues with certain parts of the market(s), which should be investigated

- the competitiveness and transparency of the market should be improved. For example, a web-enabled comparison site could be used by both centres and awarding organisations and as a means for customers to raise quality of service complaints
- the introduction of an annual proforma detailing the financial results of each awarding body's UK qualifications business should be considered. This would enable Ofqual to monitor the market in a consistent manner and help it identify where there are, if any, competition issues.

### Conclusions on reasonableness

A judgment of whether fees are reasonable should take into account the following range of factors.

#### **i) Competition and market structure**

The extent of competition in the market is dependent on characteristics such as market power, concentration, market shares, substitution and barriers to entry. Crucial to this analysis is an appropriate definition of the market.

Our opinion is that the split that separates A levels and GCSEs from other vocational qualifications may not be an appropriate definition in economic competition policy terms as there is a level of both demand and supply side substitution between them. In our opinion, it would be more appropriate to define the market in terms of the sector subject framework. Sector/subject areas are the series of categories based on industry sectors and academic subjects used to classify qualifications.

Under this definition, our conclusion is that the market is both fragmented and concentrated. There are on average more than 20 awarding organisations in each sector, but in nearly half of the 15 sectors, the largest awarding organisation has a market share in excess of 40%. Such a market definition should be explored further and tested with primary research and further evidence gathering.

#### **ii) Changes in fees charged by awarding organisations compared with inflation**

The level of increase in fees for the case study qualifications was only just above the rate of inflation. Over the 2003-2008 period, the average increase in fees for the qualifications selected was 3.5% per annum and only 0.3% per annum in real terms (ie excluding RPIX inflation).

However, the case study qualifications were generally mature qualifications so it is possible that the increase in our sample is lower than the average annual increase in fees for the whole market for other widely used qualifications. Detailed fee analysis has only been performed on the fees for the case study qualifications.

#### **iii) Views from the demand side on whether fees are reasonable**

There is a perception from the demand side that fees charged by awarding organisations have increased excessively, with 65% saying they had perceived an increase above inflation over the past three years. Clearly this perception may not be accurate, given that fees from our sample of qualifications have largely risen in line with inflation. Indeed, our visits to centres, demonstrated that there was often a lack of knowledge of the exact total or unit fee paid to different awarding organisation.

#### **iv) Cost reflective and cost efficiency**

This considers whether fees charged by awarding organisations reflect the level of costs incurred by awarding organisations and whether the costs incurred are efficient. On cost

reflectivity, we conclude that awarding organisations do not have a clear understanding of the total costs involved in delivering qualifications at the individual product level.

Cross-subsidisation from profitable to less profitable (and even unprofitable) qualifications is therefore likely to be common. This was confirmed in our discussions with awarding organisations and through our financial analysis. Reasons for such practices appear to be around providing qualification choice and range to students and centres, as part of awarding organisations charity obligations, rather than as a specific strategy to reduce competition and compete unfairly.

Some awarding organisations do compile data on the direct income and costs of individual qualifications but do not as a rule allocate indirect costs to individual products and then use this information for the purpose of setting fees.

Awarding organisations take a more holistic approach to setting fees, taking into account the fees set by their competitors, the willingness of the market to bear a particular price and the need to provide a portfolio of qualifications.

There are some public policy concerns around cross-subsidy – namely that public funds are being used to cross-subsidise qualifications but the decision on which products should benefit and by how much occurs within awarding organisations. Decisions on cross-subsidies should ideally be driven by the policy objectives of the regulator or by government policy.

#### **v) Overall financial return made by awarding organisations**

The overall return made by awarding organisations across all businesses activities ranges from -20% to 31% return of sales (a three-year average). While the overall return figures should be treated with care, they do show that there is no systematic overall basis in the industry towards excess profits – some awarding organisations make significant profits but others make losses.

#### **vi) Profitability of individual qualifications**

The previous study on A levels and GCSEs used a cost allocation approach to assess the level of profitability made by awarding organisations on individual qualifications. The cost allocation approach was used and tested for this study into other widely used qualifications. The cost allocation approach has a number of limitations: the accounting information held currently does not tend to be of the required granularity and awarding organisations tend to focus on suites or portfolios of qualifications.

The willingness of some awarding organisations to provide timely, transparent and sufficiently detailed information magnified the weakness of this approach. We conclude therefore that, due to these drawbacks, the results from the cost allocation process should not be used in isolation to conclude on reasonableness but alongside other evidence (as illustrated above).

#### **vii) Overall conclusions**

An overall conclusion that all or most fees for other widely used qualifications are either reasonable or unreasonable in our opinion is not helpful, as it underplays the complexity and dynamic nature of the market. Such an absolute conclusion would require a high threshold of evidence and an overwhelming case for or against the hypothesis. But our study has found that the picture is far more mixed and that there is not the weight of evidence to conclude with certainty one way or the other.

There is some evidence towards the reasonableness case. The fees charged for the case study qualifications are not rising at a significantly higher rate than inflation, there is no systematic basis in the industry towards excess profits and individual qualifications are priced in relation to a portfolio of products rather than to extract excess profits. But this does not equate to reasonableness. The perception, among 65% of the centres sampled for this study, that fees are rising faster than inflation remains and the question on the competitive nature of some parts of the market, which are dominated by a small number of players, is of concern.

Going forward, we believe that centres need more clarity regarding the fees they are paying so that they can make their own assessment as to whether they are reasonable. They also need confidence that the market is operating effectively and that, where this is not the case, that they have a right of recourse. Awarding organisations also need some respite from the continual changes in public policy on qualifications and confidence that future regulation will be proportionate and not burdensome. The recommendations below have been developed with consideration for this conclusion.

### Recommendations

The short-term recommendations are:

- 1. Define the market(s):** Ofqual should define the market(s) within the qualifications landscape and then consider further market investigations as necessary. A potential market definition could begin by looking at qualifications on a sector basis.
- 2. Consider building a price comparison website to educate the consumer:** Ofqual should consider whether it is beneficial and practical, given the complexity in prices and services offered, to introduce a price comparison website, potentially by building on the National Database of Accredited Qualifications.
- 3. Consider implementation of light-touch Accounting Separation:** Ofqual should consider whether it would be beneficial to require awarding organisations which have a turnover above a certain threshold to return an annual proforma setting out a basic profit and loss statement for their UK accredited qualifications business.

The medium-term recommendations are:

- 4. Understand product development costs.** Ofqual should seek to build up an evidence base on product development costs by encouraging awarding organisations to share with Ofqual (on a confidential basis) any information they have on the costs involved in developing new qualifications.
- 5. Develop service standards.** Ofqual should work with the QCA to define levels of service that centres should expect to receive from awarding organisations for the fee they are paying.
- 6. Introduce a procedure for handling competition complaints.** Ofqual should introduce a set procedure through which centres, learners, awarding organisations and other relevant organisations can raise competition complaints and other quality of service issues. This should relate and link to existing Competition Commission and Office of Fair Trading processes, as well as being monitored alongside Recommendation 5.

Other options for consideration are:

7. **Monitor awarding organisations' financial performance.** Ofqual should, via statutory accounts, monitor the financial performance of each awarding organisation's whole business.
8. **Benchmark the efficiency of awarding organisations' costs.** Ofqual should monitor the efficiency of costs incurred by awarding organisations through the use of financial and employee benchmarks.
9. **Develop a timetable for the publication of fees.** Ofqual should require that fees for other widely used qualifications for each academic year are published in advance in a similar fashion to the publication of fees for A levels and GCSEs.
10. **Produce best practice guidance for invoices.** Ofqual should work with awarding organisations and centres to improve the invoicing details that centres receive from each awarding organisation.
11. **Improve awarding organisations' visibility of costs and revenues.** Some awarding organisations do not have visibility of the costs and revenues associated with the supply of their qualifications. Ofqual should work with these organisations to improve the granularity of cost information held and promote relevant accounting systems and best practice where appropriate and cost effective.
12. **Understand the decision-making process of centres.** The process can be complex. To fully understand it and to investigate if efficiencies could be made, Ofqual should undertake or commission case studies of the centres' decision-making process.

## 2 Introduction

### 2.1 Background

The March 2006 White Paper 'Further Education: Raising Skills, Improving Life Chances'<sup>5</sup> set out a requirement for the Qualifications and Curriculum Authority (QCA) to lead a review of fees charged by awarding organisations, starting with the fees for GCSEs and A levels, and then progressing to look at the fees for 'other widely used' qualifications.

A firm of accountants<sup>6</sup> was contracted to carry out the first strand of the remit (the A levels and GCSEs study) and reported to QCA in December 2006.

This project considers the second strand of the remit – the reasonableness of the fees charged for 'other widely used' qualifications.<sup>7</sup> The key objectives of this study are:

- to assess the reasonableness of the fees charged by the awarding organisations for 'other widely used' qualifications (OWUQ)
- to consider the appropriateness of cost allocation as a method of testing the reasonableness of the fees charged by the awarding organisations for 'other widely used' qualifications
- to increase the transparency of fees charged by awarding organisations.

### 2.2 The A level and GCSE study

The A level and GCSEs study concluded that at "*the highest level the fees charged by the Awarding Bodies are considered to be reasonable as there are no significant profits being made*".

In assessing the reasonableness of fees, the A level and GCSE study used the methodology of attributing costs and revenues to individual qualifications. This is commonly referred to as cost allocation. The process of cost allocation works by identifying indirect (ie overhead and central) costs and revenues in the financial accounts of the awarding organisation (eg those not related directly to the examination business of the organisation) and then allocating them to the individual qualifications selected for review. The resulting analysis enables an assessment of profitability for individual qualifications.

### 2.3 Definitions

#### Awarding organisations and examination centres

An awarding organisation (also referred to as an awarding body) is an organisation or consortium recognised by Ofqual to award accredited qualifications. The term 'examination centre' or 'centre' is used to refer to schools, colleges and training providers who are delivering qualifications (offered by awarding organisations) to individual learners.

#### Reasonableness

The definition of fees reasonableness used by PKF for the A level and GCSEs study depended on an assessment of the profitability of fees, plus consideration of other factors.

<sup>5</sup> Published 27 March 2006. For further information see: <http://www.dfes.gov.uk/publications/furthereducation/>

<sup>6</sup> Review of Awarding Bodies' Fees, PKF, December 2006.

<sup>7</sup> The remit covers England only. Nevertheless, Ofqual invited its regulatory partners in Wales and Northern Ireland to participate in the study, and they chose to do so.

The definition was based on an assessment of whether awarding organisations were generating normal profits. Essentially, prices were compared against costs to ascertain whether profits earned are similar across the industry and to other benchmarks.

This project considers whether or not it is appropriate or meaningful to apply the cost allocation methodology (described above) in isolation to 'other widely used' qualifications. The following factors describe why this methodology, in isolation, may not be appropriate:

- Awarding organisations do not tend to consider costs and revenues at this degree of separation (ie for individual qualifications)
- Awarding organisations tend to offer whole suites of qualifications to enable both learner choice and clear progression routes even though some qualifications may attract a much lower level of demand. Consequently, some qualifications may be highly profitable whereas others may incur substantial losses.

Therefore this study has used a range of factors to assess reasonableness including:

- a review of the qualifications landscape
- supply side analysis
- demand side analysis
- financial and product analysis for a selection of 33 case study qualifications across 15 awarding organisations.

#### **Fees charged**

A variety of fees are charged, including examination entry fees, centre approval fees and moderation and verification visit fees. In addition, late registration fees can also be charged when candidates are registered after the closing dates. While all types of fees are commented on, the analysis of the trends in fees (Chapter 6) concentrates on the fees charged that relate directly to the achievement of the qualification (eg registration / certificate fees).

#### **'Other' qualifications**

The definition of 'other' qualifications is set in the context of the A levels and GCSE study and means qualifications 'other than A levels and GCSEs'. The National Database of Accredited Qualifications lists 15 types of other qualification. These are:

- Basic Skills
- Other General Qualification
- English - for speakers of other languages
- Entry Level
- Diploma
- Vocationally Related Qualification (VRQ)
- Free Standing Maths Qualification
- National Vocational Qualification (NVQ)
- Occupational qualification
- Higher Level
- Principal Learning
- Project
- Functional skills
- Advanced Extension Award

– Key Skills

These qualification types comprise approximately 8,000 active qualifications covering the range of different qualification levels (Entry Level, Level 1 to 8), 15 different sectors and a range of guided learning hours (short courses and longer courses). The different levels and types are discussed in Chapter 4.

'Widely used' qualifications

While this project considers more than the profitability of individual qualifications, 33 individual qualifications (across 15 awarding organisations) have been selected for detailed analysis. These case study qualifications have been selected because they are 'widely used'. The methodology for the project, including the basis for selecting the case study qualifications, is discussed in more detail in Chapter 3.

Diplomas and National Diplomas

The Diploma is a new qualification. Five subjects were introduced in September 2008 and by 2013 there will be 17 subjects in total.

National Diplomas refer to already established work-related qualifications including BTEC qualifications and OCR Nationals. The case study qualifications selected for this project are National Diplomas and not the new Diplomas.

2.4 Evidence base

Part of the evidence base for this project is information that is sourced and provided by the case study awarding organisations. This information has been received in good faith and has been taken at face value. The information provided by the case study awarding organisations has not been audited by Grant Thornton.

2.5 Information received from the case study awarding organisations

We would like to thank all of the case study awarding organisations for contributing both financial and qualitative data. While views differ about the approach taken, all awarding organisations willingly gave time and thought to addressing the questions.

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## 2.6 Report structure

The rest of this report is structured as follows:

- **Chapter 3 – Methodology:** An outline of our methodology with regards to selecting the case study qualifications, the survey of centres and the approach to cost allocation.
- **Chapter 4 – The qualifications market:** An outline of the structure of the qualification market in the UK.
- **Chapter 5 – Key issues when setting fees:** An outline of the ways in which awarding organisations set fees and factors that are considered.
- **Chapter 6 – Trends in fees:** An outline of the types of fees charged by the case study awarding organisations and the changes in those fees over recent years.
- **Chapter 7 – Quality of service:** This considers the services, and differential services, offered by the case study awarding organisations.
- **Chapter 8 – Financial analysis:** An outline of the financial analysis of the case study awarding organisations.
- **Chapter 9 – Wider issues around future regulation:** Highlights a number of wider or strategic regulation issues which were raised during the course of this project
- **Chapter 10 – Reasonableness:** A summary of our overall conclusions on reasonableness and our recommendations. The recommendations have been formulated as a result of the findings and conclusions contained in the previous chapters and relate to actions that Ofqual could take with regard to the overall qualifications market and specific actions on both the supply and the demand side.

## 3 Methodology

The approach used to assess reasonableness includes a review of the qualifications landscape, demand side analysis, supply side analysis and detailed financial and product analysis for a selection of 33 case study qualifications across 15 awarding organisations.

### 3.1 Demand side analysis

A demand side e-survey has been used to assess the views of the centres on the reasonableness of fees for other widely used qualifications. The survey results provide insight into how centres select awarding organisations, how satisfied they are with awarding organisations' products and service delivery, the impact of any increases in the fees charged over the past three years and the impact on centres of the removal of the NVQ Levy.

The survey was first piloted with a sample of 15 examination centres. The final survey was sent to finance directors of colleges in England and also to the membership lists of three stakeholder organisations: the Association of Colleges, the Association of School and College Leaders and the Association of Learning Providers.

A total of 170 centres completed the entire survey, with 222 centres completing some or most of the survey, as summarised below. Of the 222 respondents, 43% defined themselves as exam officers, 42% as vice principals or heads of departments, 5% as principals, 5% as finance directors and 4% as teachers or lecturers.

**Table 3.1: Summary of survey responses**

Centre Type	Number of responses
General Further Education College	109
School	48
Sixth Form College	29
Work Based provider	29
Other	7
<b>Total</b>	<b>222</b>

The quantitative results for the survey have been integrated into the report within the appropriate chapters. As well as the quantitative results, the survey also allowed respondents to provide qualitative comments. In particular, whether they had any suggestions on how awarding organisations could improve their services. The most representative qualitative responses have also been incorporated into appropriate chapters.

### 3.2 Supply side analysis

#### Assessment of the overall financials of the awarding organisations

We have assessed the overall financials by considering the Return on Sales (ROS) for each case study awarding organisation. For this study, we have defined ROS as:

$$ROS = \frac{\text{Earnings Before Interest and Tax}}{\text{Turnover}}$$

Earnings Before Interest and Tax (EBIT) is calculated as operational profit after depreciation and overheads but before interest costs (net of receipts) and taxation. We have excluded exceptional items in arriving at the EBIT. The ROS measure excludes tax and interest (payments and receivables) since these two items are likely to distort the true operational performance of the companies. It is a measure of the profit margin on sales and as such items which are liable to distort this view are excluded. Turnover is defined as reported sales value net of discounts and sales taxes.

#### Assessment of other factors

Reasonableness cannot be assessed on price alone. This is particularly the case as the fee charged is not the only driver or even the main driver for centres when selecting qualifications and awarding organisation. Other factors, including quality of service and the educational offering, are paramount. Evidence for this assessment has been taken from the demand side e-survey of centres and the qualitative submissions from the selected awarding organisations who were asked to provide:

- details of the services provided for the selected qualifications(s)
- details of the services provided for the selected qualifications(s), which are different to those provided by competitors and any charges for these services
- details of quality assurance policies and procedures and any other systems used to ensure that a satisfactory level of service is provided to examination centres in the UK.

The project team discussed qualitative issues in bilateral discussions with awarding organisations and held a small number of workshops to investigate key issues.

### 3.3 Supply side analysis

#### Product analysis for the case study qualifications

Where the information was supplied, we have undertaken a financial product analysis exercise for the case study qualifications. The analysis has derived an estimate (or estimates) of the profitability of the selected qualification(s).

The analysis to derive a profitability for all of the case study qualifications could not be completed for every qualification. This was due to the nature of, or lack of, information supplied by some of the awarding organisations (see Section 2.5 for details of the information supplied by each awarding organisation.) Where the analysis was undertaken, it was performed by identifying the direct revenue and costs that are associated with the qualification. Where this was not possible due to the reporting systems of the respective awarding organisations, an allocation method was agreed upon – for example, the number of qualification entries for the selected qualification compared to the total number of qualification entries across the organisation. This results in an estimate of the contribution of the qualification using qualification entries as an allocation driver.

Indirect costs (for example, overheads and central functions) were then identified and allocated again using the most appropriate driver. For example, exam verifier costs may be based on total enrolments, or IT costs may be based on the number of full-time equivalents

in the relevant department. Appendix D gives a detailed explanation of this methodology and Figure 3.1 below outlines the key steps in the approach.

**Figure 3.1: Calculation of the contribution for each case study qualification**

1. Identification	2. Attribution	3. Allocation	4. Checking
<ul style="list-style-type: none"> <li>• Revenues and costs</li> <li>• Management accounts</li> <li>• Awarding bodies cost allocation</li> </ul>	<ul style="list-style-type: none"> <li>• Regulated versus non-regulated</li> <li>• Attributable costs</li> <li>• Overheads and central functions</li> </ul>	<ul style="list-style-type: none"> <li>• Non-attributable revenues and costs</li> <li>• Overheads and central functions</li> <li>• By qualification</li> <li>• By subject</li> </ul>	<ul style="list-style-type: none"> <li>• 'P&amp;Ls' by subject</li> <li>• Management accounts</li> <li>• Awarding bodies cost allocation</li> <li>• Reconcile to published accounts</li> </ul>

#### Selecting the case study qualifications and awarding organisations

The consideration of the qualifications in scope was critical to ensure the results of the project were meaningful. Excluding A levels and GCSEs, there are approximately 8,000 active qualifications that could have been selected for detailed analysis. In ensuring a valid selection of 'other widely used' qualifications, we have sought to obtain a representative sample while retaining a manageable scope.

The methodology of selecting the 33 qualifications and 15 awarding organisations was based on three main drivers:

- Number of certificates (an indicator of usage)
- Guided learner hours (GLH) (to reflect qualifications that impact most on centres and ensure that the sample was not skewed towards short duration qualifications)
- Qualifications type (to ensure that the sample was not dominated by a few high volume types).

Our approach was based on an analysis of detailed qualifications data provided by Ofqual, combined with a focused survey of centres<sup>8</sup>. The data analysis involved identifying qualifications using GLH multiplied by certificate numbers as the indicator of most 'widely used'. The survey involved development of a questionnaire and the collection of data from centres via telephone, face-to-face and email contact. This was used to validate the data analysis.

A more detailed description of the methodology is included at Appendix D, alongside a list of the 33 case study qualifications and the 15 case study awarding organisations.

<sup>8</sup> Note that this was an additional survey to the e-survey mentioned above.

## 4 The qualifications market

### 4.1 Overview

The UK has a national and centrally led examination systems regulated by: Ofqual in England, the Department for Children, Education, Lifelong Learning and Skills (DCELLS) in Wales, the Scottish Qualifications Authority (SQA) in Scotland and the Council for the Curriculum Examinations and Assessment (CCEA) in Northern Ireland.

A wide range of qualifications (both accredited and non-accredited) are offered by awarding organisations (both recognised and unrecognised). These qualifications are delivered by training providers (FE colleges, schools, work-based providers) to individuals or learners, or by employers directly to their workforce. The individuals, who can be grouped generally as the 14-19 age group, employees and adult learners, are the ultimate consumers of the qualification. Qualifications, awarding organisations and training providers are discussed in more detail below.

### 4.2 The qualifications

This report concerns recognised awarding organisations and accredited qualifications. As of September 2008, there were over 8,000 active accredited qualifications available for individuals to study<sup>9</sup>. Qualifications can be described in terms of their type and their level.

#### Qualification types

Qualifications with distinctive structural characteristics are grouped together under specific types. The qualification types available (other than A Levels and GCSEs) as per the National Database of Accredited Qualifications are:

- Basic Skills
- Other General Qualification
- English - for speakers of other languages
- Entry Level
- Diploma
- Vocationally Related Qualification
- Free Standing Maths Qualifications
- National Vocational Qualification
- Occupational qualification
- Higher Level
- Principal Learning
- Project
- Functional skills
- Advanced Extension Award
- Key Skills

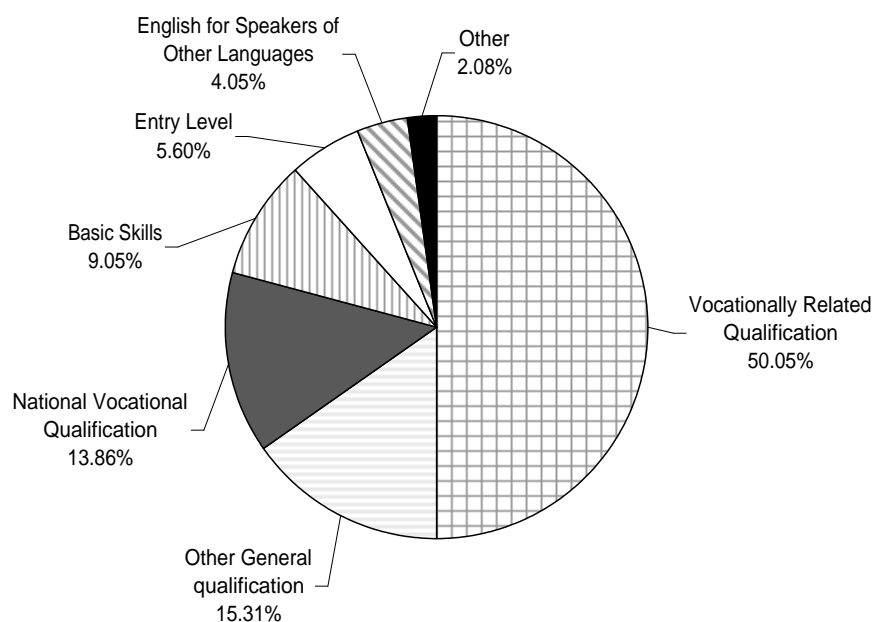
All NVQs are work-related, competence-based qualifications. They are based on National Occupational Standards (statements of performance that describe what competent people in a particular occupation are expected to be able to do). In contrast, Key Skills qualifications

<sup>9</sup> Ofqual qualifications database providing a snapshot for September 2008, extracted in December 2008, taken from Annual Qualifications Market Report, Ofqual, 2009.

demonstrate that the candidate has skills that are commonly needed for success in a range of activities in education and training, work and life in general.

The figure below illustrates that, from all the certificates awarded in the 2006/07 academic year, approximately 79% were from three qualification types: 50% were VRQs, 15% were other general qualifications and 14% were NVQs.

**Figure 4.1: Certificates awarded by qualification type (academic year 2006/07)**



Source: Ofqual database

In addition to their type, qualifications can also be distinguished by their level.

#### Qualification levels

Qualification levels are positioned within the National Qualifications Framework (NQF) and/or the Qualifications Credit Framework (QCF).

#### National Qualifications Framework

The NQF "sets out the levels against which a qualification can be recognised in England, Wales and Northern Ireland"<sup>10</sup>. All accredited qualifications are awarded an NQF level. If a qualification shares the same level as another qualification this means that they place a broadly similar demand on the learner. However, qualifications at the same level can still be very different in terms of content and duration. The NQF comprises nine levels: entry level to level 8, the latter being the most demanding.

#### Qualifications and Credit Framework

The QCF is "a new framework for recognising and accrediting qualifications in England, Wales and Northern Ireland"<sup>11</sup>. It is a vehicle that awards credit for qualifications and units (the individual components of a qualification). The aim of the QCF is to enable people to gain qualifications at their own pace along flexible routes.

<sup>10</sup> Definition taken from the National Qualifications Framework factsheet at: <http://www.qca.org.uk/libraryAssets/media/qca-06-2298-nqf-web.pdf>

<sup>11</sup> Definition taken from: [http://www.qca.org.uk/qca\\_8150.aspx](http://www.qca.org.uk/qca_8150.aspx)

The comprehensive range of type and level of qualifications suggests that there is no lack of choice for learners in choosing qualifications to study. Furthermore, new qualifications are always in development. For example, September 2008 saw the introduction of five subjects or 'lines of learning' for the new Diploma, with a further five available from September 2009.

#### Qualification choice

As noted above, at the highest level, there is a significant amount of choice for learners in choosing qualifications to study. Of course, on closer inspection the choice available to an individual is reduced as, for example, a learner is unlikely to view a Level 2 NVQ in Health and Social Care as an appropriate substitute for a Level 2 NVQ in Providing Security Services.

The choice a learner makes will of course also be informed by which qualifications the training providers they want to use are delivering because, while the learner is the ultimate consumer, it is the training provider that delivers and buys the qualification from the awarding organisation.

The training provider has to choose which qualifications to offer (and will need to be responsive to the demands from learners and from employers) but also has to choose which awarding organisation to use from all those that offer the chosen qualifications.

The amount of choice of which awarding organisation to use varies across qualifications. For example, on the National Database of Accredited Qualifications, there are currently six awarding organisations offering the Level 2 NVQ in Health and Social Care compared to 16 awarding organisations offering the Level 2 Key Skills in Application of Number qualification.

### 4.3 Awarding organisations

The Ofqual Annual qualifications market report from April 2009 recorded 130 recognised awarding organisations (as at September 2008) offering qualifications accredited by the regulatory authorities in England, Wales and Northern Ireland. In addition, the number of unrecognised awarding organisations is substantial.

#### Choice of awarding organisation

There are approximately 130 recognised awarding organisations – a fairly sizeable number. However, the choice of which of these organisations to use very much depends on the qualification and the number of organisations that offer it.

Although there are advantages to having multiple awarding organisations – such as wider choice of qualifications, competition encouraging price reduction and improved customer services – there are also disadvantages. These disadvantages are cited in the PwC report and include "*confusion among learners and employers, administrative burden on centres (as they have to pay multiple centre registration fees and handle different procedures), and the perception that the market is becoming more price rather than quality driven.*"<sup>12</sup>

#### Competitor balance

The 130 awarding organisations are not all true competitors of each other. This is because the group of recognised (and unrecognised) awarding organisations consist of a small number of very large players and many smaller and often more specialised organisations. For example, according to the PwC report, City & Guilds has the largest share of the NVQ market with 37% of awards made in 2003-04, and almost half of all NVQs are awarded by City & Guilds and Edexcel (47%), even though their titles account for 37% of the total

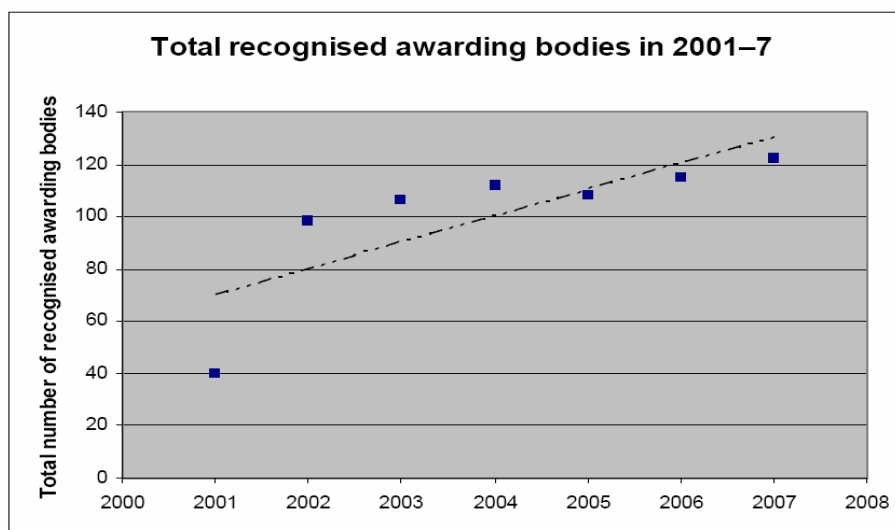
<sup>12</sup> PricewaterhouseCoopers, The Market for Qualifications in the UK, April 2005, 6-3.

numbers of NVQ titles in the Framework<sup>13</sup>. Note that this example considers NVQs only – from all the certificates awarded in the 2006/07 academic year, approximately 14% were NVQs. Competitor balance and market structure are considered in more detail below.

#### Changes in the number of awarding organisations

The number of recognised awarding organisations operating in the landscape is increasing, as shown in the graph below.

**Figure 4.2: Total recognised awarding organisations in 2001-07<sup>14</sup>**



Source: QMIS qualifications database, extracted for snapshot in September of each year.

While this graph suggests barriers to entry are low, that mainly depends on which part of the market an awarding organisation is trying to enter. Barriers may be relatively low in niche, specialised areas, but higher in more established parts dominated by the larger awarding organisations. For example, a new entrant wanting to offer National Diplomas would face higher barriers to entry due to the:

- **scale and experience of the established organisations.** A new organisation may struggle to differentiate itself (and its offering of qualifications) from a well-established organisation with years of experience in offering qualifications
- **the regulatory environment** which will add to the costs for organisations – for example, having qualifications accepted onto the regulated frameworks
- **the high costs of developing qualifications.** Awarding organisations cite that the costs of developing new qualifications are significant and that these costs are gradually recovered over the lifecycle of the qualification. Therefore, if a qualification is developed that does not succeed, the awarding organisation is not able to recover the bulk of the development costs.

#### 4.4 Training providers

Training providers – that is FE colleges, schools, work-based providers and employers – are the buyers of qualifications even though the learner is the ultimate consumer. As stated previously, the extent of their choice of which awarding organisation(s) to use depends upon the qualifications they choose to offer.

<sup>13</sup> PricewaterhouseCoopers, The Market for Qualifications in the UK, April 2005, 4-2.

<sup>14</sup> QMIS qualifications database, taken from Annual Qualifications Market Report, Ofqual, 2008.

The choice of which awarding organisation to use will depend a number of factors including the service offered and the fees charged but primarily on the specification and content of the qualification. These factors are discussed in more detail in Chapter 7.

We received a range of views from centres about the extent to which choice and competition existed, or indeed was valuable. The following quotations from the demand side survey illustrate this. They have been selected because they are representative of the centres' views of the qualifications market:

- *"There is no benefit currently to a college putting the needs of the learners first in the awarding body structure, as only way to reduce cost is to go with one awarding body and use purchasing power"*
- *"There are too many awarding bodies. If we are approved as a centre for the delivery and assessment of qualifications this should be sufficient for all awarding bodies. The administration required is out of proportion and does not reflect the fact that we have been a reliable, credible centre for 40 years."*
- *"The exam boards have an oligopoly if not monopoly situation so the idea that you can shop around to get a good service is a limited concept"*
- *"I am very unhappy with the poor consultation [redacted] has with its schools and colleges. It is a quango which seems out of touch with the world of education"*

#### Changing awarding organisations

Centres commonly switch between awarding organisations. Some of the case study awarding organisations reported that this occurred frequently. However, arguably, in some areas the ability to change to a different awarding organisation is diminished by the limited range of alternatives and also by the cost of switching supplier. For example, one of the reasons given by centres in the demand side survey for choosing qualifications was that there was only one awarding organisation providing a particular qualification.

The ease of switching is likely therefore to be dependent on the specifics of the qualification. For example, when a training provider switches supplier, the teaching staff may have to do significant amounts of work as the specification or content of the qualification may differ. Some qualifications, on the other hand, have a degree of enforced homogeneity which make this less of an issue. For example, all NVQs are based on National Occupational Standards.

Respondents to the demand side survey were asked which factors encouraged them to change to a different awarding organisation. The results are illustrated in the table overleaf.

**Table 4.1: Factors influencing the change in awarding organisation**

Factor	Number of responses
Quality of service from awarding organisations	104
Reputation of awarding organisation	50
Fees charged by awarding organisation	46
Reputation of qualification	46
Student demand	46
Qualification specification/content	41
Overall cost of qualification	34
Don't know	8
<b>Total</b>	<b>375</b>

Note: Centres were provided the list of available factors and could select more than one factor.

'Quality of service from awarding organisations' was the main factor, cited 104 times (28% of the total). 'Reputation of awarding organisations' was the next most cited factor (50 times or 13%). The 'Fees charged by awarding organisations' was cited 46 times (12% of the total).

#### Influence over awarding organisations

There are a substantial number of training providers. In addition to work-based providers and employers, there are over 450<sup>15</sup> FE colleges in England and Wales and over 3,000<sup>16</sup> state secondary schools in England. Because of this, the buying influence of any individual provider is fairly small – no one individual provider purchases a significant portion of any awarding organisations offering. Therefore the ability to negotiate discounts or other benefits can be reduced, although some training providers do receive certain volume discounts from awarding organisations. However, the view from one case study awarding organisation was that, while centres do have buyer power, they do not use this as effectively as they could.

#### 4.5 Learners

The learners are the ultimate consumers of qualifications. Training providers provide the interface between the learners and the awarding organisations. The training providers therefore choose the qualifications based partly on the demands of the learner. Most awarding organisations do not interact directly with the learners. While the learner is the ultimate consumer, it is the training provider that is viewed as the customer by the awarding organisation.

#### 4.6 Market definition

##### Background and theory

The assessment of market definition is formally undertaken by starting with the narrowest definition of the market (ie an individual product or set of products) and then considering whether a hypothetical monopolist can permanently increase its profits by raising its prices by around 5%-10% above competitive levels<sup>17</sup>. If so-called 'demand side substitution' takes place – where a significant number of consumers switch to other products – then these other products should be bought into the market.

This process is continued until no other products can be included in the market and this is taken to be the definition of the market. As well as demand side substitution, it is also necessary to consider supply side substitution and geographic substitution. If products are

<sup>15</sup> <http://www.lsc.gov.uk/Jargonbuster/FE+colleges.htm>

<sup>16</sup> <http://www.dcsf.gov.uk/popularquestions/questions.cfm?keywords=how%20many%20schools&gatewayCategoryId=11&mainCategoryId=0&expandID=8503&new=0#8503>

<sup>17</sup> This is referred to as the hypothetical monopolist test.

substitutable due to supply, demand side or geographic substitution then they should be considered to be in the same market.

In practice, it is often not possible to collect quantitative data to apply the monopolist test. Instead, markets are often defined using a wider range of evidence. For example, the Office of Fair Trading considers interviews with customers, the costs involved in switching, patterns in price changes and price elasticities to be important in determining market definition.

### The market for qualifications

We have undertaken a characteristics-type analysis of the market, which involves describing in qualitative terms the likely consumer and supplier behaviour (see Appendix C), based on our discussions with awarding organisations, centres and representative groups on how the market, for both consumers and suppliers, works.

Our conclusion is that the current definition of at least two markets (one for A levels and GCSEs and one for all other accredited qualifications) is probably not appropriate. This is because A level and GCSE qualifications can be substituted for other widely used qualifications. For example, a BTEC in Art & Design could be considered a likely substitute for an A level in Art. Furthermore, qualifications that are the same qualification 'type' and 'level' should not necessarily be regarded as substitutes for each other. A Level 3 NVQ in Beauty Therapy is clearly not substitutable for a Level 3 NVQ in Accounting.

We believe that a more appropriate market definition would be to consider the market as a collection of separate sector-based markets. In our opinion, students or centres are unlikely to switch from one sector to another when faced with a price rise of 5% or 10%. The subjects matter, teaching and assessment methods differ significantly across the distinct sectors, and employers and educational institutions do not view them as substitutable.

The question of supply side substitution between sectors is more problematic. There is clearly evidence and examples of awarding organisations switching from one sector to another. However, the crucial point in competition policy terms for products to be considered in the same market is for such market entry to take place at short notice<sup>18</sup>: "*Supply side substitution can be thought of as a special case of entry – entry that occurs quickly (eg less than one year), effectively (eg on a scale large enough to affect prices), and without the need for substantial sunk investments*". In our opinion, when a product is increased by 5%-10% in price, it is very unlikely that another awarding organisation will enter that market in less than a year. The lead times for product development and curriculum development all suggest that it takes much longer.

### Implications for market indicators

When the market is defined as 15 separate sector markets, it is quite concentrated. The largest awarding organisation has a market share in excess of 40% in seven sector markets and has a market share in excess of 50% in three sectors.

This shows that significant market power (SMP) could exist, depending on the market definition finally agreed for the market. SMP is defined as a market where the largest operator has a share of 40% or more and is a key indicator of market power.

<sup>18</sup> Market Definition, Office of Fair Trading (March 1999).

**Table 4.2: Market structure statistics for OWUQ when defined according to sector**

Market	Number of AOs	Average market share	Maximum market share
Health, Public Services and Care	38	2.6%	40.2%
Science and Mathematics	11	9.1%	37.2%
Agriculture, Horticulture & Animal Care	24	4.2%	58.3%
Engineering and Manufacturing Technologies	32	3.1%	47.7%
Construction, Planning and the Built Environment	16	6.3%	58.0%
Information and Communication Technology	19	5.3%	35.2%
Retail and Commercial Enterprise	31	3.2%	26.8%
Leisure, Travel and Tourism	29	3.4%	22.0%
Arts, Media and Publishing	30	3.3%	40.5%
History, Philosophy and Theology	10	10.0%	68.3%
Social Sciences	10	10.0%	39.7%
Languages, Literature and Culture	19	5.3%	43.7%
Education and Training	34	2.9%	37.4%
Preparation for Life and Work	31	3.2%	31.3%
Business, Administration and Law	53	1.9%	17.3%
<b>Average</b>	26	4.9%	40.2%

There are other possibilities which would need to be explored further. For example, one awarding organisation stated that it is important to consider the end point in describing the market since centres will consider end points and learner progression routes as qualifications are marketed in this way. If markets were defined in an even narrower sense than sectors, such as by both level and sector (ie over 100 separate markets), the level of concentration would increase to a greater level still.

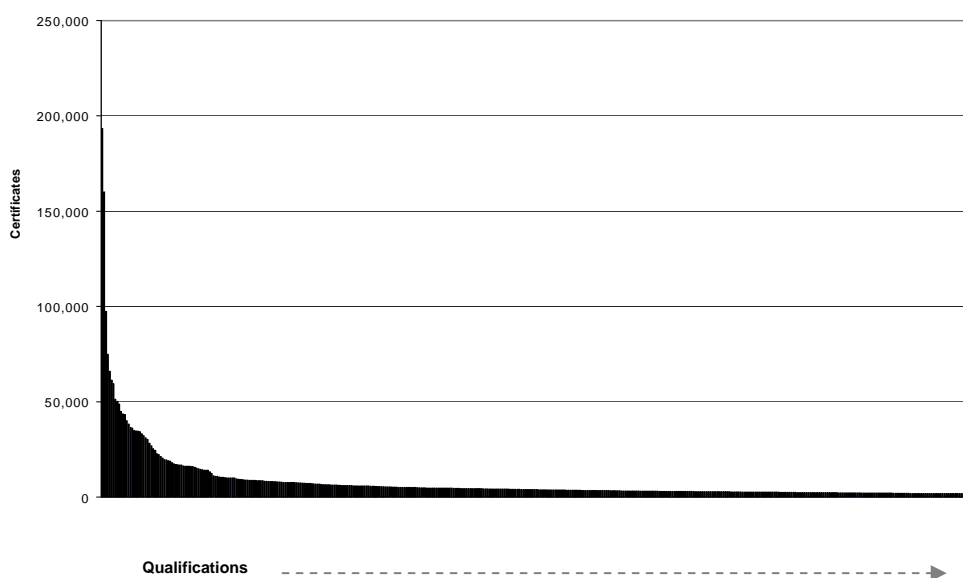
Under such a definition, general and vocational qualifications are both separate and overlapping depending on the sector considered.

#### Qualifications by volume

The figure below shows the number of certificates awarded in the 2006/07 academic year for every accredited qualification<sup>19</sup>. Each qualification is represented by one vertical bar on the graph showing how many certificates were awarded for that qualification. Note that due to the volume of qualifications (several thousand are illustrated on the graph) individual bars and qualifications cannot be clearly defined. This demonstrates that, while over 4.5 million certificates were awarded, the market for these is concentrated and fragmented with only 66 qualifications having 10,000 or more certificates awarded. These 66 qualifications represent 46% of all the certificates awarded in 2006/07. The figure indicates the wide portfolio of qualifications that are offered by awarding organisations and delivered by training providers.

<sup>19</sup> Note that data excludes certificates for A levels, GCSEs, Keys Skills and Advanced Extension Awards and only captures qualifications with 1,000 or more certificates awarded.

**Figure 4.3: Number of qualifications by volume (certificates awarded), 2006/07 academic year<sup>20</sup>**



#### 4.7 Conclusion

The qualifications landscape consists of several thousand qualifications which are offered by over 130 awarding organisations to the training providers. This would suggest that the landscape is a competitive one. However this competition is reduced by the following key factors:

- Elements of the landscape (eg certain qualification types) are dominated by a few key players
- The high number of training providers mean that their individual purchasing or buying power is limited
- The content of the qualification is of key importance and as this can be specific to the awarding organisation, which can make it difficult for a training provider to switch supplier.

While it is generally beneficial for a market to have a larger number of competitors, there can sometimes be drawbacks. For example, for the training provider, there can be disadvantages associated with higher costs such as centre registration costs.

In terms of market definition, if the landscape used thus far is considered as one qualifications marketplace, there is a danger of employing too simplistic and too wide a classification. The qualification market(s) can perhaps be better understood as all those qualifications within the same sectors. Further consideration of the market(s) for qualifications should be carried out to test this definition. Markets which show symptoms of insufficient competition under an agreed definition would then be investigated.

A number of those consulted suggested that a more holistic view should be taken when studying the issues of fees reasonableness. In particular, looking at the total costs and wider impact of policy changes on the overall qualifications system.

<sup>20</sup> *ibid.*

## 5 Key issues when setting fees

### 5.1 Overview

This section sets out the considerations of awarding organisations when setting the fees of other widely used qualifications. In this section we consider:

- how awarding organisations set the fees for other widely used qualifications
- the key factors that affect the costs to awarding organisations of delivering other widely used qualifications
- the risks that are considered by awarding organisations when setting the fees for other widely used qualifications.

In addition to existing research, the information provided in this section has been sourced from the individual submissions received from, and discussions held with, the awarding organisations involved in the study. Information has also been sourced from the workshops held at the awarding organisation event run by Ofqual in November 2008.

### 5.2 Setting the fees

#### Types of fees and charging

Awarding organisations charge a variety of different fees (eg registration fees, certificate fees, late fees) and the complexity varies greatly from one awarding organisation to another. Fees can be charged to examination centres, employers or individual leavers. For example:

- ABRSM charges exam fees and no other type of fee. There is one fee for each graded music exam which is valid for each calendar year. These will be payable by the individual learners or by the examination centre. ABRSM uses approved regional centres to which candidates go to take the exams.
- In contrast, AAT has a wide range of different fees ranging from exam fees, membership fees, late fees to emergency situation fees. Fees may be charged direct to learners or their employers, or to examination centres.
- OCR gives two options for its NVQ qualifications. One option involves paying a candidate registration fee and then paying an individual unit fee as you go. The second option involves a one-off payment covering both the candidate registration and certification fee for a lower total cost. Similarly OCR's National Diplomas can either be paid per unit or through a full qualification fee.

Therefore the price actually paid by an examination centre, an individual, or an employer, will depend on factors other than simply entering for an exam, such as the number of retakes, late and very late entries.

Centres view the clearer publication of fees (including late registration fees) on a unit by unit basis as important. This was also considered necessary for centre approval and external verifier visit fees.

### Late fees

Many awarding organisations charge fees for late entry and this has been cited as unpopular in our discussions/surveys with examination centres. However, late fees have been instrumental in reducing the number of late entrants which have a cost to the overall system.

Late fees vary significantly between awarding organisations. For example, while VTCT charges just £2 for a late fee, other awarding organisations charge double the existing registration fee. In addition, some of the case study awarding organisations said that revenue from late fees accounted only for a nominal amount of their overall profit. Late fees are charged by awarding organisations to both incentivise on-time entries and to cover the cost of the additional administration.

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The demand side survey highlighted the unpopularity of late fees. While centres appear to acknowledge that late fees have a purpose, there is a concern that they are excessive and that awarding organisations could be more supportive when late fees are incurred in certain circumstances. This is illustrated by the following quotations which have been selected because they are representative of the comments received from centres about late fees:

- *"The level of late charges seems disproportionate to the level of work performed by the Awarding Bodies as a result of late entries. (I am writing as someone who worked for over 10 years in a senior position with an awarding organisation)"*
- *"Late fees have a purpose but they are out of proportion in many cases and the AB provides little flexibility. Although we have minimal late fees at our centre, there are occasions with adult learners particularly enrolment late/change entries due to circumstances yet there is no support for this from the awarding organisation"*

### Setting fees

The awarding organisations involved in the study were asked how they set the fees for the other widely used qualifications they offer. The factors generally considered were:

- competitor fees
- transparency across a suite of qualifications
- general economic factors
- consideration of the direct and indirect costs
- to generate resources to meet overall business objectives
- to avoid making low volume qualifications unaffordable.

### Competitor fees

The case study awarding organisations overwhelmingly said that, when setting their fees, they consider the fees charged by competitors for similar qualifications to ensure that their products are competitively priced. This was further evidenced by findings from the awarding organisation event where representatives from awarding organisations made the following points:

- *"pricing [is] based on [the] sector [and] what can it stand as a cost"*
- *"[awarding organisations] set costs at what is considered optimum for [the] sector/provider/ learner"*

- *"benchmarking against existing qualifications, market forces and knowledge of [the] type of learner and their circumstances"*

#### **Transparency across a suite of qualifications**

Qualifications need to be offered at different levels (including Entry Level, Level 1, Level 2 and so on) and have been identified at the granularity for this project. However, awarding organisations will typically provide a qualification not only at one level, but across a suite of levels. This is true even where, say, the Level 1 qualification is in much greater demand than the Level 2 qualification. An awarding organisation could not responsibly provide only the Level 1 qualification without also providing the qualification at higher levels, as learners need identified progression routes.

Some of the awarding organisations stated the need to provide price transparency across this suite despite variances in cost and demand: *"[We] cannot reasonably offer this qualification without also offering levels 1 and 2, even though the latter are much less frequently demanded."*

#### **General economic factors**

Again, the awarding organisations overwhelmingly stated that general economic factors affect the fees that they set. The factors that were cited included RPI/CPI, average earnings, base rate and pension costs. This is further evidenced by the PKF study which found pension costs to be a specific risk to awarding organisations: *"There have been significant increases in Awarding Body pension costs over the last number of years and this is expected to continue into the future....These increased costs are currently borne by most of the Awarding Bodies. In order to reduce the impact of the increased costs the Awarding Bodies need to generate more income through increased fees."*<sup>21</sup>

#### **Consideration of the direct and indirect costs**

The direct and indirect costs of providing other widely used qualifications were cited as a consideration by several of the case study awarding organisations. This is to be expected and is likely to be considered by all awarding organisations. Other awarding organisations cited the need to generate resources to meet overall business objectives (discussed below) – by looking at the costs and revenues holistically rather than on a qualification by qualification basis.

#### **Generate resources to meet overall organisational objectives**

The awarding organisations in the study have a variety of different structures and natures, varying from charities to companies. The objectives of each organisation are likely to vary with the structure and nature. For example, a company's objectives will generally be to maximise shareholder profit whereas a charity will generally aim to break-even with surpluses required to fund future investment (to invest in new qualifications), to improve delivery (modernisation/new technology) or to recover past losses/provide some mitigation against risks.

For example, the objectives for one not-for-profit awarding organisation (Cambridge ESOL) are *"to provide language learners and teachers in a wide variety of situations with access to a range of high quality international examinations, tests and teaching awards, which will help them achieve their life goals and have a positive impact on their learning and professional development experience."*

Relevant comments from the case study awarding organisations included:

- *"[we] revise the fees as necessary to ensure that the total anticipated income for the organisation is sufficient to achieve the overall annual financial targets".*

<sup>21</sup> Review of Awarding Bodies' fees, PKF, December 2006, p52.

- *"our approach to setting fees is somewhat independent of the characteristics of individual qualifications... fees for individual qualifications are set... in such a way as to generate total revenue to meet objectives"*.

**Cross-subsidy**

Cross-subsidy means that, although the cost of providing one qualification is higher than the cost of providing another qualification, the respective fees charged for the qualifications do not reflect this. The margin earned on each qualification will therefore be different. Effectively, the provision of one qualification is supporting the provision of another less profitable or even unprofitable one.

Several of the case study awarding organisations reported the need to avoid making low-volume qualifications unattractive (which would jeopardise their future viability) by making them unaffordable through high fees. Consequently, it would appear that cross-subsidisation is very common and that some awarding organisations consider it a necessity to *"keep fees for groups of similar qualifications aligned, in order to avoid distorting educational choices in schools and colleges and keep fees simple and transparent"*.

On a similar basis, one awarding organisation stated that *"Fees are uniform throughout the UK, despite significant differences in the costs of examining in more geographically remote parts of the country. They vary internationally with the strength of demand for our services and the local economic circumstances."*

One of the main roles of regulators is to avoid unfair cross-subsidisation<sup>22</sup> between or among different classes of customers or unfair cross-subsidisation of a competitive service by a non-competitive service that creates competition concerns. For example, a business could use the profits it makes in one sector to support low prices in other markets where it faces more competition. If the business was dominant in a market, cross-subsidy may lead to anti-competitive practices such as predatory pricing and selective price cutting.

In the context of the business of providing qualifications, some awarding organisations argue that cross-subsidisation is necessary to provide a suite of qualifications at similar prices so that learner decisions are based on educational choice rather than price.

Cross-subsidisation is common in many regulated industries for political, social or economic reasons (such as a decision to subsidise tariffs for low-income customers).

<sup>22</sup> Cross-subsidisation in itself is not restricted by competition law. Rather, it is the anti-competitive practices (eg predatory pricing) which often occur alongside cross-subsidisation that cause the concerns.

### Discounts/penalties

The demand side survey asked respondents whether they had received any discounts or incurred any penalties in the previous financial year. The results are shown in the table below.

**Table 5.1: Discounts and penalties**

Centre type	0% - 5% discount on fees	5% - 10% discount on fees	Greater than 10% discount on fees	Late registration penalties	Don't know	Other
Further Education College	11	4	1	75	20	3
Other	1			2	2	2
School	3		1	32	8	3
Sixth Form College	7			13	4	2
Work Based Provider	8		2	3	7	8
<b>Total</b>	<b>30</b>	<b>4</b>	<b>4</b>	<b>125</b>	<b>41</b>	<b>18</b>

A total of 38 centres stated that they received discounts from awarding organisations in the last financial year, with the majority of discounts being between 0% and 5%. Four FE colleges said they received discounts of between 5% and 10% and a total of four respondents stated that they received a discount of greater than 10%. In contrast, 125 respondents reported that they had incurred late registration penalties.

The results show that a relatively small number of fee discounts are received by centres. This is supported by views from the case study awarding organisations who generally, although not exhaustively, stated that they did not offer discounts and that the advertised fees were the fees paid by centres.

### Other considerations

Other considerations noted by the awarding organisations include the following:

- The need to consult with centres, representatives, schools and teachers
- The likelihood of the need to discount fees to win business. This suggests that awarding organisations set their fees taking into account the fact that they will need to apply discounts to some customers
- Future prospects or the lifespan of the qualifications. For example, a qualification with a lifespan that has become limited (due to a change in public policy, for instance) may subsequently attract a reduced number of entries. The awarding organisation may raise fees to support the qualification over its remaining reduced lifetime
- Strategic intent (the length of time over which a qualification would be delivered or expected to be delivered). One awarding organisation stated that this impacted the fee set
- Benchmarking. While benchmarking against other qualifications was raised at the awarding organisation event, one awarding organisation submitted that it used other sector-specific, historic benchmarks.

### 5.3 Factors affecting the costs of other widely used qualifications

The lifecycle cost base of other widely used qualifications can largely be split into development costs and running costs (both direct and indirect). These are each discussed in more detail below.

#### Development costs and the lifecycle costs of qualifications

A qualification will typically incur high upfront costs during the research and development phase, during which no revenue is received. When the qualification is ready to be rolled out and is delivered, the awarding organisation will then incur running costs which are at least partly offset by the revenue received from examination fees. Therefore the high upfront costs are recouped over the lifecycle of the qualification. However, the varying lifespan of qualifications means that some may never become profitable, whereas other successful mature qualifications are likely to become highly profitable.

Awarding organisations state that they do not know with certainty what the lifespan of any given qualification will be. A qualification may cease to exist due to changes in public policy, or anticipated demand may never be realised.

Some of the awarding organisations involved in this study have commented that they would expect the case study qualifications selected for this study to be highly profitable, earning a significant gross margin. This is because the sample comprises 'widely used' and therefore successful, mature qualifications. As one awarding organisation stated: "*The most widely used qualifications tend to be those that have been developed successfully over time, and thus their present economies are based on a long history of investment, development, refinement and marketing, which is often not reflected in current-year financial accounts.*"

In contrast, an awarding organisation may also be delivering a suite of qualifications that are currently unprofitable and indeed may never become profitable. The future for qualifications in development is uncertain: for example, future demand is not a certainty with the new Diplomas. Awarding organisations at the workshops cited examples of qualifications that they had developed only to find subsequent demand insufficient. In effect therefore, the profits from the well-established qualifications are diverted to the development of new qualifications or the subsidising of other, less profitable qualifications.

So while the cost allocation exercise considers the profitability of specific qualifications at a point in time (for the previous financial year), it is also important to consider the organisation as a whole for the awarding organisations involved in the study. Both sets of financial analysis are considered in Chapter 8.

#### Running costs: direct

The direct running costs involved in the delivery of other widely used qualifications are cited as a key consideration when setting the fees. Direct costs are those that are directly related to the delivery of a qualification and that would therefore vary with the number of qualifications delivered. Major direct running costs cited by the awarding organisations (in their responses and via the workshop) include, but are not limited to, examiner/assessor costs, production of examination papers, venue hire fees, examiner travel and accommodation expenses.

#### Running costs: indirect

Indirect costs take into account all associated costs, including the overheads, necessary to maintain an accredited examination board within the UK. This includes, for example, overheads incurred from running an office and finance, IT and HR functions. Indirect running costs are also cited as a key consideration when setting the fees. Many of these

indirect costs will be fixed and will relate to a wide variety of qualifications delivered in the UK and, possibly, overseas.

Both the direct costs and indirect running costs (though not the development costs) have been considered in detail for the qualifications in scope via the cost allocation exercise. However, awarding organisations do not tend to consider the direct and indirect running costs incurred at an individual qualification level. Rather, the organisation, and its objectives, are considered as a whole. This is considered further below.

#### 5.4 Risks relevant to setting fees

The key risks that are considered by awarding organisations when setting fees include public policy changes, development risk and demand risk<sup>23</sup>.

##### Public policy changes

Public policy changes may lead to both the withdrawal of existing qualifications (for example, as with GNVQs) and the introduction of new qualifications that need to be developed by awarding organisations. In addition, public policy may lead to changes in the qualifications demanded – for example, the policy around encouraging uptake of the new Diplomas may lead to a reduction in the demand for A levels and GCSEs. As such, the revenue received by awarding organisations for existing, and possible profitable qualifications, may be reduced with there being no guarantee that the qualifications in development will succeed.

Developments and changes in public policy were cited as a significant risk factor for awarding organisations and as therefore being very likely to influence fees. The need to comply with the NQF, and more recently the QCF, were cited specifically as examples of this.

##### Development risk

New qualifications may need to be developed for a number of reasons, notably in response to a change in public policy (for example, as with the new Diplomas) or in response to a request from a Sector Skills Council resulting from a needs assessment as part of their sector qualifications strategy. An awarding organisation involved in the development of a new qualification will incur significant development costs that, as described above, will only be recouped over the lifecycle of the qualification. The lifespan of a qualification is however uncertain and there is also a risk of low take-up.

##### Demand risk

The demand for qualifications is often uncertain. While certain qualifications may be needed for regulatory purposes (and therefore subject to a more firmly projected demand), others, particularly new qualifications, incur a high demand risk. A similar finding was made by PKF with reference to the diploma: "*Not only is the cost of investment in the diplomas uncertain, but there is also uncertainty about what the level of demand will be.*"<sup>24</sup>

#### 5.5 Conclusions

The business of delivering qualifications incurs high upfront development costs. Awarding organisations intend to recoup these (and the ongoing running costs) over the lifespan of the qualification and in general manage profitability across a portfolio. This is by no means an easy task as the demand for qualifications can be uncertain and subject to the risk of public policy change.

<sup>23</sup> The issues around these risks with regards to awarding organisations' views on future regulation are discussed in Chapter 9.

<sup>24</sup> Review of Awarding Bodies' fees, PKF, December 2006, page 7.

The profits from successful qualifications are often diverted to the development of new qualifications or the subsidising of other, less profitable qualifications which are provided to improve learner choice, to make prices transparent across a suite of qualifications and to avoid making low volume qualifications unaffordable.

As such, awarding organisations tend to consider profitability across the whole of their organisation or suite of qualifications – rather than on a qualification-by-qualification basis – and set fees accordingly, taking into account the fees charged by other awarding organisations in order to remain competitive.

## 6 Trends in fees

### 6.1 Overview

This chapter considers the components of the fees that awarding organisations charge to centres. Specifically, it documents the trends in the fees charged for the case study qualifications. In addition, the relevant results from the demand side survey are discussed, as is the removal of the £10 NVQ levy.

### 6.2 Components of fees

There is not one single fee that examination centres are subject to for other widely used qualifications. Centres can incur centre approval fees, registration fees, certification fees, late entry fees and external verifier visit fees, among others. Fees are bespoke to the awarding organisations. For example, one of the case study awarding organisations charges an exam late change fee, an exam late entry (after main closing date) fee and an exam very late (register additions) fee. In addition, some awarding organisations charge differential rates for the same type of fee. For example, OCNW charges lower rates to full and associate members than to non-members (such as approved centres).

Late fees may not be incurred by all centres but are payable on a contingent basis for late registrations. There is a very significant variation in the extent of late fees charged, with some awarding organisations charging double the original fee and others charging negligible fees, or not charging late fees at all.

The demand side survey asked centres to consider all fees. The discussion of the supply side results focuses on the fees charged that relate directly to the achievement of the qualification such as registration or certificate fees.

### 6.3 Fees to centres and fees to individuals

Certain fees are incurred at a qualification level (registration or entry fees, for instance) while other fees, such as external verifier visit fees and centre approval fees, are incurred at an awarding organisation level. This means that a centre may be able to benefit from using fewer awarding organisations as they will have to pay, for example, fewer centre approval fees and fewer external verifier fees. The disadvantages of having multiple awarding organisations were cited in the PwC report as including the "*administrative burden on centres (as they have to pay multiple centre registration fees and handle different procedures)*"<sup>25</sup>. In addition, using fewer awarding organisations may increase the buying power of that centre. As one centre in the demand side survey commented, "[The] only way to reduce cost is to go with one awarding body and use purchasing power."

Awarding organisations may deal exclusively with centres even though benefits are offered to learners. A lifetime membership fee may apply that enables the learner to become a member of the awarding organisation. For example, learners can become members of VTCT, AAT and Construction Skills. The centre will often contract with the awarding organisation to pay this fee – Construction Skills, for example, deal exclusively with centres – and it is then for the centre to consider whether any fees are recharged to the learner. Other awarding organisations may deal direct with either a centre or a learner. For example a learner can contract individually with ABRSM.

<sup>25</sup> PricewaterhouseCoopers, *The Market for Qualifications in the UK*, April 2005, 6-3.

## 6.4 Trends in fees and fee rates

### Demand side results

According to the demand side e-survey, 65% of centres perceive that the fees charged by awarding organisations are increasing at a rate higher than inflation. However, this is not backed up by an analysis of the average fee rates for the selected qualifications. The average fee increase for case study qualifications over the past five years was 3.5% per annum, which is only just above inflation.

The demand side survey asked respondents: "Over the past three years has the centre seen an increase (above inflation) in the fees charged by awarding organisations?" The results are shown in the table below.

**Table 6.1: Over the past three years has the centre seen an increase (above inflation) in the fees charged by awarding organisations?**

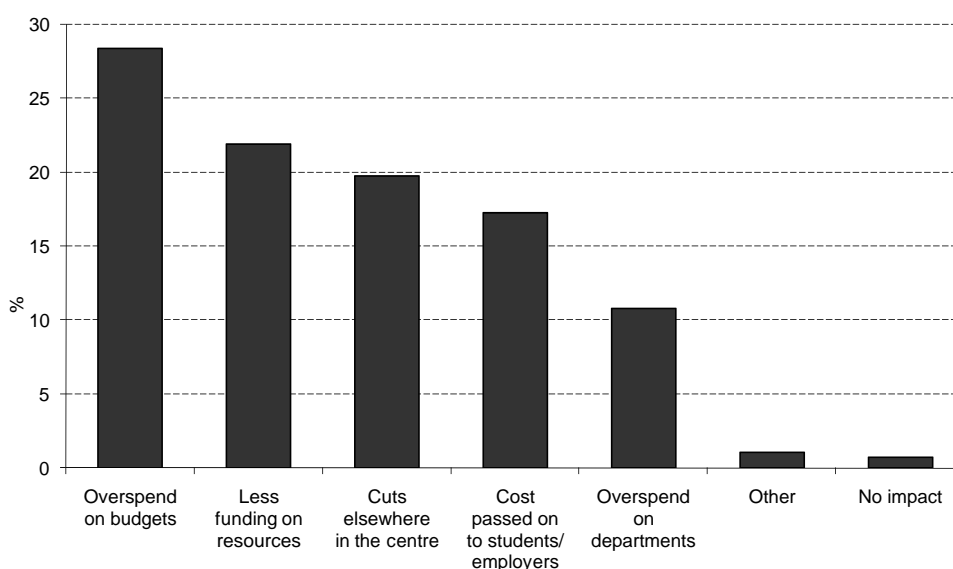
Centre type	Yes	No
School	89 %	11 %
Further Education College	79 %	21 %
Work Based Provider	77 %	23 %
Sixth Form College	72 %	28 %
Other	60 %	40 %
All	65 %	35 %

\* Note: respondents who answered 'Don't know' have been excluded from the analysis in this table.

Out of the 205 centres who responded to the question, 65% said they had perceived an increase (above inflation) in the fees charged by awarding organisations over the past three years, 19% responded that they didn't know whether they had seen an increase (above inflation) and 17% reported that they had not seen an increase (above inflation).

Respondents who answered that they had seen an above inflation increase in the fees charged by awarding organisations were then asked about the resulting impact on the centre. The results are shown in the figure below.

**Figure 6.1: What has been the impact on the centre of the increase in fees?**



The greatest impact (28% of the total) was an overspend on exam budgets, followed by less funding on resources (22%) and cuts elsewhere in the centre (20%). Meanwhile, 17% of responses stated that the increased costs were directly passed onto the end user (student or employer).

Approximately 1% of responders gave other effects of an increase in fees. These included fewer student numbers, a reduction in the scope of qualifications/units that students opt to take, a bias towards selecting funded courses and an increase in the exams budget to cope with the increase in costs.

### **6.5 Summary of fees charged**

The table below summarises the core level of fees for the case study qualifications for the previous five years and the data behind the charts discussed previously. The table and charts use the published fee information provided by the awarding organisation. Note that we have not accounted for any changes in service delivery or any enhancements to qualifications.

Where more than one route is available for the same qualification we have, for clarity, included all of the routes (for example, Full Route and Unit Route). However, one of the case study awarding organisations noted that the Full Route options tend to be more widely used than the Unit Route option for qualifications.

Table 6.2: Summary of fees charged

Number	Qualification	Awarding Organisation	Notes	2003	2004	2005	2006	2007	2008
1	Level 2 Award in Food Safety in Catering	CIEH		N/S	6.75	7.05	7.65	7.99	8.93
		RSH		N/A	N/A	N/A	10.00	10.50	11.00
		RIPH		N/A	N/A	N/A	9.50	10.50	11.00
2	Level 2 Key Skills in Communication	Edexcel	F	12.50	12.95	14.50	14.95	16.15	16.60
		City & Guilds (3638-01 Full Route)	E	13.50	18.00	18.70	19.10	19.60	20.10
3	Entry Level Certificate in ESOL Skills for Life	TCL (Entry 2)	A	N/A	N/A	43.50	45.00	45.00	48.00
		Cambridge ESOL (Entry 2)	A	N/S	36.00	37.20	39.60	43.00	45.30
		City & Guilds (3692-02) Entry 2	A	14.00	15.00	15.60	16.00	16.40	17.00
		City & Guilds (3692-07) Entry 1-3	A	24.00	25.00	26.00	26.60	27.30	28.30
4	Level 2 Intermediate Construction Award	CSkills Awards	B	75.00	75.00	75.00	75.00	75.00	62.50
5	Foundation Graded Examination in Music Performance	ABRSM	C	N/S	28.00	29.00	30.50	31.70	33.10
		TCL	C	N/S	27.33	28.50	31.17	33.33	35.00
		TVU	C	N/S	27.17	28.50	29.33	30.33	31.33
6	Level 2 Award in Health and Safety in the Workplace Level 2 Certificate in Health and Safety in the Workplace Level 2 Progression Award in Health and Safety in the Workplace Level 2 Progression Award in Health and Safety in the Workplace	CIEH			6.75	7.05	7.65	7.99	8.93
		OCNW		N/S	23.00	30.00	30.00	30.00	31.00
		City & Guilds (3681-01 Full Route)	G	61.00	63.00	65.40	67.00	68.90	71.30
		City & Guilds (3681-91 Unit Route)	H	125.00	131.00	135.80	139.50	143.00	147.80
7	Level 2 NVQ in Health and Social Care	City & Guilds (3172-21 Full Route)	D	89.50	92.50	93.60	95.90	97.60	91.00
		City & Guilds (3172-91 Unit Route)	D	202.00	111.50	115.60	119.30	121.20	115.20
		Edexcel		84.00	84.00	84.00	84.00	84.00	76.50
		OCR (Unit Route)	D	N/A	N/A	52.60	54.60	61.20	59.00
		OCR (Full Route)	D	N/A	N/A	45.40	50.10	54.50	52.60
8	Level 3 National Diploma for IT Practitioners	Edexcel		130.00	136.50	146.00	150.40	154.90	161.90
9	Level 3 National Diploma in Business	Edexcel		130.00	136.50	146.00	150.40	154.90	161.90
		OCR		N/A	160.70	123.60	129.90	136.30	142.50
10	Level 2 NVQ in Hairdressing	City & Guilds (3014-02 Full Route)		75.50	77.50	80.50	82.40	85.00	77.00
		City & Guilds (3014-52 Full Route with Gola Tests)		N/A	N/A	N/A	109.10	112.60	104.50
		City & Guilds (3014-92 Unit Route)		112.00	117.50	122.20	124.70	128.10	124.50
		VTCT		N/S	56.00	56.00	58.00	61.00	64.00
11	Level 2 Certificate in Electrotechnical Technology	City & Guilds		69.50	70.00	72.80	74.60	75.00	
12	Level 3 National Diploma in Art and Design	Edexcel		130.00	136.50	146.00	150.40	154.90	161.90
	Level 3 National Diploma in Art and Design	OCR		N/A	N/A	N/A	N/A	136.30	142.50
13	Level 2 Certificate in Basic Plumbing Studies	City & Guilds (Full Route)	I	146.50	152.50	158.40	162.20	168.20	213.20
14	Level 3 NVQ in Acoustics	AAT		N/S	28.00	31.00	36.00	38.00	41.00
15	Level 2 NVQ in Beauty Therapy	VTCT (General Route)		N/S	56.00	56.00	58.00	61.00	64.00
		VTCT (Nail Services Route)		N/S	52.00	52.00	58.00	61.00	64.00
		VTCT (Massage Route)		N/S	52.00	52.00	58.00	61.00	64.00
		City & Guilds (3023-02 - Full Route)	D	65.50	67.50	70.20	71.90	74.70	67.00
		City & Guilds (3023-03 Make Up Full Route)	D	65.50	67.50	70.20	71.90	74.70	67.00
		City & Guilds (3023-52 - General Full Route and Online Questions)		88.50	92.50	96.10	98.40	102.30	95.50
		City & Guilds (3023-53 - Make Up Full Route and Online Questions)		88.50	92.50	96.10	98.40	102.30	95.50
16	Level 3 NVQ in Children's Care Learning and Development	City & Guilds (3023-92 - Unit Route)	D	112.00	117.50	122.20	124.70	128.10	124.50
		City & Guilds (3023-93 - Make Up Unit Route)	D	102.50	107.50	111.80	114.10	117.20	124.50
		CACHE (Unit Route)	D	N/A	N/A	N/A	112.00	106.00	108.00
		CACHE (Full Route)	D	N/A	N/A	N/A	90.00	95.00	92.00
		City & Guilds (3171-03 Full Route)	D	104.50	107.50	111.70	114.40	117.40	111.50
	Level 3 NVQ in Children's Care Learning and Development (3171-03)								
	Level 3 NVQ in Children's Care Learning and Development (3171-93)								
	Level 3 NVQ in Children's Care Learning and Development (3171-93)								
		Edexcel		121.00	126.50	131.20	134.60	138.00	132.60
				110.00	110.00	110.00	110.00	110.00	103.00

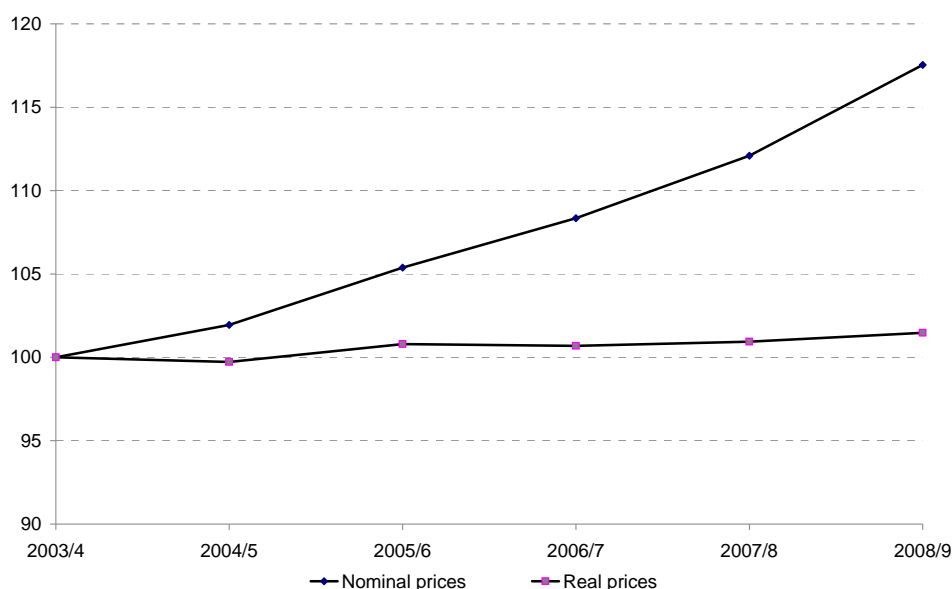
Notes	Details
N/A	Not applicable
N/S	Not supplied for that year
A	States the total for Speaking & Listening, Reading and Writing.
B	From 2008, a fee of £62.50 is charged. For the previous 5 years the fee consisted of a first time registration fee of £30 and a qualification registration fee of £45 for the first award a candidate is registered for (ie total fee of £75 for the first qualification) and £45 registration fee for each subsequent qualification the candidate registers for.
C	The average for Grades 1 to 3 is given as all three grades are covered by this qualification.
D	Two options - candidate registration and pay as you go unit fee or one payment covering registration and certification fee for lower total cost.
E	In order to obtain a Key Skills qualification the candidate needs the 'registration', the 'moderation of portfolio' and then either the 'multi choice', or the 'claim for proxy qualification' or the 'Gola' option. 'Multi choice' is shown here. This is the most expensive option. 'Gola' is a type of multiple choice exam specific to City & Guilds.
F	In order to obtain a Key Skills qualification the candidate needs the 'moderation of portfolio' and then either the 'test' or the 'claim for proxy qualification'. 'Test' is shown here. This is the most expensive option.
G	Nine mandatory units (001-009) are included in the registration fee. The final unit is charged separately. This can either be 'multi choice dated', 'multi choice on demand' or 'Gola'. 'Multi choice dated' / 'on demand' are the same price and are shown here.
H	The fee charged is the registration fee then, nine mandatory units at a set price each. The final unit is charged separately. This can either be 'multi choice dated', 'multi choice on demand' or 'Gola'. 'Multi choice dated' / 'on demand' are the same price and are shown here.
I	The increase in fee in 2008 is due to the replacement of centre devised examinations with 12 'Gola' online assessments for a cost of £45 in October 2008.

## Impact of inflation

### Actual fee increases

Our analysis of the increases in fees for the case study qualifications suggest that the average real increase in fees has been far less than the centres have perceived. Much of the increase in fees over the past five years (3.5% on average) has been due to inflation and not a real increase by the awarding organisations, as illustrated below.

**Figure 6.2: Trend in average fee increases (real and nominal prices)**



Note: Inflation source: ONS, RPI index. Change from 2007/8 to 2008/9 excludes NVQs due to the influence on fees of the abolition of the NVQ levy.

## 6.6 Removal of the £10 NVQ levy

The NVQ levy was a £10 charge applied to each NVQ certificate issued by awarding organisations. The levy was intended to support the development and improvement of standards in relation to vocational qualifications. However, the levy was withdrawn with effect from 30 September 2008 when legislation relating to it was revoked.

### Supply side results

The removal of the levy has resulted in some savings for centres offering NVQs. Fees for NVQs offered by the case study organisations have fallen by 3.3% in nominal terms 2008/9 compared to the previous year (or 7.6% in real terms). However, it appears that the removal of the levy has not yet been passed on in the form of lower fees. If the removal of NVQ levy is passed on in full, then NVQ fees should fall in real terms by around 11% as shown in the table below.

**Table 6.3: Impact of the abolition of the NVQ levy on NVQ fees**

	Change in fees from 2007/8 to 2008/9	
	Nominal price change	Real price change
Actual change in NVQ fees for sample	-3.3%	-7.6%
Implied change in fees for sample (if fees for all NVQs assumed to increase in line with RPI and the removal of NVQ levy passed on in full)	-6.6%	-11.0%

There are a number of possible reasons why the impact has not been passed on in full, including:

- The impact of the abolition of the NVQ levy may take several years to fully feed through
- Awarding organisations may have chosen not to directly pass on the NVQ levy to customers in the first place, choosing to absorb the costs in other parts of their business and so any abolition will not have an impact on fees
- Some awarding organisations may have taken the opportunity to increase margins on NVQ products by not passing on the full cut.

#### Demand side results

Centres responding to the demand side survey were asked about the removal of the levy. The results suggest that the majority of respondents were unaware that the levy existed. This is demonstrated in the table below.

**Table 6.4: Are you aware of the removal of the £10 NVQ levy ?**

Centre Type	Didn't know the levy existed	No	Yes
Further Education College	47	18	28
Other	2	1	0
School	5	3	1
Sixth Form College	1	4	0
Work Based Provider	9	12	6
<b>Total</b>	<b>64</b>	<b>38</b>	<b>35</b>

Overall, 47% of respondents were not aware that the levy existed. Of those that were aware of the levy, 52% did not know that the levy had been removed, compared to 48% who did know that it had been removed.

Respondents were then asked: 'For the awarding organisations that the centre uses to supply NVQs, please identify how many have':

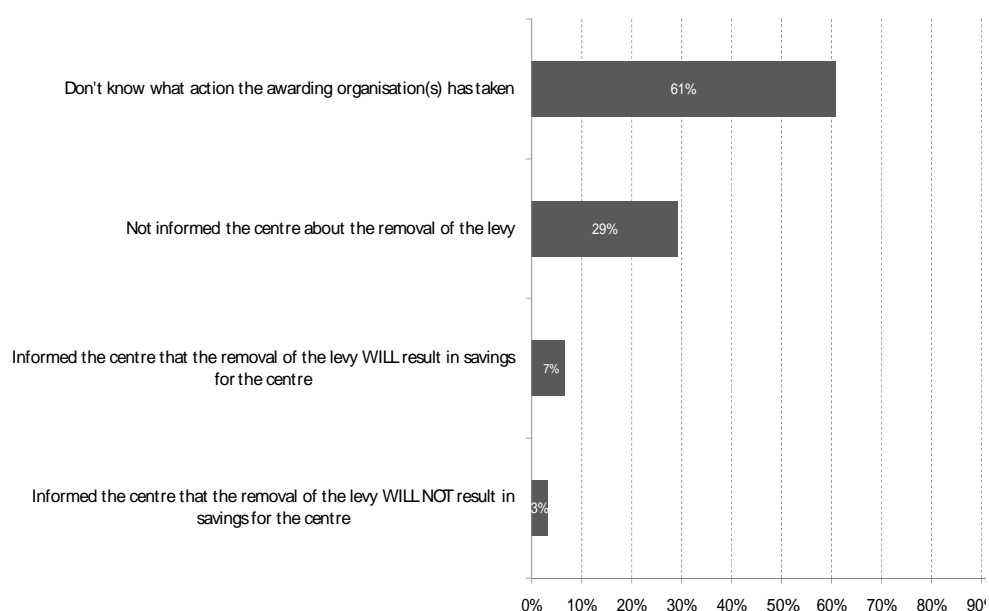
- informed the centre that the removal of the levy WILL NOT result in savings for the centre
- informed the centre that the removal of the levy WILL result in savings for the centre

- not informed the centre about the removal of the levy
- don't know what action the awarding organisation(s) has taken.

The results (illustrated in Figure 6.3) show that for 90% of awarding organisations centres either did not know what action had been taken (61%) or the awarding organisation had not informed the centres about the removal of the levy (29%). Of the remaining 10% of awarding organisations, the respondents reported that 7% had informed the centre that the removal of the levy would result in savings for the centre and 3% had informed the centre that the removal of the levy would not result in savings for the centre. These results are demonstrated in the figure overleaf.

Note that the results for this question reflect the individual respondent's *knowledge* of the action taken by awarding organisations. The results do not necessarily reflect the action *actually taken* by awarding organisations. That is, the awarding organisations in question could have informed the centre but the individual respondent may not have been aware of this.

**Figure 6.3: Removal of the NVQ levy – action by awarding organisations**



Centres were also invited to give their views on the removal of the NVQ levy. Views expressed tended towards an appeal for information regarding the removal of the NVQ Levy and the suggestion that awarding organisations should be forced to reduce the fees charged for NVQs as a result of the removal of the levy. The impact of the removal of the NVQ levy is subject to a separate review by Ofqual.

## 6.7 Conclusions

The majority of centres (65%) that responded to the demand side survey reported that, over the past three years, they had perceived an increase (above inflation) in the fees charged by awarding organisations. The main impact of the increase was an overspend on exam budgets and less funding on resources.

The perceived above inflation increase is not backed up by an analysis of the average fee rates for the selected qualifications. Analysis reveals that the majority of the fee increase (3.5%) is due to the general inflation rate and not real increases by the awarding organisations. Although, for qualification products in some areas, fees do show year-on-year increases of greater than 3%, these are one-off rises rather than a constant incline. Some qualifications decreased in price, and Edexcel's NVQ fees have remained static (and decreased following the removal of the NVQ levy).

The fees charged for the same or similar qualification across different awarding organisations tend to be closely aligned so that there is minimum price differential, although the extent of any savings would clearly depend on the number of candidates entered. There is, however, a much greater price differential in some fees, for example in the fees charged by City & Guilds and Edexcel compared to OCR for the Level 2 NVQ in Health and Social Care.

There was a significant lack of awareness from the respondents about both the existence and the removal of the £10 NVQ levy. In total, 47% of respondents were not aware that the levy existed and, of those that were aware of the levy, 52% did not know that the levy had been removed.

## 7 Quality of service

### 7.1 Overview

Consideration of just the fees charged by awarding organisations would not illustrate the complete picture of the other widely used qualifications market. The fees charged are only part of the consideration for examination centres when selecting the qualifications they will offer. Fees are generally less of a consideration than the qualification/specification content, as some centres choose to use an awarding organisation that charges a higher fee for the same qualification than another awarding organisation does.

The service offering must therefore be considered alongside the fee charged, since two identical fees for the same qualification could be considered either reasonable or unreasonable depending on what the centre received for its expenditure. This chapter considers these issues, drawing on the evidence from the demand side survey and the qualitative submissions from the case study awarding organisation.

### 7.2 Different service offerings

All of the case study awarding organisations were asked to provide details of the services they provided for the selected case study qualifications.

The service offerings are often bespoke to the awarding organisations and can be of core benefit to either the student, the centre, or both. The responses of the awarding organisations are summarised in the table below.

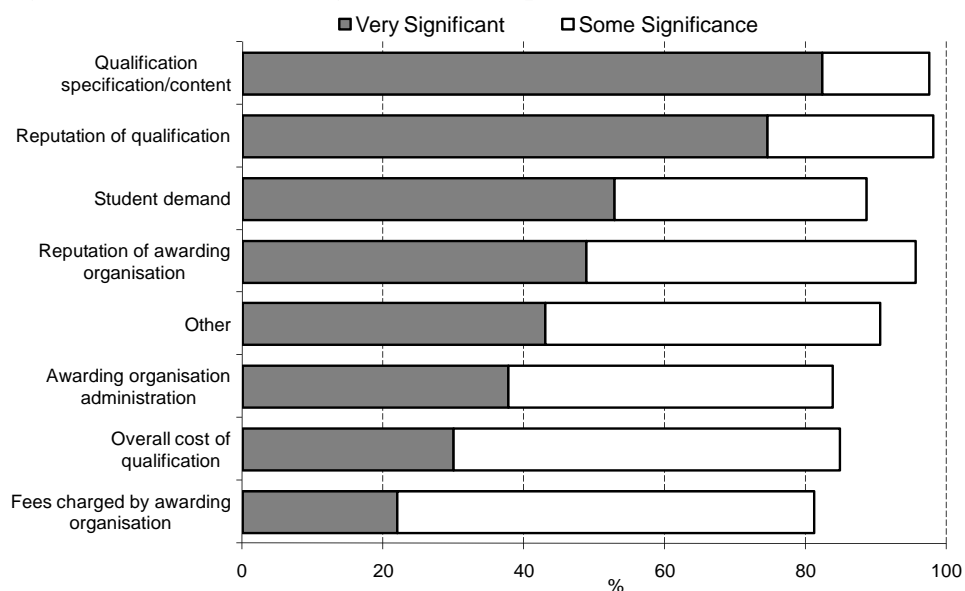
**Table 7.1: Case study awarding organisations' services**

Service provided (for no additional fee)	ABRSM	AAT	CACHE	Camb- ridge ESOL	CIEH	City & Guilds	CSkills	Edexcel	OCNW	OCR	RSH	RIPH	TCL	TVU	VTCT
Web enabled guidance and materials/resource centre	✓	✓		✓	✓	✓	✓	✓		✓					
Guidance, support and training materials/induction packs	✓		✓	✓	✓	✓	✓	✓		✓	✓	✓	✓		
Past exam papers/sample questions		✓		✓	✓					✓	✓	✓	✓		
Online forums	✓	✓			✓					✓					
Online administration of exams	✓		✓	✓		✓	✓	✓	✓	✓	✓	✓			
Exams available on demand				✓	✓	✓				✓			✓		
Professional development/training	✓	✓	✓	✓	✓	✓	✓		✓	✓					
Seminars/forums/events	✓	✓	✓	✓	✓	✓	✓			✓					
Publications such as magazines, newsletters and e-zines	✓	✓	✓	✓	✓	✓	✓			✓					✓
Centres teams/account managers/customer service helpline		✓	✓	✓	✓	✓	✓	✓							
Single points of contact (telephone) (a named individual)					✓		✓				✓	✓		✓	✓
External Verifier visits		✓	✓	✓		✓	✓	✓		✓					✓
Guaranteed turnaround times		✓	✓	✓	✓	✓	✓		✓					✓	
Scholarships/bursaries/hardship funds	✓	✓				✓									✓
CV and job hunting help and advice		✓													
Student helpline		✓					✓								
Other	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

### 7.3 Survey results

Respondents to the demand side survey were asked to rate the significance of several factors on the choice of qualifications offered. The results are shown in the figure below.

**Figure 7.1: Factors affecting the choice of qualifications that the centre offers**

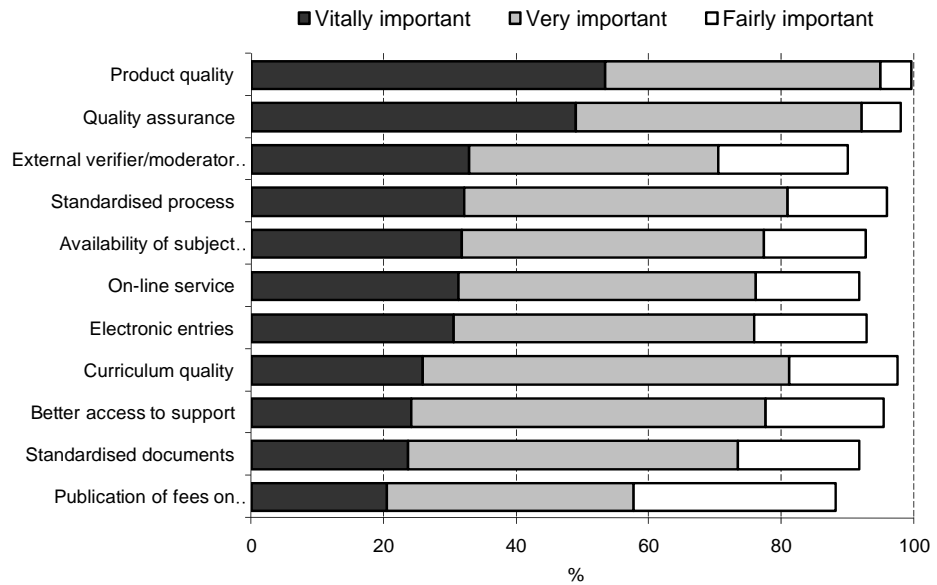


The results show that 'qualification specification/content' and 'reputation of qualification' were cited as 'very significant' by 82% and 75% of respondents respectively. In contrast, only 22% of respondents said that 'fees charged by awarding organisations' were 'very significant', with a further 59% stating that fees charged were of 'some importance'. A further 20% stated that the fees charged were of 'no significance'.

Centre responses to 'other' factors included employer perception, the nature of the assessment regime, the ease of teaching, funding constraints, requirements from employers, fee structure, accuracy of examiner standard, qualification language and the fact that there was only one awarding organisation providing a particular qualification.

#### Services offered by awarding organisations

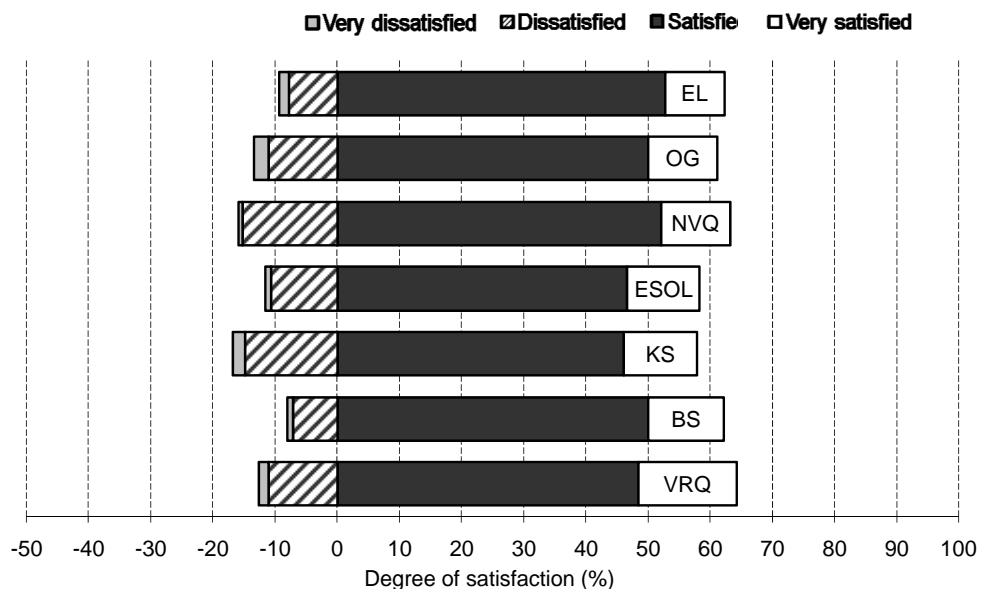
Respondents to the survey were asked to 'rate the importance of the following services provided by awarding organisations'. Respondents were asked to rate each service on a scale from 'vitaly important' to 'not important'. The results are illustrated in the figure below. Note that only the results for the top three rankings ('vitaly important', 'very important' and 'fairly important') are shown.

**Figure 7.2: Importance of services provided by awarding organisations**

'Product quality' and 'quality assurance' were rated as the two most vitally important services, with 53% and 49% of centres ranking these in the highest category respectively. 'Publication of fees on a unit by unit basis' received the lowest percentage of centres ranking it as vitally important at 20%.

#### 7.4 Overall satisfaction

Centres were asked 'In general for the total fee you pay, how satisfied are you with the service and product received for the following qualification types?' It is recognised that responses to this question act only as a general gauge of opinion, since centres will likely experience different levels of satisfaction within the qualification types. The results, illustrated on the figure below, indicate that the majority of centres are 'satisfied' with the service and the product they receive.

**Figure 7.3: For the total fee paid, how satisfied are you with the service and product received for the following qualification types?**

Key Skills and NVQs show the highest dissatisfaction with 17% and 16% of centres respectively stating they are either dissatisfied or very dissatisfied. In general for each qualification type, approximately 60% of centres are either satisfied or very satisfied. This ranges from 64% (for VRQs) to 58% for Key Skills and ESOL.

Centres were also asked the following specific questions about the case study awarding organisations that the centre uses:

- How satisfied are you with their performance against their customer service statement/charter?<sup>26</sup>
- How satisfied are you with the information provided on organisational structure, contacts, fee structures, deadlines and exams information?
- For the following fees that you pay, how satisfied are you with the service and product that you receive?<sup>27</sup>
- How satisfied are you with the way the fee information is provided in terms of transparency and timeliness?

The key results are demonstrated in the figures below. The additional results are included at Appendix A. The results show the percentage of centres that were 'very satisfied', 'satisfied', 'dissatisfied' and 'very dissatisfied'. 'Don't know' answers have been excluded from the analysis and 'neither satisfied or dissatisfied' answers have not been shown on the graphs.

Note that some of the smaller, more specialised, awarding organisations received a smaller number of responses, as shown in the table below. Six awarding organisations received less than 50 responses. The results for these six organisations have been combined and reported on as 'Other AOs' within the graphs below and at Appendix A.

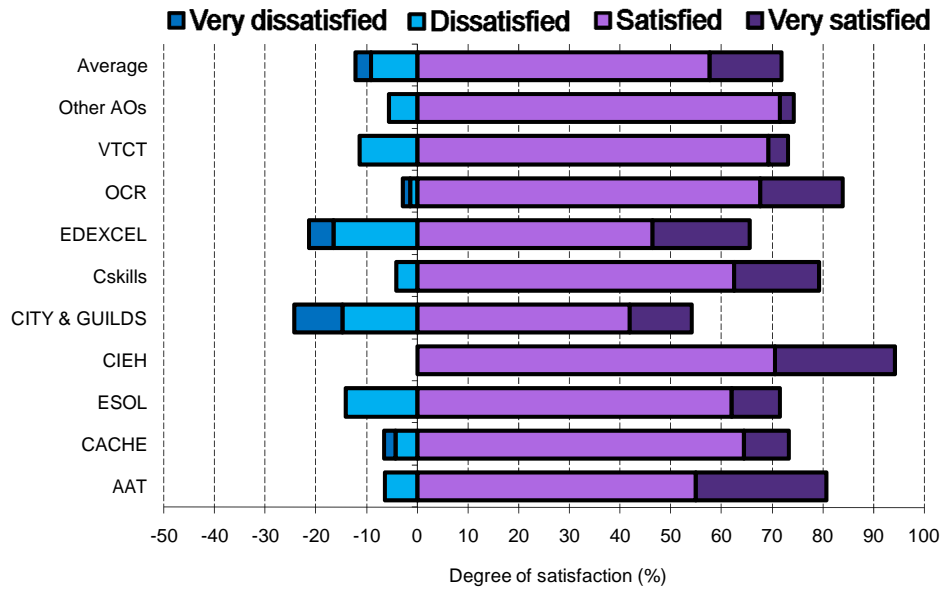
**Table 7.2 Number of responses received by each case study awarding organisation**

Awarding organisation	Number of responses
AAT	75
CACHE	87
ESOL	51
CIEH	61
City & Guilds	107
CSkills	70
Edexcel	136
OCR	125
VTCT	62
Other AOs	113
Total	887

<sup>26</sup> Only centres that had seen the customer service statement/customer charter for the relevant awarding organisation were asked this question.

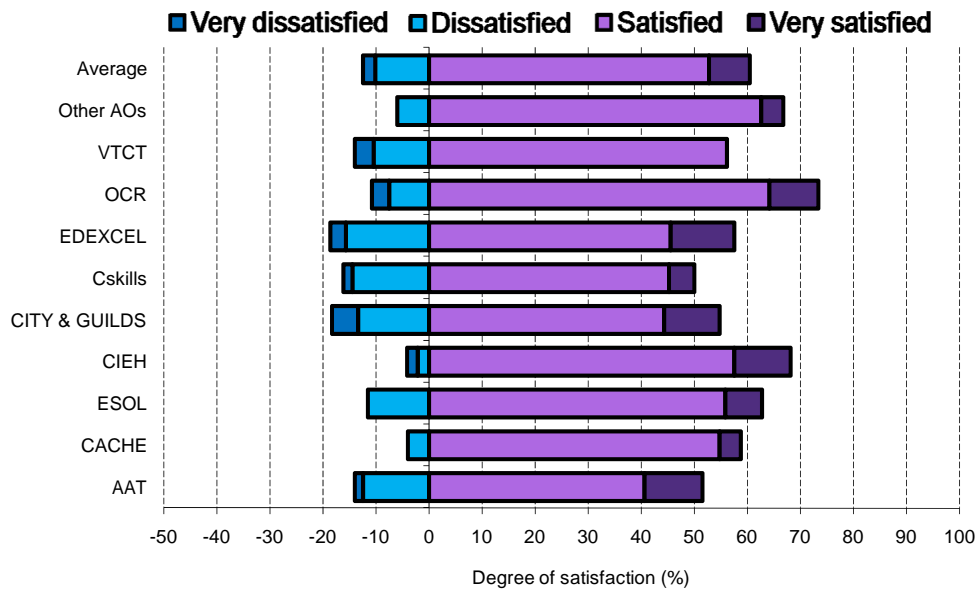
<sup>27</sup> Examination entry fee, candidate registration fee, late registration fee, moderation and verification visit fees.

**Figure 7.4: How satisfied are you with their performance against their customer service statement/ customer charter?<sup>28</sup>**



The results suggest that centres are generally 'satisfied' with awarding organisations' performance against their customer service statement/customer charter. On average, 72% of respondents are either 'satisfied' or 'very satisfied' compared with 12% who are either 'dissatisfied' or 'very dissatisfied'. The results for two awarding organisations (Edexcel and City & Guilds) show that over 20% of the centres responding to this question are either dissatisfied or very dissatisfied with the performance against the customer service statement/customer charter. AAT and CIEH have particularly positive results with 26% and 24% of centres respectively scoring their satisfaction levels as 'very satisfied'.

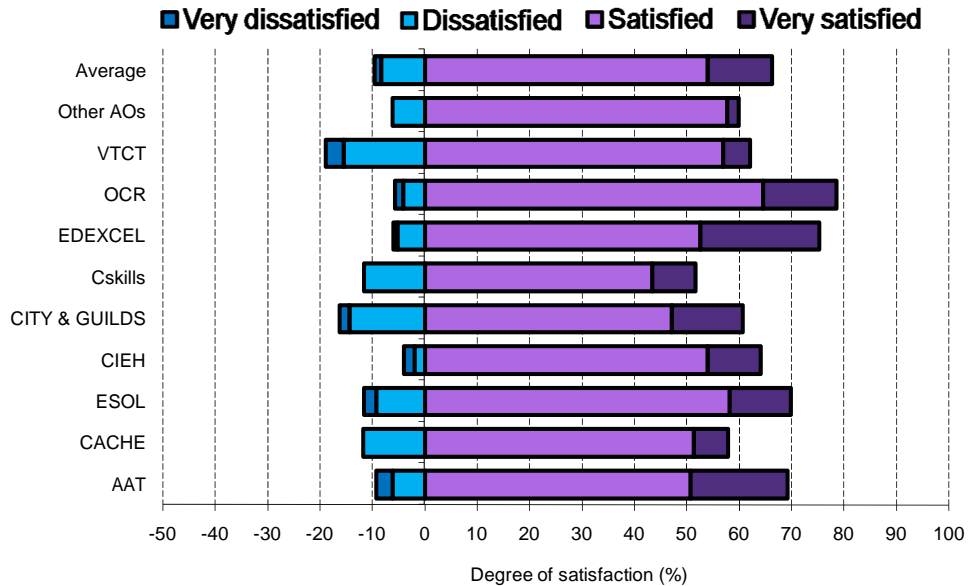
**Figure 7.5: How satisfied are you with the information provided on fee structures?**



<sup>28</sup> Only centres that had seen the customer service statement/customer charter for the relevant awarding organisation were asked this question.

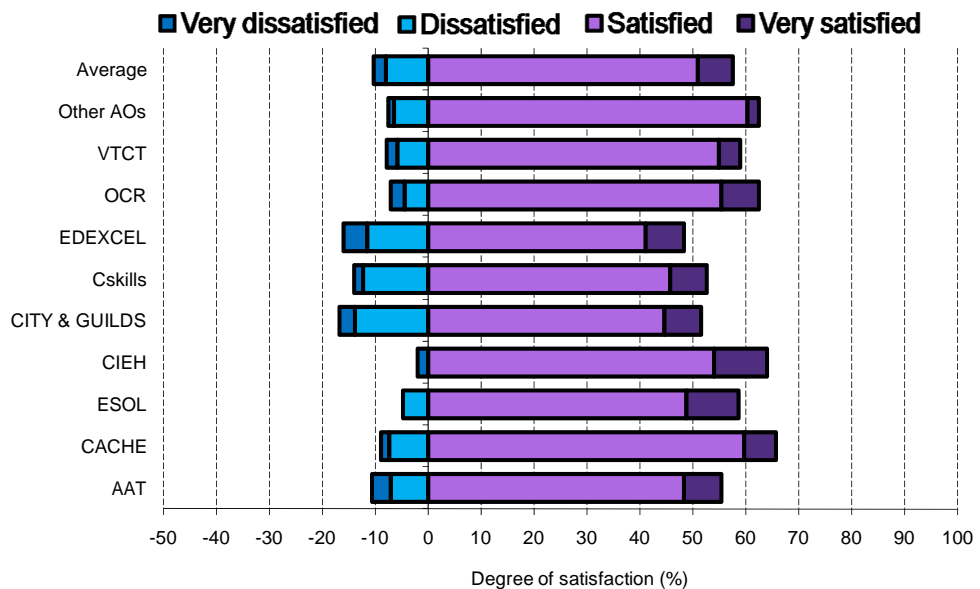
The results suggest that centres are generally 'satisfied' with the information provided on fee structures. Approximately 20% of centres responding about Edexcel and City & Guilds were either 'dissatisfied' or 'very dissatisfied'.

**Figure 7.6: How satisfied are you with the information provided on exams information?**



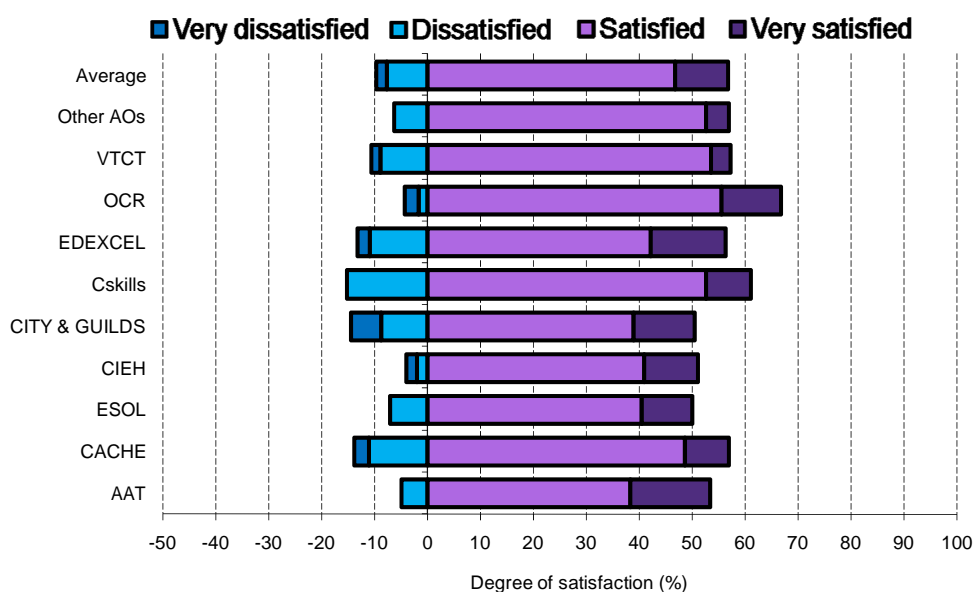
The results suggest that centres are generally 'satisfied' with the information awarding organisations provide on exams information. VTCT has the highest percentage of centres returning either a 'dissatisfied' (16%) or 'very dissatisfied' (3%) answer. Edexcel and OCR both have a high percentage of centres responding that they are either 'satisfied' (53% and 64% respectively) or 'very satisfied' (23% and 14% respectively).

**Figure 7.7: For the examination entry fee that you pay, how satisfied are you with the service and product that you receive?**



The results suggest that centres are generally 'satisfied' with the service and product they receive from awarding organisations for the fee they pay for examination entries. On average, 57% of respondents were either 'satisfied' or 'very satisfied'. Edexcel, City & Guilds and Cskills have higher percentages of centres returning either a 'dissatisfied' or 'very dissatisfied' answer. The combined total is 17% for City & Guilds, 16% for Edexcel and 14% for Cskills.

**Figure 7.8: How satisfied are you with the way the fee information is provided in terms of transparency?**



Again, the results suggest that centres are generally 'satisfied' with the way fee information is provided in terms of transparency. OCR scores well with 67% of centres responding that they are either 'satisfied' or 'very satisfied' compared to 4% that are either 'dissatisfied' or 'very dissatisfied'.

### 7.5 Qualitative survey results

The qualitative demand side survey results (and the results from a previous survey used when selecting the case study qualifications) illustrated the following key themes regarding quality of service:

- Customer service/contacts within awarding organisations
- Standardisation of processes
- Electronic data interchange
- External verifiers/moderators

#### Customer service/contacts within awarding organisations

Several respondents highlighted that increases in prices had not corresponded with an increase or improvement in customer service. The use of single points of contact at exam boards available Monday to Friday with telephone and email communication channels was praised because it means that "*queries can be answered speedily*". One respondent stated that "*what is needed is someone at the end of a phone who can sort out the small problems and issues*". In

contrast, "organisations who do not respond in a timely manner" as well as the use of call centres were criticised.

Many centres commented on their frustration with call centres used by awarding organisations. This frustration was generally due to being put on hold for a long period of time, having a query passed from person to person and receiving incorrect answers to questions. The survey illustrates a demand for a single point of contact at each awarding organisation and for this contact to be accessible via the telephone. The following quotations are representative of comments made by centres on this point:

- *"More and more awarding organisations are moving to call centres which takes away our only link with some one who has the expertise and can answer any problems we have"*
- *"Queries need to be followed up in a timely manner by the awarding bodies, especially during our busy periods. Having standard contacts within all awarding bodies would help"*
- *"More face-to-face contact with somebody that can provide answers. Too often, with all awarding bodies, I get put through to someone that cannot answer my questions"*

#### Standardisation of processes

Many centres commented that they would like to see a consistent approach taken by awarding organisations. Different centres stated different areas that required consistency, although the consensus appears to be that as much consistency as possible would be beneficial. The following quotations are representative of comments made by centres on this point:

- *"We would like more consistency between examination boards in all features, from fees to standardisation of procedures"*
- *"Administration Guides and Entry Fees need to be issued earlier – especially the fees as budgets need to be prepared prior to the start of new academic years. Generic forms with generic titles such as estimated grades sheets and coursework mark sheets. Deadline dates for entries also differ between the exam boards for the same type of qualification"*
- *"I would like all awarding bodies to ask for candidate registration details in the same format"*
- *"There are far too many of them [awarding organisations] and very little standardisation across them in terms of the processes and procedures"*

#### Electronic data interchange

Respondents appreciated the use of technology to improve communications and generally wanted to see more of this. One respondent stated that exam officers "want easy access to information via a website and non complex online registration systems".

#### External verifiers/moderators

One respondent stated that "curriculum staff like to have external verifier visits, possibly only once per year, with opportunities to contact the person earlier during the year by email to forward examples of assessments. This would encourage networking for subject areas and sharing good practice." Similarly, it was noted that "there has been a decrease in the availability of external verifiers and moderators who do centre visits" and that "these visits are highly valued by the curriculum teams as they provide opportunities for networking and sharing good practice. Centres have to now pay to attend events to share good practice."

## 7.6 Conclusions

All of the case study awarding organisations provide an expansive range of services for their customers. The demand side survey shows that quality of service is of high importance with 28% of centres citing it as a factor when changing awarding organisation.

The survey results also show that 'qualification specification/content' and 'reputation of qualification' are the most significant factor when choosing a qualification.

The demand side survey highlights that the majority of centres are satisfied with the service and product they are receiving for the fee they are paying. Centres were also asked "*Do you have any comments on how the support, and type of support, from awarding organisations can be improved?*" Perhaps unsurprisingly, responses to this question highlighted some concerns with the quality of service. These mainly related to the use of call centres and the lack of one-to-one contact with someone at the awarding organisations who could assist efficiently and responsively.

## 8 Financial analysis

### 8.1 Overview

This chapter sets out our financial analysis of the case study qualifications and the wider organisations. It examines the different structures of the awarding organisations and comments on how awarding organisations hold information relating to other widely used qualifications.

### 8.2 How awarding organisations hold their information

Of the case study awarding organisations, none have financial and management systems that allow them to identify direct income and costs for specific qualifications. This has resulted in allocation methods being required for the direct revenues and costs as well as for indirect costs. There are three broad groups into which the financial data compiled by the awarding organisations can be categorised:

1. Direct income and costs are held for a suite of similar qualifications or considered across the whole examinations business and not necessarily split out for other widely used qualifications
2. Direct income and costs are not reported on by any distinct division or profit centre that is directly responsible for the provision of qualifications. In this case, allocation needs to be estimated on all income and costs using the most appropriate income or cost driver
3. Income and cost allocation exercises have been performed in-house (for both direct and indirect costs) in response to this project or previously to establish a contribution for a specific qualification

### 8.3 Case study awarding organisations' structures

Of the 15 awarding organisations selected for this study, 13 are registered charities or departments/divisions of registered charities in the UK, one is an unincorporated organisation and one is a limited company. Two of the 15 awarding organisations – the Royal Society of Health (RSH) and the Royal Institute of Public Health (RIPH) – merged in October 2008 and formed the Royal Society for Public Health (RSPH), an independent charity. This reduced the total number of awarding organisations to 14. The cost allocation exercise has been performed on the pre-merger organisations.

The principal difference in the business model for charities and private companies is that charities will typically exist for their charitable purpose first and foremost, with profitability (or surplus) a secondary consideration. Private companies will exist to generate a return that is acceptable to their owners or shareholders, so they will not enter or remain in a market place where there is insufficient scope for profit.

As such, a financial assessment of a charitable organisation will need to assess the significance of any surplus or deficit as well as concentrating on 'traditional' financial measures of performance.

When assessing charities, it is important to do so in the context of their particular business model. A 'standard' financial assessment does not provide a thorough assessment for a number of reasons:

- Charities as 'not-for-profit' organisations do not exist solely to make a return on their assets
- Profitability may be sacrificed in order to fund good causes or for the public benefit (in this case the advancement of education)
- Charities have specific statutory requirements in order to qualify for charitable status.

#### 8.4 Characteristics of a charity

Charities are bound by specific rules with regard to their business model and service offering. A charity must exist to provide a specific benefit to the public. For awarding organisations, this may be the advancement of education to the public. Charities with an annual income over a specific threshold have a series of obligations and fall under the regulation of the Charity Commission.

Charities in the UK are governed by the Charity Commission, and the advancement of education is one of purposes described in the Charities Act 2006. All charities have a Public Benefit Requirement (PBR) as part of their aims and there are two key principles to the PBR:

1. There must be an identifiable benefit(s)
2. Benefit must be to the public or sections of the public

The awarding organisations in this study are all fee charging. However within the second principle is a requirement that the public must not be unreasonably restricted by their ability to pay any fees charged.

While private companies have the ability to set fees in accordance with their strategic aims charities have a requirement to set fees for services which relate to its charitable activities in a way which incorporates the principles set out above.

Charities have a statutory duty to report upon their public benefit in their annual report. The extent to which charities meet their PBR is then assessed by the Charity Commission.

#### 8.5 Summary of results

Table 8.1 below summarises the financial performance of the case study awarding organisations for the previous three years. The financials stated are sourced from the organisations' statutory accounts. Therefore they do not necessarily relate solely to awarding organisation activity because the organisations often also have other business streams.

**Table 8.1: Summary of financial performance**

Name	Organisation type	Three-year average turnover £000s	Three-year average net surplus/ (Deficit) £000s	Three year average return on sales %
Edexcel	Limited company (owned by Pearson Plc)	203,612	32,845	16%
Cambridge Assessment Group	Charity	191,567	5,153	3%
OCR	Charity	107,133	6,620	6%
City & Guilds	Charity	92,500	4,200	5%
ABRSM	Charity	25,680	(351)	-1%
TCL	Charity	15,414	521	3%
AAT	Charity	14,029	313	2%
CIEH	Charity	13,350	518	4%
CACHE	Charity	6,648	(717)	-11%
VTCT	Charity	4,215	(830)	-20%
RSH	Charity	1,282	52	4%
Construction Skills Awards	Division of CITB-Construction Skills which is a registered charity and part of the partnership that makes up ConstructionSkills SSC. Those partners do not have any ownership of Cskills Awards.	254,556	(209)	0%
RIPH	Charity	1,250	(251)	-20%
TVU	Charity	104,422	(4,342)	-4%
OCNW	Unincorporated association	1,214	378	31%

Source: Awarding organisations statutory accounts

Note: Return on sales excludes all unrealised gains/losses and is before interest and tax but after depreciation

Note: Cambridge Assessment Group and OCR have accounts in 2007 for a 10 month period.

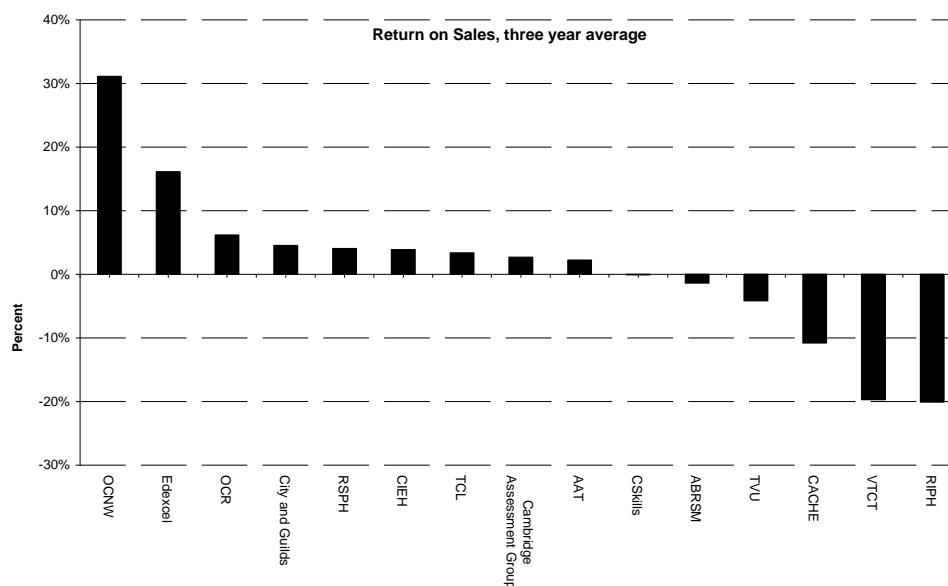
After consultation the figures have been adjusted to account for a disproportionate level of income over costs recognised in this period.

Note: Excludes Investment Income and transfers from reserves

Note: Excludes Asset revaluations and disposals

The results for the return on sales calculation are summarised in the figure below.

**Figure 8.1: Return on sales, three year average**



There is a very wide range in return on sales. OCNW reports the highest return on sales, although it should be noted that the turnover for this organisation (around £1.2 million over a three-year average) is the lowest of all the selected awarding organisations.

Four of the awarding organisations have reported a deficit on average, in the last three years. VTCT and RIPH both have a return on sales of minus 20% over the past three years' financial results. In VTCT's case, this was predominantly due to an approximate £3 million deficit (excluding investment income) in the 2008 financial results. RIPH reported net deficits in each of the past three financial years. In that time, revenue has increased by around 10% per annum.

### 8.6 Costs of qualification provision

There are a number of different costs involved in the provision of qualifications. These include direct costs such as printing, publications and examiner fees but also the indirect costs such as training, administration and premises costs.

In consultation with the awarding organisations, we have calculated the costs of providing the sample qualifications, split into distinct categories. These are aggregated and weighted according to the number of qualifications selected per awarding organisation, and presented in the figure overleaf.

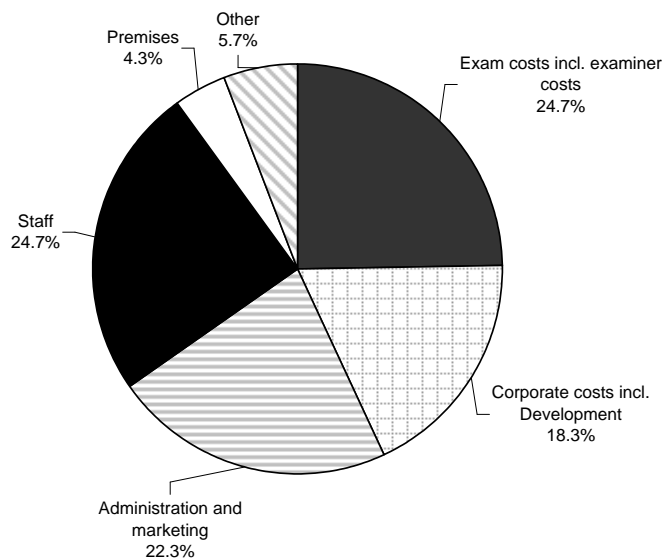
Direct examination costs comprise 25% of the total costs of providing the selected qualification. This category includes examination setting and marking, examiner and external verifier costs, mock exams and certification costs. The cost breakdown has been calculated using the information received from the awarding organisations and using cost allocation techniques.

Staff costs make up the same percentage (25%) as examination costs, and administration and marketing costs comprise 22% of the total costs. 'Administration and marketing' costs contain those indirect costs which relate to the qualifications, including printing and postage, student support and marketing and magazines.

Corporate costs comprise approximately 18% of the total costs. These costs are made up of support costs (finance, HR and examination support), licence fees, training, audit and consultancy fees, IT and governance costs. In all cases, the corporate costs were allocated costs with drivers being selected in consultation with the awarding organisation or allocated by the awarding organisation themselves.

Premises costs make up approximately 4% of costs and 6% of costs are classed as 'Other costs'.  
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 \*\*\*\*\*

**Figure 8.2: Average cost breakdown for selected qualifications**



Source: Grant Thornton analysis

The development costs relating to new qualifications are captured in some cases  
 \*\*\*\*\*. However, the majority of awarding organisations do not account for development costs per se, in part due to the sophistication of the financial systems and because they do not capitalise development costs. Awarding organisations reported that current development costs focus on a move to an online presence in every area of their business, from purchasing, content delivery and examinations. \*\*\*\*\*

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## 8.7 Information received and key assumptions

The table below summarises the financial information received from the various awarding organisations. Ticks represent information received from the awarding organisations.

**Table 8.2: Summary of analysis and key assumptions**

Awarding organisation	Direct income	Direct costs	Product analysis conducted internally	Key assumptions and cost drivers
Edexcel	-	-	✓	Full Income and Expenditure statement has been provided by Edexcel under 'OWUQ' heading. This includes but is not limited to the selected qualifications. Uses Activity Based Costing (ABC) method which has not been verified.
Cambridge ESOL	✓	✓	-	Gross margins provided for selected qualifications. Breakdown of overheads and key drivers of these have not been provided.
OCR	✓	✓	-	Gross margins provided for selected qualifications. Breakdown of overheads and key drivers of these have not been provided and an explanation of the rationale for not providing these was given.
City & Guilds	✓	✓	✓	Data provided from SAP accounting system which captures price, volume and candidate data. Direct income and costs provided for a suite of qualifications only. Allocation of overheads based on: <ul style="list-style-type: none"> <li>• Qualification units</li> <li>• Registrations</li> </ul> The costs include development costs.
ABRSM	✓	✓	✓	Directs income and cost figures provided for 'Practical' division of exams. Overheads allocated using the following drivers: <ul style="list-style-type: none"> <li>• Turnover</li> <li>• Candidate numbers</li> <li>• Product analysis calculated using:</li> <li>• Exam numbers.</li> </ul>
TCL	✓	✓	-	Direct income and costs provided for suite of qualifications only. Consultations concluded no practical method to drill down below this level. Central costs have been allocated on: <ul style="list-style-type: none"> <li>• Candidate numbers.</li> </ul>
AAT	✓	✓	-	Direct income and costs provided for 'Exams and Training' division only. Overheads are allocated to the division using a number of drivers: <ul style="list-style-type: none"> <li>• Student members</li> <li>• Division contribution margin</li> <li>• Staff FTEs</li> <li>• Product profitability for selected qualification calculated using:</li> <li>• Qualification entries</li> <li>• Simulations</li> <li>• NVQ levels.</li> </ul>
CIEH	✓	✓	✓	Direct income and costs provided for specific qualifications. Overhead costs are allocated to the division using a number of drivers: <ul style="list-style-type: none"> <li>• Revenue</li> <li>• Candidate numbers.</li> </ul>
CACHE	✓	-	-	Limited direct cost information. Costs are allocated on the basis of: <ul style="list-style-type: none"> <li>• Exams.</li> </ul>
VTCT	-	-	-	Both income and costs required to be allocated to the selected qualifications. Income and costs are allocated to the division using a number of drivers: <ul style="list-style-type: none"> <li>• Candidate numbers.</li> </ul>
RSH	✓	-	-	Costs allocated to the exams division using: <ul style="list-style-type: none"> <li>• Staff FTEs</li> <li>• Floor space</li> </ul> Costs are then allocated to the selected qualification using the following drivers: <ul style="list-style-type: none"> <li>• Candidate numbers.</li> </ul>
CSkills	✓	✓	✓	Direct income and costs provided for the exam directorate which is then allocated. Full cost allocation methodology

Awarding organisation	Direct income	Direct costs	Product analysis conducted internally	Key assumptions and cost drivers
				provided to calculate a product contribution for the selected qualification. Drivers used by CSkills include: <ul style="list-style-type: none"> <li>Income</li> <li>Staff FTEs</li> <li>Publications.</li> </ul>
RIPH	✓	✓	✓	Overheads are allocated to the division using a number of drivers: <ul style="list-style-type: none"> <li>Floor space</li> <li>Staff FTEs</li> <li>Exam contribution margin</li> </ul> Product profitability is calculated for the selected qualification calculated using: <ul style="list-style-type: none"> <li>Candidate numbers.</li> </ul>
TVU	✓	✓	-	All income and costs allocated on candidate registrations.
OCNW	✓	✓	-	Direct Income and costs estimated figures. Indirect costs allocated using the following drivers: <ul style="list-style-type: none"> <li>Candidates</li> <li>Usage (Postage and stationary)</li> </ul> Product profitability is calculated for the selected qualification calculated using: <ul style="list-style-type: none"> <li>Candidate numbers.</li> </ul>

## 8.8 Product analysis of case study qualifications

This study looks to calculate an estimate of the profitability of the qualifications selected. The financial information we have received from the awarding organisations varies considerably.

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Note that, where possible, the analysis has used management information, which is more detailed than statutory accounts. While reconciliations have been received between the two sets of accounts, we have not attempted to audit the information provided.

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### Product analysis results

The diagrams below show the results of the product analysis conducted on the 33 selected qualifications. Specifically, we have estimated the gross and net profit margins of either the selected qualification where possible or the suite of qualifications in which the selected qualification sits.

**Figure 8.3 Total allocated income less allocated direct costs for the case study qualifications**  
[Redacted]

**Figure 8.4: Estimated net margin of selected qualifications**  
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### Product analysis

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**Product Development Costs**

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**8.9 Conclusions**

The overall return made by awarding organisations across all businesses activities ranges from -20% to 31% return of sales (three-year average). While the overall return figures should be treated with care, they do show that there is no systematic overall basis in the industry towards excess profits, with some awarding organisations making significant profits but others making losses.

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The cost allocation approach was used and tested for this study into other widely used qualifications. The cost allocation approach has a number of limitations:

- The accounting information currently held does not tend not to be of the required granularity
- Awarding organisations tend to focus on suites or portfolios of qualifications.

The willingness of some awarding organisations to provide timely, transparent and sufficiently detailed information magnified the weakness of this approach. We conclude that, due to these drawbacks, the results from the cost allocation process should not be used in isolation to conclude on reasonableness.

## 9 Wider issues around future regulation

### 9.1 Overview

In this section, we highlight a number of wider or strategic regulation issues which were raised during the course of this project, either by the awarding organisations, centres or other interested parties. These include:

- the appropriateness of cost allocation as a means of assessing reasonableness
- the impact of changes in public policy
- other methods of assessing reasonableness, including a market study, increasing transparency, customer complaints/satisfaction and accounting separation.

It should be noted that some of the ideas in this section are for future discussion and there was often no consensus between all awarding organisations who submitted views.

These are discussed in more detail below.

### 9.2 Cost allocation as a means of assessing reasonableness

Some of the case study awarding organisations involved in this project have strongly expressed the view that cost allocation is not an appropriate method of assessing the reasonableness of fees.

This is based on the argument that, in order to meet demands for learner choice and learner progression routes, awarding organisations tend to offer a wide range of qualifications. This range will cover both high and low volume qualifications. Low volume qualifications will often not attract enough learners to make the qualification economically viable. Nonetheless, a low volume qualification must have the same stringency applied to it as a high volume qualification and therefore the supporting infrastructure and systems within an awarding organisation are in place for all qualifications (both high and low volume).

As a result, some of the case study awarding organisations believe that the allocation of overheads to specific qualifications would not provide a meaningful analysis of either financial return or 'reasonableness'.

### 9.3 The impact of changes in public policy

Several of the case study awarding organisations have been keen to stress that regulatory and public policy change has a significant impact on the market and the costs incurred by awarding organisations. This is due to speed of change and the unpredictability of future policy. The following were cited:

- work based accreditation
- the Qualifications and Credit Framework
- the need to work with a number of different Sector Skills Councils
- the development of the new Diploma

- the development of modular qualifications – for example, the new A levels with four units instead of six.

The awarding organisations cited that such change involved a very significant amount of work and investment. This cost of this investment will need to be recouped by the awarding organisations. Specifically, some awarding organisations will have to invest heavily in the development of the new Diploma (which the Government intends to be available nationally in 17 subjects by 2013). If the Diploma is successful, this will mean that awarding organisations can recoup their initial investment. However, an increase in the number of candidates taking the Diploma is likely to be matched by a decline in other vocational qualifications some of which currently provide a steady stream of income for awarding organisations.

They also stated that such public policy change and regulation could also lead to a disincentive to innovate. The need to deal with the approval criteria of both Ofqual and the relevant Sector Skills Councils is one example.

The impact of public policy churn on awarding organisations, and then subsequently on the wider market, should clearly be considered as future regulatory options are assessed. The need for proportionality is important.

#### 9.4 Consumer behaviour

Some of the case study awarding organisations suggested there was a mismatch within centres between the choosers of qualifications and the budget holder at the centre. One awarding organisation expressed frustration that, although their qualifications were offered at a more competitive rate, centres were not switching providers. This can be considered alongside the results from the demand side survey which highlight that the fees charged by awarding organisations are often not the most significant factor when selecting qualifications. This would be expected as decisions are likely to be made based on educational outcomes. However, concern was expressed that decisions were being made without any knowledge of the fee.

#### 9.5 Market study

A number of other options for assessing reasonableness have been considered. The most widely held view was that, as a first step, a market study involving market definition and standard competition policy techniques should be undertaken. This would be used to identify the level of competition in the market and whether there were any further competition issues which needed to be investigated.

The case study awarding organisations expressed different views on how the 'market' or the perceived market is operating. These ranged from:

- **a belief that the market is competitive.** Some of the awarding organisations expressed the view that the qualifications market is large and not concentrated, that there is a high level of transparency and a high degree of switching between suppliers and that there is a steady level of new entrants and new product launches. The view was also expressed that complaints from consumers should be the basis for any investigations into the market
- **a belief that there probably are issues** with certain parts of the market and that these should be investigated.

In either case, there was a general view that a market study would be a useful approach to investigating reasonableness. Such an approach would first involve defining the market or markets for qualifications. Once established, research and market analysis would then be

used to identify the extent of competition in the different markets and the impact of this on fees.

### 9.6 Increasing transparency

More could be done to increase consumer knowledge of what awarding organisations are offering and at what price. Examination centres would welcome further transparency (on price and service). The idea of a web-enabled comparison site for qualifications is a popular one, just as the uSwitch<sup>29</sup> website is for gas, electricity, home phone, broadband providers and personal finance products. It was noted that the National Database of Accredited Qualifications could be used as an initial platform for increasing transparency by including the fee for each qualification and the services that are included with this. Awarding organisations are supportive of methods that will make the market stronger.

### 9.7 Customer complaints/satisfaction assessment

Monitoring in this way could focus attention on industry hotspots and target the quality of service provision. This could be considered alongside the current Ofqual consultation on proposals to reform the performance indicators for qualifications delivery. The performance indicators (under consultation) cover the timely despatch of assessment material to centres, the timely issuing of results to centres/candidates and responding to enquiries about results and appeals within deadline.

Monitoring could be done via a standard proforma with variable limits that would trigger an investigation. In addition to customer complaints, Ofqual could monitor complaints made by awarding organisations – such as concerns about market dominance.

### 9.8 Accounting information

Awarding organisations do not tend to separate their business reporting into the profitability/return of single qualifications, suites of qualifications or even, where applicable, into general and 'other' qualifications. In addition, in their statutory accounts, awarding organisations may not generally report purely on the income, expenditure, assets and liabilities related to the business of supplying qualifications. This is because the organisation can have other activities – they may also receive investment income or, in the case of AAT for example, they may receive income and incur costs supporting their members (as distinct from their students).

Obtaining consistent and speedy information across awarding organisations, for the UK regulated qualifications business has been significantly difficult. A potential solution is to require awarding organisations to complete a simple annual proforma splitting out the qualifications business from the non-qualifications business (where necessary) and then splitting this into UK and non-UK.

This should be reconciled to the audited financial statements to ensure some comfort. Ofqual would therefore gain greater clarity over the business of providing qualifications if the awarding organisations produced a further set of accounts that contained the results for the regulated qualifications business exclusively.

Organisations operating in other regulated industries – such as the water industry and the electricity industry – are required by their regulator to produce a set of regulated accounts.

<sup>29</sup> "uSwitch.com is a free, impartial online and phone based comparison and switching service that helps customers compare prices on a range of services including gas, electricity, home phone, broadband providers and personal finance products. Our aim is to help customers take advantage of the best prices and services on offer from suppliers. The company has developed a series of calculators that evaluate a number of key factors including price, location, service and payment method, and advises customers on the best deal to suit their needs." Wording taken from: <http://www.uswitch.com/corporatepages/information/about-uswitch.aspx>

In our view, it is not appropriate to require awarding organisations to produce full sets of regulated accounts that would need to be subject to a separate audit. Regulated accounts typically include:

- a profit and loss account (or, as appropriate, an income statement)
- a statement of total recognised gains and losses (or, as appropriate, a statement of changes in equity and if appropriate a statement of recognised income and expense)
- a balance sheet
- a cash flow statement
- a corporate governance statement
- a directors' report
- an operating and financial review.

Regulatory accounts are prepared to provide financial information about regulated businesses for use by the regulator, the industry, investors, consumers and other stakeholders. They provide information that is more focused than that contained in statutory accounts as they relate to regulated businesses or activities, whereas statutory accounts relate to the regulated company as a whole and are more focused on the requirements of investors.

Such an approach would require that awarding organisations use cost allocation within the regulated accounts, for example to allocate costs shared across the whole organisation such as the HR or IT functions. This would be burdensome for awarding organisations, many of whom have charitable status and have to comply already with the Charity Commission.

## 9.9 Conclusions

While the method of using cost allocation can consider the returns made on individual, higher volume qualifications, these returns may not always accurately reflect the business of an awarding organisation. Further options to be explored could include:

- defining the market(s) and then investigating areas of concern. Awarding organisations differ in their views of just how competitive the market(s) is
- supporting the competitiveness and transparency of the market via a web-enabled comparison site. This could also be used by both centres and awarding organisations to issue complaints which could instigate investigations as appropriate
- introducing an annual proforma return from awarding organisations, as a less burdensome approach to regulated accounts to enable Ofqual to monitor the awarding organisations' businesses in a consistent manner.

## 10 Reasonableness

### 10.1 Assessing reasonableness

This section summarises our overall conclusions on reasonableness and our recommendations. The recommendations have been formulated as a result of the findings and conclusions contained in the previous chapters and relate to actions that Ofqual could take with regard to the overall qualifications market and specific actions on both the supply and the demand side.

We conclude that a judgment of whether fees are reasonable should take into account a wide range of factors including:

- the extent of competition in the market which, in turn, is dependent on characteristics such as market power, concentration, market shares, substitution and barriers to entry
- whether fees charged by awarding organisations have increased in line with inflation
- perceptions from the demand side on whether fees are reasonable, in terms of overall price as well as price relative to the quality of service provided
- whether fees charged by awarding organisations reflect the level of costs incurred by awarding organisations and whether the costs incurred are efficient
- the level of the overall financial return made by awarding organisations
- the extent to which the financial returns made on individual or groups of qualifications are fair, taking into account cross-subsidy, business strategy and granularity of costs.

### 10.2 Competition and market structure

Our conclusion is that the split between A levels and GCSEs, and other vocational qualifications may not be appropriate in economic competition policy terms as there is a level of both demand and supply side substitution between them.

In our opinion, it is more appropriate to define the market in terms of the subject sector framework ('Health, Public Services and Care', 'Science and Mathematics' etc). Such a definition allows the market to be analysed using standard competition policy techniques and tested for evidence of market power – the extent to which a company can increase the price of its products above competitive levels.

Market shares, market concentration, barriers to entry and buyer power are all important factors in determining the level of market power present in a market. Our conclusion on market share and concentration is that the market is both fragmented and concentrated.

There are on average 26 awarding organisations in each of the 15 sectors on the sector subject framework, suggesting the potential for significant competition and innovation. However, the average market share across the 15 sectors for the largest awarding organisation at 40% is quite high. In seven of the 15 sectors, the largest awarding organisation has a market share in excess of 40% and in three sectors the largest awarding organisation had a share in excess of 50%.

The growth in the number of awarding organisations serving the market from 40 in 2001, to nearly 100 in 2002 and to just over 130 currently suggests that there are low barriers to entry. However, for more mature markets which have become dominated by the larger organisations, the barriers to entry may be higher as new entrants would have to invest heavily on product development, advertising and infrastructure to break into the market.

The level of individual buyer power in the market is another weakness which could inhibit competition. Not only is the number of centres high, but many centres lack the information on fees and clarity of roles to make informed judgments on fees and choice of awarding organisations. *"Empirical studies have shown that the stronger and more concentrated the buyer's side of the market is, the less is any ability of sellers to elevate their prices."*<sup>30</sup>

The issue of market definition should be explored further and tested with primary research and further evidence gathering.

### 10.3 Changes in fee rates

The level of increase in fees for the case study qualifications is broadly in line with inflation. Over the past five years, the average increase in fees for the qualifications selected at 3.5% per annum over the 2003/4-2008/9 period is only just above the rate of inflation. The increase is 0.3% per annum excluding RPIX inflation.

The question that then arises is whether the fee increase from our sample is representative of the wider OWUQ sector. In our discussions with the industry, awarding organisations argued that many of the products selected, firstly, were mature products and, secondly, had high product development costs.

In such circumstances, one would expect economics of scale to be significant and the unit cost per qualification to fall (as the product matures and more and more units are delivered over time). In such circumstance, fixed costs are increasingly spread over a larger number of units increasing the levels of profits, all other things being equal (that is, if prices remain the same). However, higher profits would encourage market entry and innovation by other organisations and such competition would drive down prices and hence profit levels would revert back to normal levels.

In short, one would expect mature qualifications which initially had significant product development costs to experience lower increases in fees per annum than other newer or niche products. It is therefore likely that our sample is lower than the average annual increase in fees in the other widely used market. This should be tested in further work.

### 10.4 Views from the demand side

There is a perception from the demand side that fees charged by awarding organisations have increased excessively, with 65% of centres responding to the demand side survey reporting that they had perceived an increase above inflation over the past three years.

Clearly, this perception may not be accurate, given that fees from our sample of qualifications have largely risen in line with inflation. Our visits to centres, demonstrated that there was often a lack of understanding of both the total fees paid to different awarding organisations and the breakdown by qualification.

Fees charged by awarding organisations were viewed as a less important by centres when choosing qualifications. 'Fees charged by awarding organisations' was cited as 'very

<sup>30</sup> Market power handbook: competition law and economic foundations.

significant' by only 22% of centres, compared to 82% for 'qualification specification/content' and 75% 'reputation of qualification'.

### 10.5 Cost reflective and cost efficiency

Another aspect of reasonableness relates to cost efficiency and cost reflectivity. Cost reflectivity is the extent to which fees relate to both direct costs of delivering the qualification (course development or marking, for example) and indirect costs (the central and shared costs such as corporate costs, overheads, property, marketing, advertising).

On cost reflectivity, we conclude that awarding organisations do not have a clear understanding of the total costs involved in delivering qualifications at the individual product level. Some awarding organisations do compile data on the direct income and costs of individual qualifications but do not as a rule allocate indirect costs to individual products and then use this information for the purpose of setting fees.

Awarding organisations argue that such an allocation process on each and every qualification is not a business need, and would be difficult and problematic for a number of reasons:

- Awarding organisations offer a wide range of qualifications, with some more successful qualifications cross-subsidising other less profitable and/or uneconomic qualifications which are provided for high educational value reasons.
- Many awarding organisations do not tend to manage the costs of their business at the individual product level, but instead focus on delivering portfolios or suites of qualifications and manage individual qualifications fees with respect to demand.

The visibility of income and costs for suites (ie groups) of qualifications is better. Two-thirds of the awarding organisations studied regularly compile data for the direct revenues and costs of groups or suites of qualifications. But, again, cost allocation methods are not used for the purpose of setting fees. One institution in our sample allocated costs and revenues to groups and, in some cases, individual qualifications, although the results are not used for the purpose of setting fees.

### 10.6 Overall return

The overall return made by awarding organisations across all businesses activities ranges from -20% to 31% return of sales. These figures are based on published statutory accounts and so, in some cases, includes income from and expenditure on General Qualifications (A levels and GCSEs) as well as non-UK markets.

While the overall return figures should be treated with care, they do show that there is no systematic overall basis in the industry towards excess profits, with some awarding organisations making significant profits but others making losses.

While the figures are smoothed over three years, they show that awarding organisations appear to be facing different influences on their business. While this is not true in all cases, awarding organisations that are experiencing a negative return are undertaking significant investment programmes such as IT and the development of new qualifications.

These two groups virtually cancel each other out with an average return across the sample of 15 awarding organisations of 2% per annum which is significant lower than 12% for the overall average in the UK economy and the average of 19% for the top 800 companies in

the UK<sup>31</sup>. Within the sample, one organisation (ie 7% of the sample) had a return of 31%, compared to 13% of companies in the UK who had the same or greater return on sales.

### 10.7 Profitability of individual qualifications

The previous study on A levels and GCSE used a cost allocation approach to assess the level of profitability made by awarding organisations on individual qualifications. The cost allocation approach was used and tested for this study into other widely used qualification.

An assessment of reasonableness is dependent on an appropriate and suitable cost allocation methodology to calculate the return is appropriate and whether it is suitable in the first place to consider profits at the single product level.

The cost breakdown of a typical qualification can be segmented into direct and indirect costs. Examination costs, the largest category of costs accounting for 27% of the total and are usually defined as direct costs which are usually attributed to the delivery of individual qualifications. The remaining proportion are all indirect costs and are overhead costs which cannot be directly attributed to the individual qualifications.

The cost allocation approach has a number of limitations

- Accounting information currently held by many awarding organisations does not tend to be of the required granularity for the allocation process
- Strategies of awarding organisations tend to focus on suites or portfolios of qualifications, with some successful qualifications cross-subsidising other less profitable qualifications.

The willingness of some awarding organisations to provide timely, transparent and sufficiently detailed information magnified the weakness of this approach, inhibiting the extent to which robust conclusions could be made using this approach.

We conclude therefore that, due to these drawbacks, the results from the cost allocation process should not be used in isolation to conclude on reasonableness but alongside all the evidence described in this chapter.

### 10.8 Recommendations

Our recommendations are aimed at increasing the understanding of the market, improving the sophistication and power of the demand side and improving transparency on the supply side.

The short-term recommendations are:

1. **Define the market(s).** Before concerns or conclusions about the competitiveness of the market can be made, the market must first be formally defined. Arguably, there is more than one market in the qualifications landscape and the existing split (defined prior to this project) of A levels and GCSEs as distinct from other accredited qualifications may not be appropriate. Ofqual should first define the market(s) within the qualifications landscape and then consider further market investigations as necessary.
2. **Consider building a price comparison website to educate the consumer.** Centres need easy access to accurate information so that they can make informed

<sup>31</sup> BERR

decisions and help the market(s) to work more efficiently. Ofqual should consider whether it is beneficial and practical, given the complexity in prices and services offered, to introduce a price comparison website, potentially by building on the National Database of Accredited Qualifications. As a minimum, these should detail the total price of the qualification and list the key services received. Ofqual should also publish the annual increase in the fees for individual qualifications and the annual overall percentage increase in all fees.

3. **Consider implementation of light-touch Accounting Separation.** Ofqual should consider whether it would be beneficial to require awarding organisations that have a turnover above a certain threshold to return an annual proforma detailing their financial information for the UK accredited qualifications elements of their business only. The proforma would exclude costs and revenues associated with the non-UK parts of the awarding organisation's business and exclude parts of the business that did not deal with accredited qualifications (such as educational materials, training and investment income). The proforma would contain a basic profit and loss statement for the UK accredited qualifications business. Ofqual should reserve the right to request that any information provided is subject to an independent audit (most likely as part of the existing auditors' responsibilities).

The medium-term recommendations are:

4. **Understand product development costs.** Many awarding organisations have commented on the significant costs involved in developing new qualifications, and of the subsequent risk of insufficient demand and uncertain lifespan of the qualification. Ofqual should seek to build up an evidence base on product development costs by encouraging awarding organisations to share with Ofqual (on a confidential basis) any information they have on the costs involved in developing new qualifications. Such evidence, suitably anonymised, would be invaluable in demonstrating to government departments and other interested parties the financial costs involved in implementing new policy initiatives, frameworks and qualifications.
5. **Develop service standards.** The demand side survey showed that in general centres were satisfied with the service and product they received for the fee they paid. However, centres made comments about aspects of service standards, including the quality of service received from call centres. Ofqual should work with the QCA to define levels of service that centres should expect to receive from awarding organisations.
6. **Introduce a procedure for handling competition complaints.** Ofqual should introduce a set procedure through which centres can raise complaints and issues, which should be developed and monitored alongside Recommendation 5. It should be linked and based on existing procedures set out by the Office of Fair Trading and the Competition Commission, as well as being proportionate given that the size of the awarding organisations industry is smaller than other regulated sectors. The procedure could comprise a form or questionnaire which asks for details of the complaint, evidence of the complaint and the action the centre had already taken to try to resolve their issue. A more detailed form could be developed for use by other organisations, including awarding organisations themselves, to raise concerns about competitive behaviour in areas of the market(s). Trigger points such as the volume and significance of a complaint should be set to indicate when Ofqual should investigate further and when Ofqual should intervene.

Other options for consideration include:

7. **Monitor awarding organisations' financial performance.** While Ofqual needs to understand the UK-accredited qualifications part of each awarding organisation's business, Ofqual should also, via statutory accounts, monitor the financial performance of each awarding organisation's whole business.
8. **Benchmark the efficiency of awarding organisations' costs.** Ofqual should monitor the efficiency of costs incurred by awarding organisations through the use of financial and employee benchmarks (such as the ratio of human resources staff to total staff, property costs as proportion of total and annual increase in salaries). This could be done using both the awarding organisation's statutory accounts and the annually returned proforma (Recommendation 3).
9. **Develop a timetable for the publication of fees.** Ofqual should require that fees for other widely used qualifications for each academic year are published in advance in a similar fashion A levels and GCSEs. The specific timetable should balance the need for flexibility from awarding organisations against the need for the publication to coincide with centres' decision making timeline.
10. **Produce best practice guidance for invoices.** Our contact with centres highlighted that not all centres are fully aware of the total fee that they pay to each awarding organisation they use or what the breakdown of that total fee comprises. Ofqual should work with awarding organisations and centres to improve the invoicing details that centres receive from awarding organisations.
11. **Improve awarding organisations' visibility of costs and revenues.** Some awarding organisations have insufficient visibility of the costs and revenues associated with the supply of their qualifications. While it is probably not practical, or reflective of the awarding organisation's business, to compile costs and revenues at an individual qualification level for each and every qualification produced, Ofqual should work with awarding organisations to improve the level of cost information held and promote relevant accounting systems and best practice where appropriate and cost effective. This would not only make the cross-subsidy between products more transparent, but also allow a more informed discussion on the trade-off between educational value and financial return to take place.
12. **Understand the decision-making process of centres.** The decision-making process at a centre is complex since decisions about which qualifications to offer are not likely to be made by the budget holder. To fully understand this and to investigate if efficiencies could be made, Ofqual should commission case studies of the centre decision-making process.

While fees for qualifications are a significant cost, they represent less than 5%<sup>32</sup> of the overall spend of centres and an even smaller proportion of the total costs of operating and delivering the qualifications system. So it is important that these recommendations take this into account. They should only be implemented if they support and promote the wider regulatory strategy of Ofqual.

<sup>32</sup> Broad indicative estimated provided by one awarding organisation.

## A Demand side survey

### Methodology

The demand side e-survey was undertaken in order to capture the views of centres on the reasonableness of fees for other widely used qualifications. The aim of the survey was to provide insight into why centres decide to select awarding organisations, how satisfied they are with awarding organisations' products and service delivery, the impact of any increases in the fees charged over the past three years and the impact on centres of the removal of the NVQ levy.

The survey was an e-survey and was first piloted with a sample of 15 examination centres. The final survey was sent to finance directors of colleges in England and also to the membership lists of three stakeholder organisations: the Association of Colleges, the Association of School and College Leaders and the Association of Learning Providers. The survey instructed that it should be completed by the most appropriate person at the centre. Details on the circulation of the survey are shown below.

**Table A.1: Circulation of the survey**

Organisation/circulation	Members/numbers
Finance Directors	364
Association of Colleges	386
Association of School and College Leaders	12,000 (includes more than one person at the same school or college)
Association of Learning Providers	470
<b>Total</b>	<b>13,220</b>

The aim of the survey was to achieve a response rate of 100 centres consisting of a representative sample with the following characteristics:

- Location of centre: across each of the regions in England
- Type of centre: schools, sixth form, general further education college
- Main source of funding of centre: public, private, trust etc
- Size of centre: ranging from large centres with over 1,000 students to lower specialist and niche centres.

The number of responses (a total of 222 centres started the survey and of these, 170 centres completed the entire survey) means that the original objective was achieved. But in any online survey, there are some limitations which should be acknowledged, including the following pertinent to this survey:

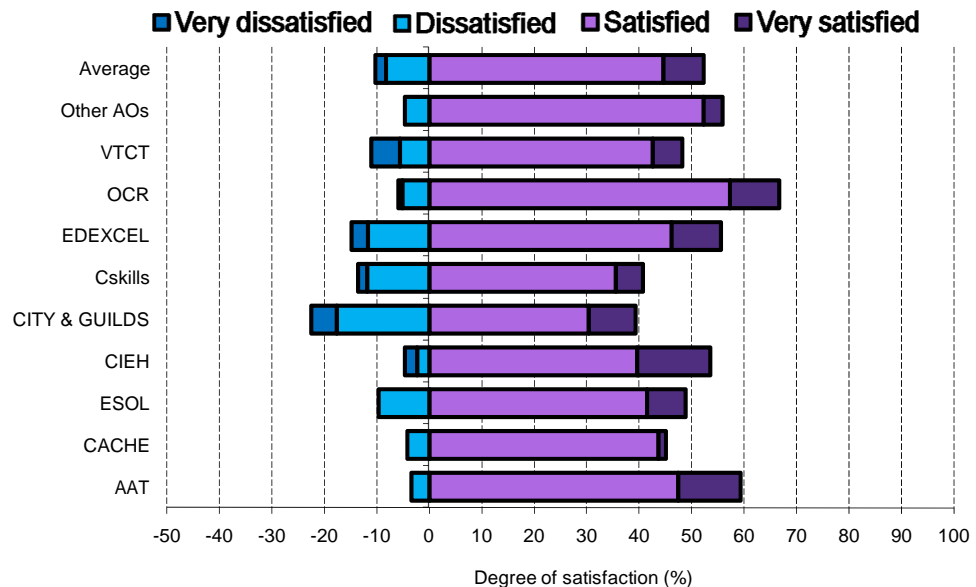
- The decision-making process in centres, regarding qualifications and awarding organisations, is likely to be undertaken by more than one individual. Consequently, the respondent may not be the only decision maker at the centre
- There was a lower response rate on questions specific to smaller awarding organisations. Six awarding organisations received less than 50 responses so the results, it could be argued, are not statistically significant. The results for these have therefore been combined and reported as 'other AOs'

- There are concerns around self-selection: that individuals are more likely to respond if they are unhappy with a particular awarding organisation rather than satisfied. While this is possible, it is not backed up by evidence from the survey itself. Only 14% of respondents said they were dissatisfied with the service and product received for the examination fee paid.

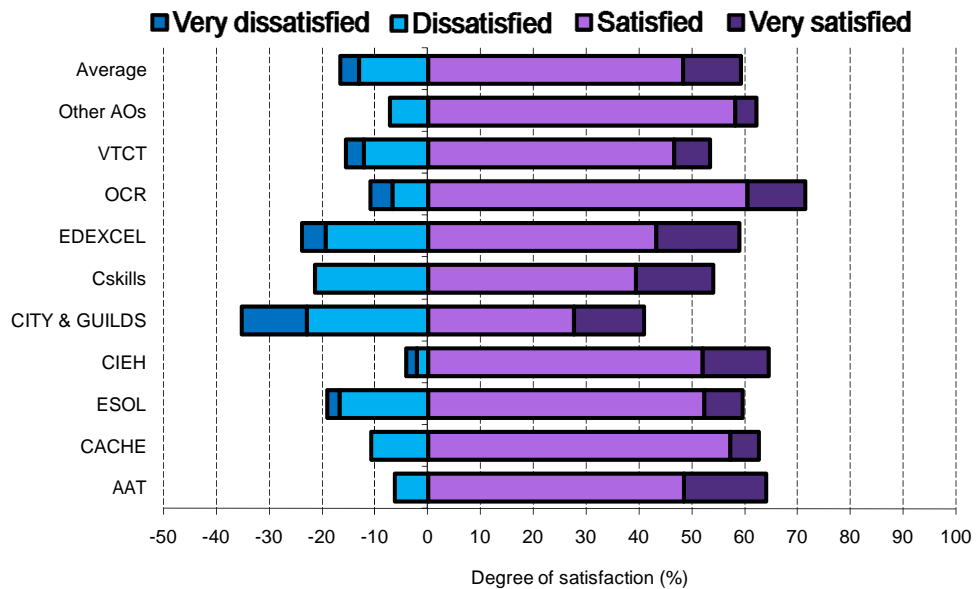
### Results

This rest of this appendix captures quantitative results from the demand side survey that have not been included in the main body of the report. As well as the quantitative results respondents were given the option to comment on two open questions ("Do you have any comments on how the support, and type of support, from awarding organisations can be improved?" and "Do you have any other comments that you would like to make?"). Representative responses from these questions have been included in the main body of the report.

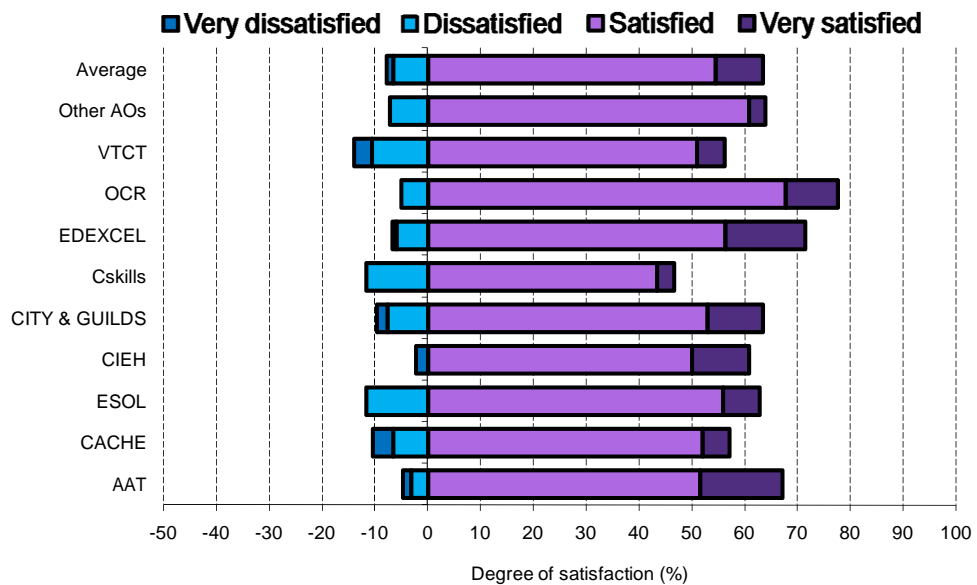
**Figure A.1: How satisfied are you with the information provided on organisational structure?**



The results suggest that in general centres are satisfied with the information awarding organisations provide on organisational structure. City & Guilds had the highest percentage of centres responding that they were either 'dissatisfied' (18%) or 'very dissatisfied' (5%).

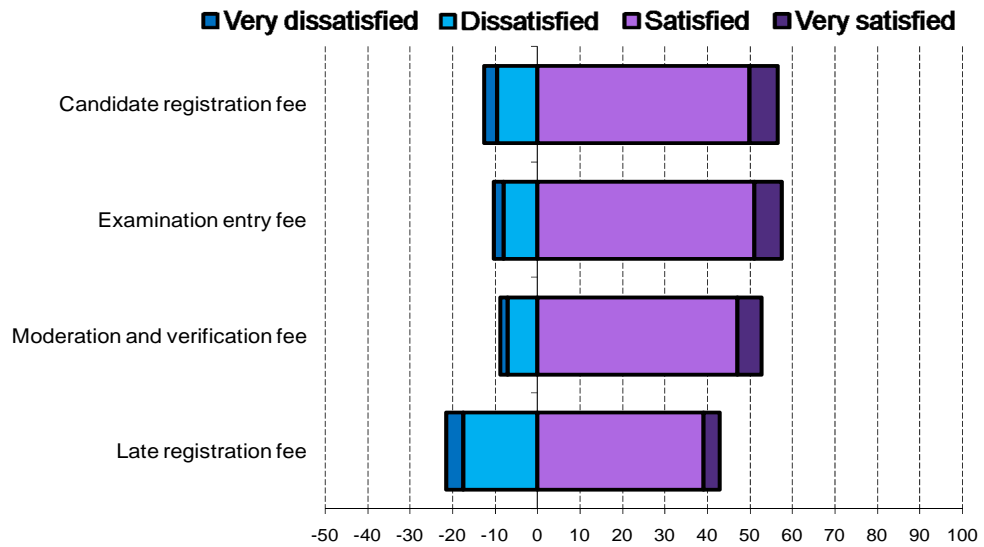
**Figure A.2: How satisfied are you with the information provided on contacts?**

The results suggest that, in general, centres are satisfied with the information that awarding organisations provide on contacts. City & Guilds had the highest percentage of centres responding that they were either 'dissatisfied' (23%) or 'very dissatisfied' (13%). Edexcel have a high percentage (16%) of centres responding that they were 'very satisfied' but also 24% of centres responding that they were either 'dissatisfied' or 'very dissatisfied'.

**Figure A.3: How satisfied are you with the information provided on deadlines?**

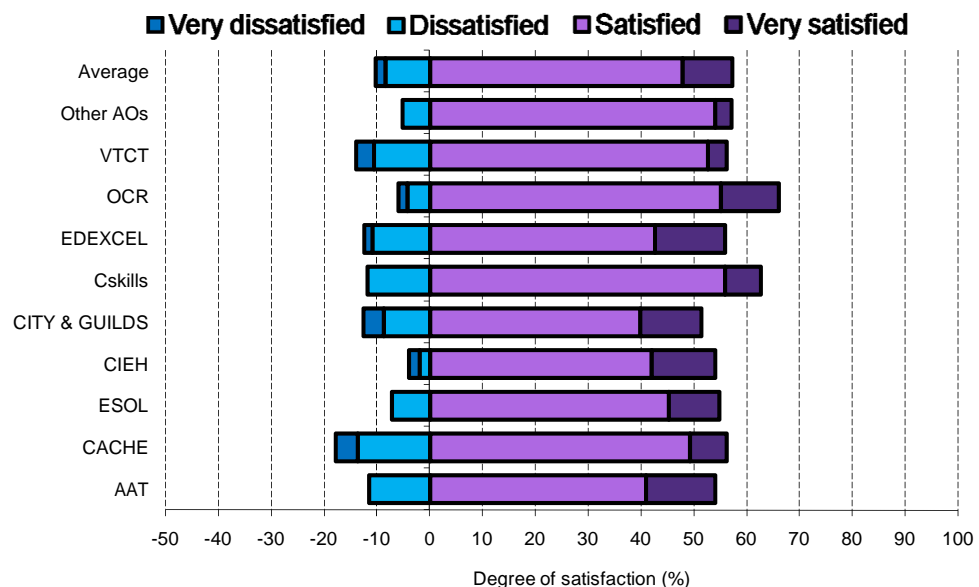
AAT and Edexcel return the highest percentage of centres responding 'very satisfied' to this question, approximately 15% each. OCR returned the highest percentage of centres responding either 'satisfied' or 'very satisfied' at 77%. This compares with only 5% of centres responding that they are 'dissatisfied' with no centres responding that they are 'very dissatisfied' with OCR.

**Figure A.4: For the following fees, how satisfied are you with the service and product that you receive?**



The graph shows the average results across all awarding organisations. Few centres responded that they were 'very satisfied' with the service and product that they receive for the late fee that they pay (only 4%). This is not surprising since centres do not receive any additional service for this fee. The fee is in place to discourage late entries. The levels of satisfaction across the other types of fees are comparable: 57% of centres responded that they were either 'satisfied' or 'very satisfied' with the service and product that they receive for both candidate registration fee and the examination entry fee that they pay. Meanwhile, 53% of centres responded that they were either 'satisfied' or 'very satisfied' with the service and product that they receive for the moderation and verification fee that they pay.

**Figure A.5: How satisfied are you with the way fee information is provided in terms of timeliness?**



AAT and Edexcel return the highest percentage of centres responding 'very satisfied' to this question, approximately 13% each. CACHE have the highest percentage of centres responding that they are either 'dissatisfied' (14%) or 'very dissatisfied' (4%) with the way CACHE provide fee information in terms of timeliness.

## B Detailed analysis of supply side fees

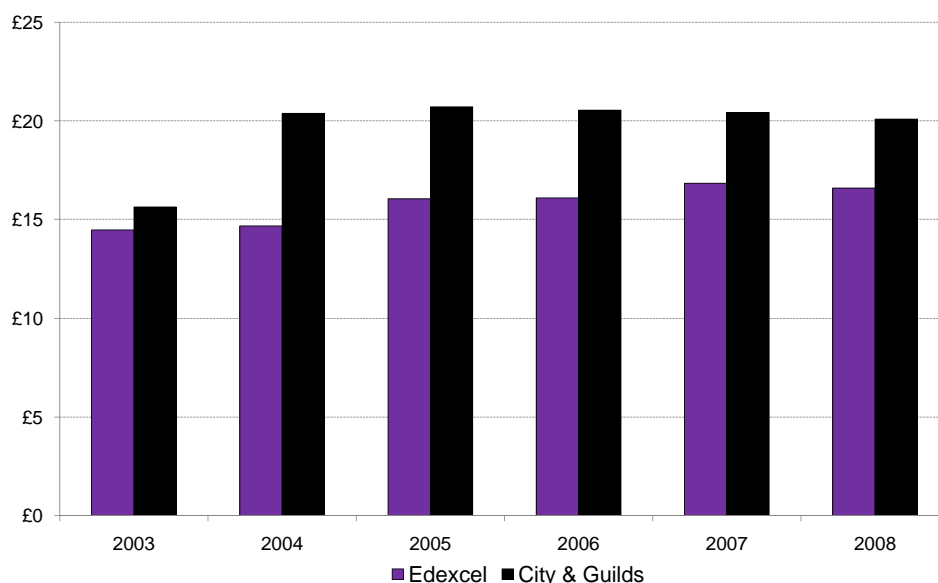
This section focuses on the fees charged that relate directly to the achievement of the qualification such as registration and certificate fees. Fees have been discussed across qualification types (NVQs, Key Skills, ESOL etc) for further comparability.

The fees charged are all shown in absolute values in Chapter 6. The graphs in this appendix are shown with the fees restated so that they appear in 2008 prices. That is, the fees are all shown in real prices because the fees from 2003 - 2007 have been inflated at RPIX. Therefore, the graphs illustrate movements in the fees excluding inflation.

### Key Skills

The case study Key Skills qualification selected is 'Level 2 Key Skills in Communication'. Edexcel and City & Guilds were the two awarding organisations selected.

**Figure B.1: Level 2 Key Skills in Communication (fees for 2003 to 2007 have been restated in 2008 prices)**



For City & Guilds, in order to obtain a Key Skills qualification, the candidate needs the 'registration', the 'moderation of portfolio' and then either the 'multi-choice', or the 'claim for proxy qualification' or the 'Gola' option. 'Multi-choice' is shown here. This is the most expensive option. 'Gola' is a type of multiple-choice exam specific to City & Guilds.

For Edexcel, in order to obtain a Key Skills qualification the candidate needs the 'moderation of portfolio' and then either the 'test' or the 'claim for proxy qualification'. 'Test' is shown here. This is the most expensive option.

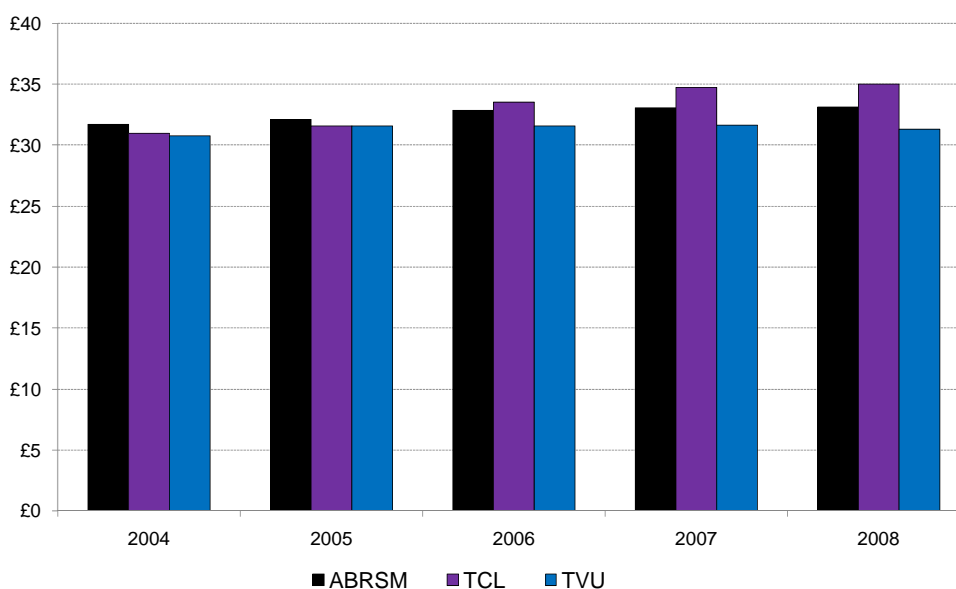
In real terms Edexcel's fees increased by 15% between 2003 and 2008 and City and Guild's by 29%.

### Other general qualifications

The other general qualification selected is the 'Graded Examination in Music Performance at Foundation Level / Level 1'. This qualification actually covers three grades (Grade 1 to 3).

The awarding organisations selected provided the information across all three grades. The figure below shows the average fee for these three grades.

**Figure B.2: Graded Examination in Music Performance at Foundation Level/Level 1 (fees for 2004 to 2007 have been restated in 2008 prices)**



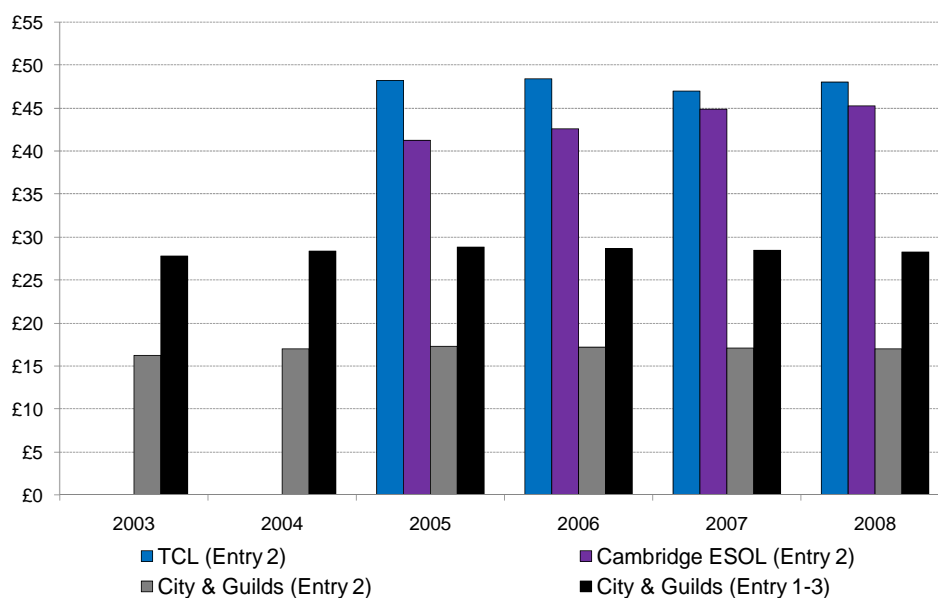
The fees charged for the Level 1/Foundation Graded Examination in Music Performance have increased over the previous five years across the three awarding organisations selected. The fees charged across all three awarding organisations have risen between 2004 and 2008. In real terms, TVU's fees have risen by 2%, ABRSM's by 4% and TCL's fees by 13%.

TVU's fees are consistently the lowest, although the difference in the fees charged is minimal and always within a few pounds of each other. However, the divergence between the fees charged appears to be growing. In 2004, there was a difference of less than £1 between the highest and lowest fee (between the advertised fees, in nominal terms). This compares to a difference of more than £3 (between the advertised fees, in nominal terms) in 2008.

#### ESOL Skills for Life

The ESOL qualifications selected for analysis is Entry Level ESOL Skills for Life (Entry 2). Entry Level includes three separate Levels (Entry Level 1, Entry Level 2 and Entry Level 3). Three awarding organisations have been selected: TCL, Cambridge ESOL and City & Guilds. City & Guilds provided two separate fees, one for Entry 2 only and one for a qualification spanning all three levels. The fees for ESOL are split across three modules: Reading, Writing, and Speaking and Listening. The figure below gives the total fee across the three modules.

**Figure B.3: Entry Level ESOL Skills for Life (fees for 2003 to 2007 have been restated in 2008 prices)**



In real terms, the fees charged by TCL fell between 2005 and 2008 by approximately 0.5%. In contrast, Cambridge ESOL's fees for Entry Level ESOL Skills for Life increased by approximately 10%. City & Guilds (Entry 2) fees increased by 5% in real terms between 2003 and 2008.

TCL's fees are consistently higher than Cambridge ESOL's fees, although the difference, albeit minimal, appears to be decreasing with Cambridge ESOL's fees increasing at a greater rate than TCL's. There was a £6.30 difference in 2005 compared to a £2.70 difference in 2008 (between the advertised fees, in nominal terms).

The fees charged by City & Guilds are significantly lower than both TCL's and Cambridge ESOL's. In 2008 City & Guilds charged £17 (advertised fee in nominal terms) for the Entry 2 qualification compared to £48 for TCL and £45.30 for Cambridge ESOL. (advertised fees in nominal terms).

#### NVQs

Five NVQs have been selected for analysis:

- Health and Social Care (Level 2), from three awarding organisations
- Children's Care Learning and Development (Level 3), from three awarding organisations
- Accounting (Level 3), from one awarding organisation
- Hairdressing (Level 2), from two awarding organisations
- Beauty Therapy (Level 2), from two awarding organisations.

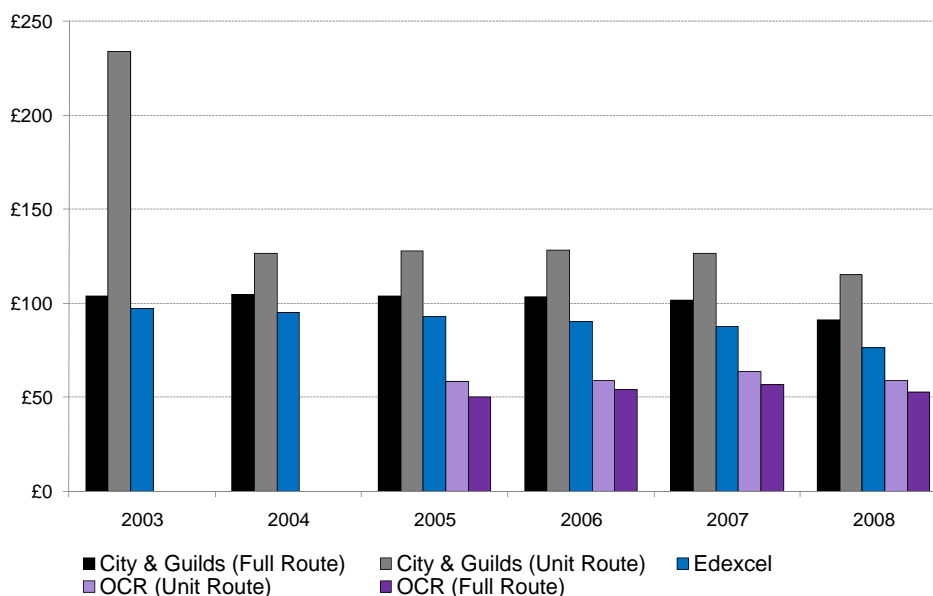
The case study NVQs are generally charged on a full qualification basis (Full Route). However, some awarding organisations offer the choice of either the full qualification payment or an initial registration fee followed by a unit-by-unit (Unit Route) fee. While the one lump sum payment (Full Route) is cheaper, the pay-as-you-go (Unit Route) option

offers centres more flexibility. This may be a beneficial option for learners who are less likely to complete the entire qualification, for example.

### NVQ in Health and Social Care (Level 2)

The figure below shows the fee analysis for the Level 2 NVQ in Health and Social Care.

**Figure B.4: Level 2 NVQ in Health and Social Care (fees for 2003 to 2007 have been restated in 2008 prices)**



Edexcel's fees have remained at a flat rate of £84 (advertised fee in nominal terms) for the years 2003 to 2007 and therefore their fees for this qualification have decreased in real terms by approximately 10%. It is noted that in 2008/09 Edexcel's fee has been reduced by £7 to reflect the removal of the £10 NVQ levy. Both OCR and City & Guilds offer two payment options. The 'Unit Route' (candidate registration and pay unit fee as you go) has a higher total cost but greater flexibility than the 'Full Route' (one-off payment covering registration and certification fee). The graph also demonstrates a reduction in OCR's fees and City & Guilds' fees in 2008/09.

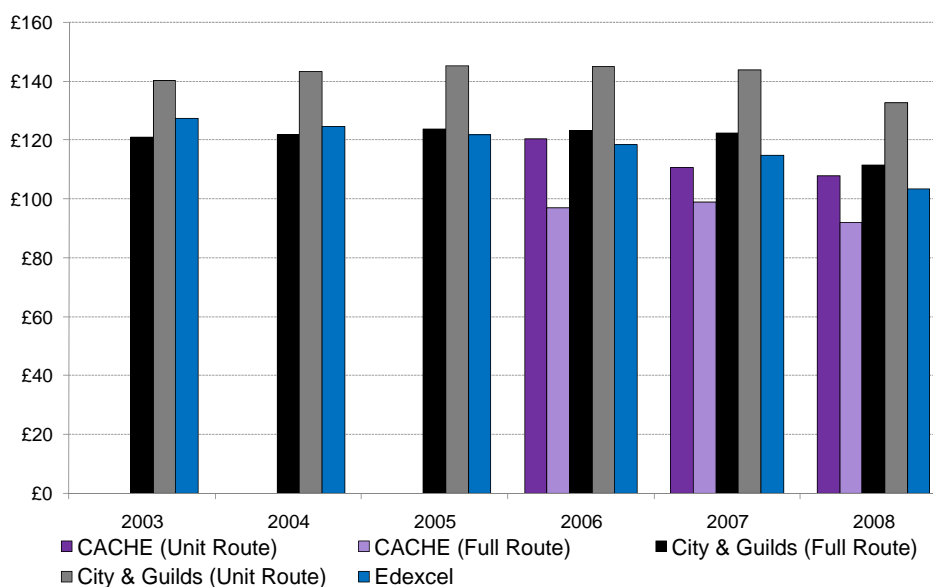
For OCR, the Unit Route has increased by approximately 1.27% in real terms and the Full Route by 4.6% in real terms between 2005 and 2008. OCR's fees remain significantly lower than both Edexcel's and City & Guilds'.

The City & Guilds' fees are the most expensive for both routes. The City & Guilds' Unit Route fee fell by 51% in real terms between 2003 and 2008. This was largely due to a £3.50 reduction in the cost of each unit component fee. The fees for the Full Route fell by 12% in real terms between 2003 and 2008.

**NVQ in Children's Care Learning and Development (Level 3)**

The figure below shows the fee analysis for the Level 3 NVQ in Children's Care Learning and Development.

**Figure B.5: Level 3 NVQ in Children's Care Learning and Development (fees for 2003 to 2007 have been restated in 2008 prices)**



As with their NVQ in Health and Social Care, Edexcel's fees for the NVQ in Children's Care Learning and Development have remained consistent (at £110) for the years 2003 to 2007 and have therefore decreased (by 10% ) in real terms. It is noted that in 2008/09 the fee has been reduced by £7 to reflect the removal of the £10 NVQ levy. Similarly CACHE's fees and City & Guilds' fees also reduce in 2008/09.

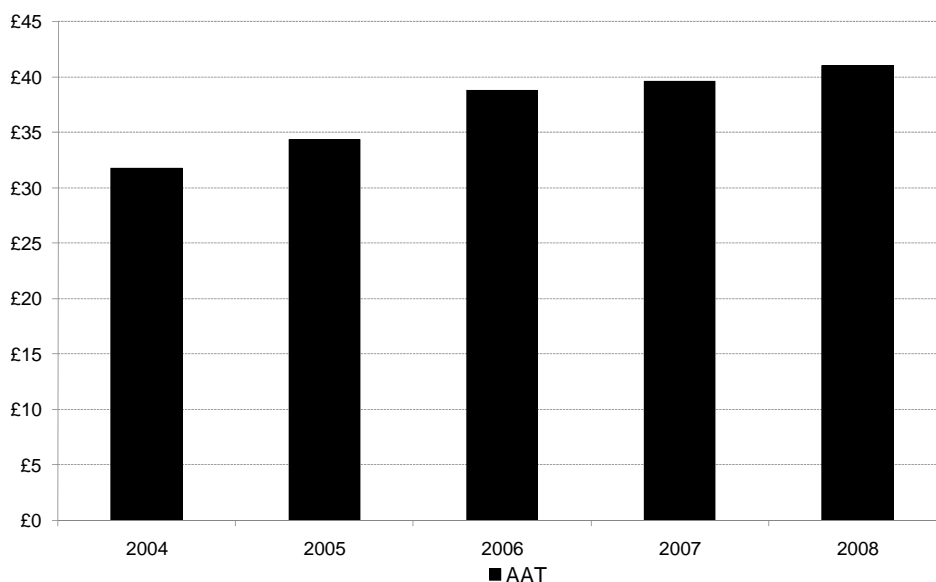
CACHE offers two payment options for the NVQ which it first offered in 2006. The higher priced Unit Route was first priced at £112 (in nominal terms) before being reduced by 5% (in nominal terms) the following year. Between 2006 and 2008 CACHE's Unit Route fee decreased by 10% in real terms and the Unit Route decreased by 5% in real terms.

Again, City & Guilds offers both a Unit Route and a Full Route. The fee for the Full Route decreased by 8% in real terms between 2003 and 2008 and the fee for the Unit Route decreased by 5% in real terms.

**NVQ in Accounting (Level 3)**

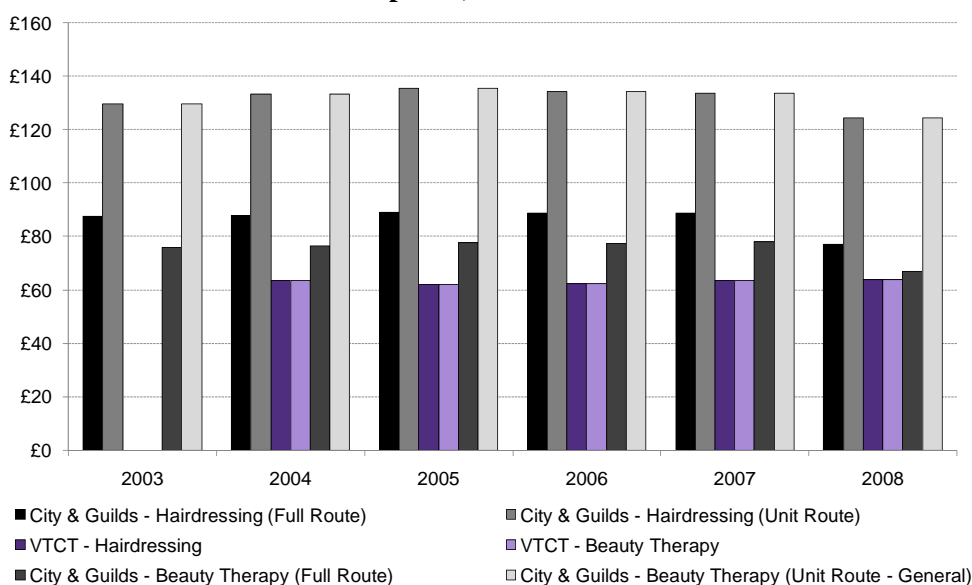
Between 2004 and 2008, the fee for AAT's NVQ in Accounting has increased by 29% in real terms.

**Figure B.6: Level 3 NVQ in Accounting (fees for 2004 to 2007 have been restated in 2008 prices)**

**NVQ in Hairdressing (Level 2) and NVQ in Beauty Therapy (Level 2)**

The figure below shows the fee analysis for the Level 2 NVQ in Hairdressing and the Level 2 NVQ in Beauty Therapy. These qualifications have been shown on the same figure as they are similar in nature and offered by the same two awarding organisations.

**Figure B.7: Level 2 NVQ in Hairdressing and in Beauty Therapy (fees for 2003 to 2007 have been restated in 2008 prices)**



**Beauty Therapy**

As with its other NVQs, City & Guilds offers both a Full Route and a Unit Route. In addition, candidates can take the following different routes:

VTCT	City & Guilds
General Route	General (Full Route)
Nail Services Route	General (Unit Route)
Massage Route	Make Up (Full Route)
	Make Up (Unit Route)
	General (Full Route and online questions)
	Make Up (Full Route and online questions)

- The fee is the same for each of the VTCT routes.
- For City & Guilds, the fee for the Full Route for both General and Make Up is the same.
- For City & Guilds, the fee for the Unit Route for General is slightly higher than for the Unit Route for Make Up, due to the qualifications containing a different number of units.
- The City & Guilds General Unit Route has been illustrated in Figure B7.
- The City & Guilds online questions routes contain a premium due to this additional service. Neither of these routes are illustrated in Figure B7.

The fee for the VTCT qualification is lower than that for City & Guilds (all routes). Between 2004 and 2008, the fee charged by VTCT increased by less than 1% in real terms. The fee for the City & Guilds Full Route fell by 12% in real terms between 2003 and 2008.

**Hairdressing**

As with its other NVQs, City & Guilds offers both a Full Route and a Unit Route. In addition, City & Guilds operates an online questions route which contains a premium due to this additional service. Only the Full Route and Unit Route are illustrated in Figure B7.

The fee for the VTCT qualification is lower than that for City & Guilds (both routes). The VTCT fee is the same as that charged for the Level 2 NVQ in Beauty Therapy. In contrast City & Guilds charges more for the Full Route in Hairdressing than for Beauty Therapy. Between 2004 and 2008, the fee charged by VTCT increased by less than 1% in real terms. The fee for the City & Guilds Full Route fell by 12% in real terms between 2003 and 2008.

**Vocationally Related Qualifications**

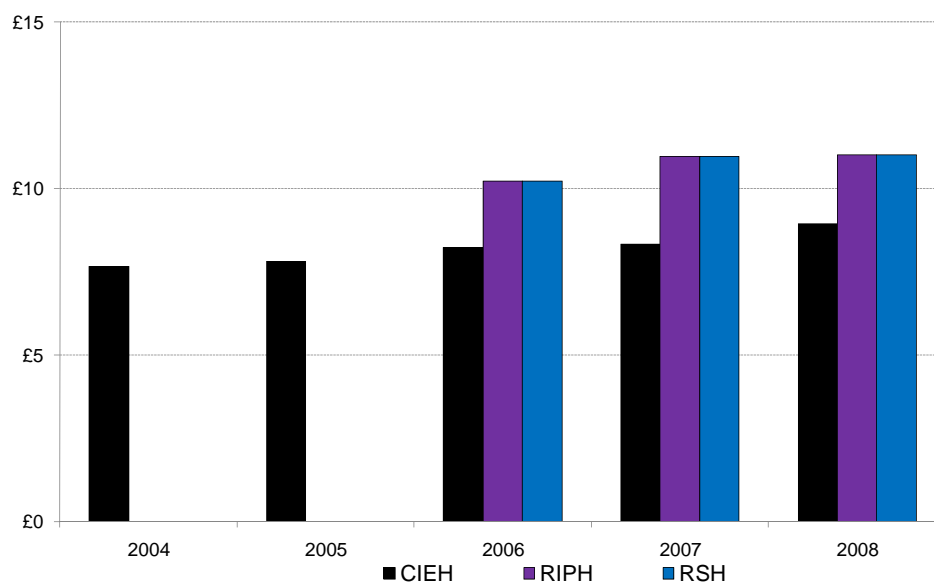
Other than National Diplomas (discussed separately below), five VRQs have been selected for analysis.

- Food Safety in Catering (Level 2). Three awarding organisations have been selected.
- Health and Safety in the Workplace (Level 2). Three awarding organisations have been selected.
- Intermediate Construction Award (Level 2). One awarding organisation has been selected.
- Electrotechnical technology (Level 2). One awarding organisation has been selected.

- Plumbing Studies (Level 2). One awarding organisation has been selected.

### Food Safety in Catering

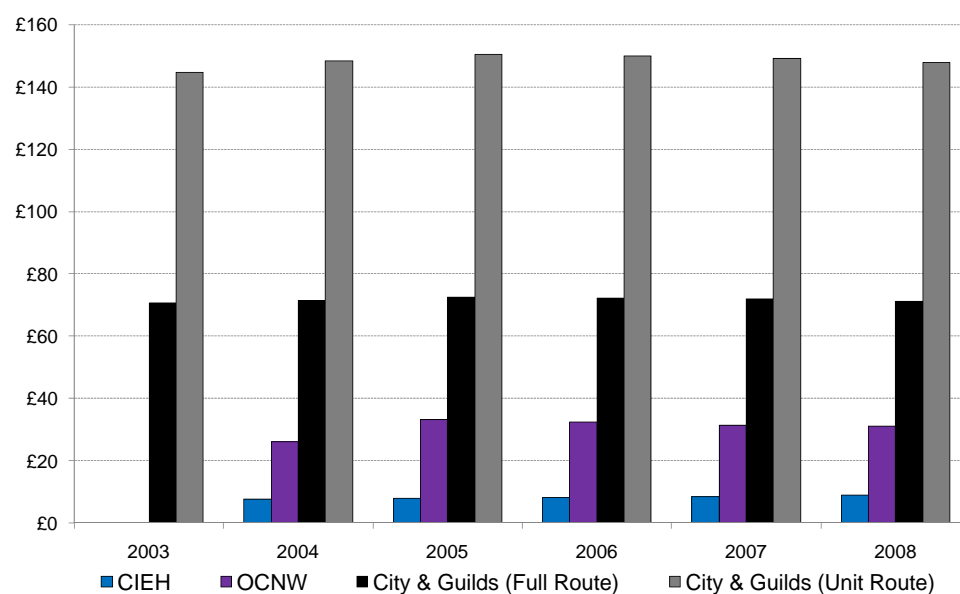
**Figure B.8: Level 2 Food Safety in Catering qualifications (fees for 2004 to 2007 have been restated in 2008 prices)**



Between 2003 and 2008, the fee for CIEH's Level 2 Award in Food Safety in Catering increased by 17% in real terms. RIPH's qualification and RSH's qualification were priced the same in all years given and increased by 7% in real terms between 2006 and 2008

### Health and Safety in the Workplace

**Figure B.9: Level 2 Health and Safety in the Workplace qualifications (fees for 2003 to 2007 have been restated in 2008 prices)**



The Level 2 Health and Safety in the Workplace VRQs are three different qualifications:

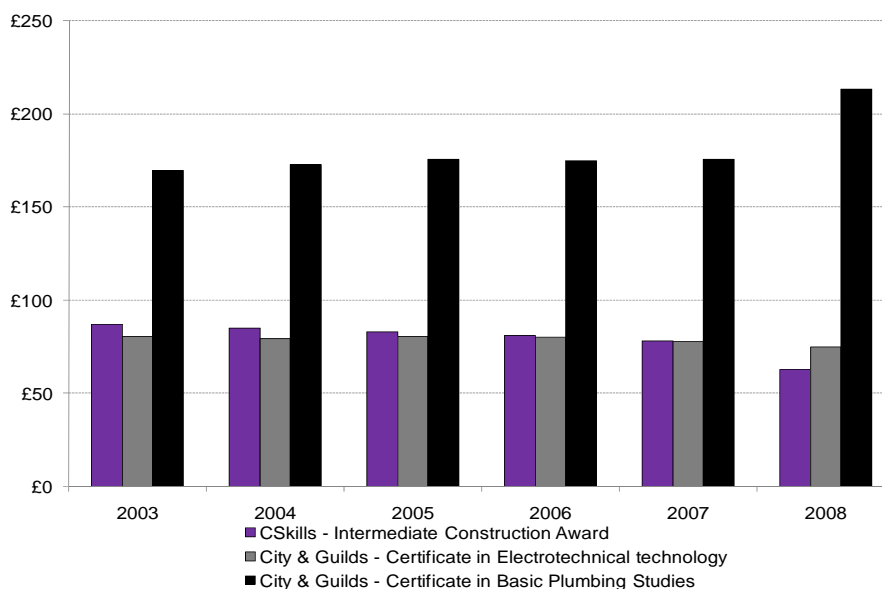
- Award in Health and Safety in the Workplace from CIEH
- Certificate in Health and Safety in the Workplace from OCNW
- Progression Award in Health and Safety in the Workplace from City & Guilds. This is offered as either a Unit Route or a Full Route.

Between 2003 and 2008, the fee for CIEH's Level 2 Award in Health and Safety in the Workplace increased by 17% in real terms. The fee for OCNW's qualification increased by 19% in real terms between 2004 and 2008.

The fee for the Unit Route for the Progression Award in Health and Safety in the Workplace from City & Guilds decreased by 0.4% in real terms between 2003 and 2008; the fee for the Full Route decreased by 0.1% in real terms.

### Other VRQs

**Figure B.10: Other vocational related qualifications (fees for 2003 to 2007 have been restated in 2008 prices)**



The other case study VRQs are:

- CSkills Intermediate Construction Award (Level 2)
- City & Guilds Certificate in Electrotechnical Technology (Level 2)
- City & Guilds Certificate in Basic Plumbing Studies (Level 2)

### **CSkills Intermediate Construction Award (Level 2)**

In response to customer feedback, from 2008 a flat fee of £62.50 is being charged for all qualifications. Previously, the fee consisted of a first-time registration fee of £30 and a qualification registration fee of £45. Therefore the candidate would have paid £75 for their first qualification and then £45 for any subsequent qualifications. This results in a 28%

decrease in the fee real terms for the first qualification. However, viewed in isolation this could be misleading as if a candidate takes more than one qualification they will be paying more for their second, third and fourth qualifications (£62.50 rather than £45).

### City & Guilds Certificate in Electrotechnical Technology (Level 2)

The fee breakdown to complete this qualification comprises a registration fee then four gola units which are charged individually. The qualification also includes one practical component and one assignment. No additional charge is made for either of these components. The total fee for this qualification has decreased by 7% in real terms between 2003 and 2008.

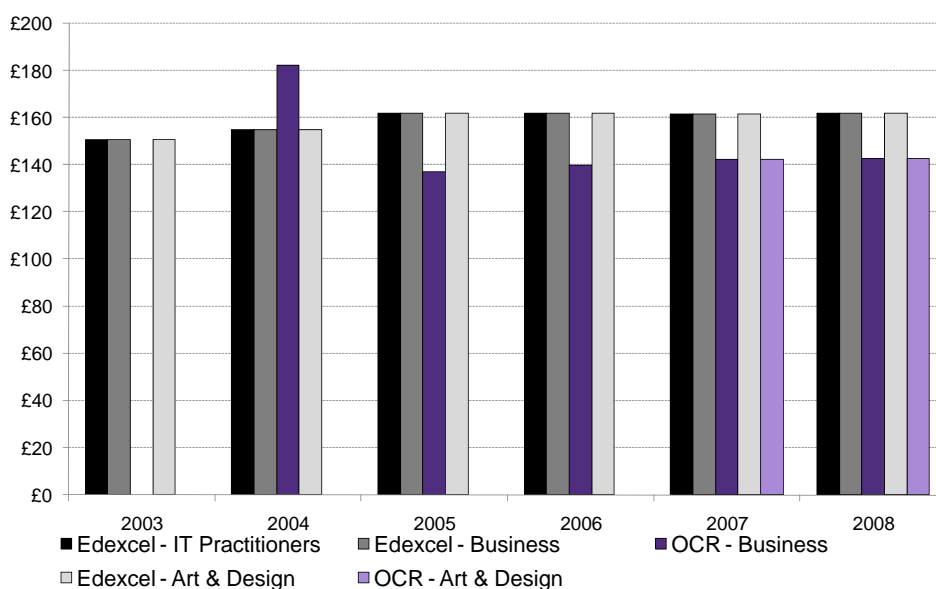
### City & Guilds Certificate in Basic Plumbing Studies (Level 2)

The total fee for this qualification has increased by 26% in real terms between 2003 and 2008. The increase in fee in 2008 is due to the replacement of centre devised examinations with 12 'Gola' online assessments for a cost of £45 in October 2008.

### National Diplomas

Three National Diplomas have been selected for analysis from Edexcel and OCR. As noted in the Introduction (Chapter 2), National Diplomas refer to already established work-related qualifications and not the new Diplomas which were introduced in September 2008. The analysis for all the Diplomas is shown in the figure below.

**Figure B.11: National Diplomas (fees for 2003 to 2007 have been restated in 2008 prices)**



The figure shows that Edexcel charges the same fee for each of the Diplomas. The fees have increased by 8% in real terms between 2003 and 2008. The fee for OCR's National Diploma in Business was more than £20 higher (in nominal terms) than that charged by Edexcel in 2004. The fee was significantly reduced the following year before rising slightly each year for the following two years. This results in a decrease in real terms of 22% between 2004 and 2008. The fee for OCR's Art and Design Diploma in 2008 was the same as that charged for the Diploma in Business.

## C Market definition

### C.1 Background

In competitive markets, the extent to which the price charged by a company or organisation is reasonable is largely influenced by the level and nature of competition in the market. If an organisation sets a price which is higher than the market clearing level in order to extract excess profits, then it is likely that the market demand for its product would fall significantly, as consumers switch to rival competitors for the same product or to other similar products.

Whether a product or service has a reasonable fee is therefore not particularly relevant when there is competition. In competitive markets, the price which an organisation can charge will be dictated by market forces. However, many markets and industries are not competitive. For example, in situations where there is one seller (a monopoly), a small number of sellers (an oligopoly) or many sellers but producing heterogeneous (differentiated) goods, firms have greater control over the level of price that they offer and can extract excess profits.

This level of control over prices and fees is captured in competition analysis by the term 'market power'. This is formally defined as "*the ability to raise price consistently and profitably above competitive levels (or where a buyer has market power, the ability to obtain prices lower than their competitive levels)*"<sup>33</sup>. The first step in assessing the extent to which there is market power is an appropriate definition of the market.

### C.2 Definition of the relevant market

This assessment of market definition is undertaken through the framework known as the hypothetical monopolist test, or the 'small, significant non-transitory increase in price (SSNIP) test. This test examines whether a hypothetical monopolist can permanently increase its profits from a specific product (or group of products) by raising its prices by around 5%-10% above competitive levels.

A company can only increase the prices of the specific product above competitive levels if there are no substitutable products available for the consumer to switch to or for another company to enter the market. If the monopolist is unable to increase prices because of this demand or supply side substitution, then these products are added to the potential market.

The starting point for the test is the narrowest definition of the market (that is, a individual product or set of products). The test is applied and other products are brought into the definition of the market and the test is reapplied. This process is continued until no other products can be included in the market and this is taken to be the definition of the market.

Assessing the relevant market requires an assessment of:

- **Supply side substitution:** the extent to which companies can start to supply the qualification at short notice if prices rises
- **Demand side substitution:** the extent to which a significant number of customers, but not necessarily the majority, when would switch to other products if prices rises
- **Geographic substitution:** whether customers would switch to suppliers from other countries, should the price of products from UK suppliers rise.

<sup>33</sup> Competition Commission.

If products are substitutable due to supply side, demand side or geographic substitution then they should be considered to be in the same market.

Such a definition of the market allows some basic indicators to be calculated such as market shares and market concentration. Combining these indicators with other evidence such as barriers to entry, then allows some conclusions to be made about market power.

### C.3 Characteristics of the market

In practice, it is not generally possible to apply the monopolist test and so it is necessary to consider a wide range of evidence on consumer and supplier behaviour in the market. The first step is to segment the market into a number of narrow definitions as the theory implies and then to consider the level of demand and supply side substitution.

#### Vocational and general qualifications

The scoping study by Europe Economics<sup>34</sup> considers whether general qualifications are substitutes for vocational qualifications. It concludes that these are separate markets arguing that:

- teaching and assessment methods differ
- certain subjects (such as French or History) are only available as a general qualification while others (eg Hairdressing) are only available as a vocational
- learning providers, students and employers consider general qualifications to be in a separate market to vocational qualifications.

While it is helpful to ask whether general and vocational qualifications are separate markets, the Office of Fair Trading methodology<sup>35</sup> states that the "*market definition process usually starts by looking at a relatively narrow potential definition*". It is therefore appropriate to start from a narrower product definition, defined by qualification level, assessment type and subject.

General and vocational qualifications are considered to be not necessarily in different markets or the same market. It depends on the degree of product and supply side substitutability for a given qualification level and sector.

In particular, the starting point for an appropriate definition of the market is to define or segment the market into a set of narrow characteristics and then to consider the level of demand and supply side substitution for similar and related qualifications. The set of characteristics to consider are:

- the subject or content of the qualification
- the level (GCSE, A levels, etc) of the qualification (ie progression routes)
- the delivery and assessment method.

#### Defining markets by qualification level

Consider a qualifications system according to the level of the qualification (ie routes). The question is then the extent to which students and centres view different qualifications at different levels as substitutes for each other.

<sup>34</sup> Scoping Exercise for a Study of the Efficiency of the Qualifications System

<sup>35</sup> Market Definition, Office of Fair Trading (March 1999).

The following characteristics appear to suggest that the demand side substitution between qualifications is low, since:

- employers and universities are unlikely to give a lower level qualification the same weight as a qualification with a higher level
- qualifications are mostly aimed at specific age groups.

On the supply side, it is unlikely that substitution of products will take place fast enough in response to a hypothetical rise in price of 5%-10%. According to the guidelines from the Office of Fair Trading, entry in the market needs to occur in less than one year. In our opinion, this is unlikely because:

- the rigid timeframe of the academic year allows entry at certain points of the academic year (eg September)
- it can take anything up to two years for an awarding organisation to develop the content of the course
- awarding organisations have to advertise prices a year in advance of the actual start of the course
- product development costs are argued by awarding organisations to be significant, implying there is some lead time between the initial decision to enter the market and a centre being able to switch supply.

Product development costs also appear to be significant, so sunk investments are also substantial invalidating another of the criteria.

It is debatable whether the market should also be defined according to level (Entry Level, Level 1, Level 2, Level 3 etc). While demand side substitution is likely to be low between levels, there could be significant supply side substitution. The issue is one of timing, as competition policy guidelines state that supply side substitution should occur within one year and it may take awarding organisations longer than this to produce a new product, market this to centres and then to students.

#### **Defining markets by sector**

The degree of substitutability between qualifications from different sectors of the subject/sector framework is likely to be low. For example, it is unlikely that a Level 3 NVQ in Accounting is considered to be in the same market as a Level 3 NVQ in Beauty Therapy by either awarding organisations, centres or students. However, qualifications within the same sector are likely to be highly substitutable, such as a NVQ in Business Management and a NVQ in Accounting. In our opinion, therefore, a market based on sectors could be a more appropriate definition to test competition issues, as described in the table below.

Area	First Tier	Area	Second Tier
1.	<a href="#">Health, Public Services and Care</a>	1.1	Medicine and Dentistry
		1.2	Nursing and Subjects and Vocations Allied to Medicine
		1.3	Health and Social Care
		1.4	Public Services
		1.5	Child Development and Well Being
2.	<a href="#">Science and Mathematics</a>	2.1	Science
		2.2	Mathematics and Statistics
3.	<a href="#">Agriculture, Horticulture and Animal Care</a>	3.1	Agriculture
		3.2	Horticulture and Forestry
		3.3	Animal Care and Veterinary Science
		3.4	Environmental Conservation
4.	<a href="#">Engineering and Manufacturing Technologies</a>	4.1	Engineering
		4.2	Manufacturing Technologies
		4.3	Transportation Operations and Maintenance
5.	<a href="#">Construction, Planning and the Built Environment</a>	5.1	Architecture
		5.2	Building and Construction
		5.3	Urban, Rural and Regional Planning
6.	<a href="#">Information and Communication Technology</a>	6.1	ICT Practitioners
7.	<a href="#">Retail and Commercial Enterprise</a>	6.2	ICT for Users
		7.1	Retailing and Wholesaling
		7.2	Warehousing and Distribution
		7.3	Service Enterprises
8.	<a href="#">Leisure, Travel and Tourism</a>	7.4	Hospitality and Catering
		8.1	Sport, Leisure and Recreation
9.	<a href="#">Arts, Media and Publishing</a>	8.2	Travel and Tourism
		9.1	Performing Arts
		9.2	Crafts, Creative Arts and Design
		9.3	Media and Communication
10.	<a href="#">History, Philosophy and Theology</a>	9.4	Publishing and Information Services
		10.1	History
		10.2	Archaeology and Archaeological Sciences
		10.3	Philosophy
11.	<a href="#">Social Sciences</a>	10.4	Theology and Religious Studies
		11.1	Geography
		11.2	Sociology and Social Policy
		11.3	Politics
		11.4	Economics
12.	<a href="#">Languages, Literature and Culture</a>	11.5	Anthropology
		12.1	Languages, Literature and Culture of the British Isles
		12.2	Other Languages, Literature and Culture
13.	<a href="#">Education and Training</a>	12.3	Linguistics
		13.1	Teaching and Lecturing
14.	<a href="#">Preparation for Life and Work</a>	13.2	Direct Learning Support
		14.1	Foundations for Learning and Life
15.	<a href="#">Business, Administration and Law</a>	14.2	Preparation for Work
		15.1	Accounting and Finance
		15.2	Administration
		15.3	Business Management
		15.4	Marketing and Sales
		15.5	Law and Legal Services

### Defining markets by the delivery and assessment method

The delivery and assessment methods range from e-assessment, external verifiers, moderators, course work and exam based qualifications. The different forms of assessment or delivery methods could be viewed as value added services to the core product offering and typically such additional services are often price sensitive. If the fee for one method of delivery or assessment is increased then a significant number of centres may switch to other forms of assessment/delivery.

Such characteristics imply that the same qualification which is delivered or assessed in a different way should be considered to be in the same market.

### C.4 Conclusions on a working assumption

A definition of the appropriate market is outside the scope of this study. We have therefore not undertaken any primary research on the extent to which there is demand or supply side substitution. We have, however, been able to set out the characteristics of the market, collect views from awarding organisations on how the market works and analyse available data in order to set out a working assumption. This is based on a high-level review of the

characteristics of the market and the competition policy approach that markets should start with a narrow definition.

Our working assumption on market definition is that there are many markets in the qualifications industry, defined by sector. This means that general and vocational qualifications are both separate and overlapping depending on the sector considered.

Such an assumption allows us to consider the level of concentration in the market: ie how many competitors there are and the market shares of those competitors. The purpose of such analysis is to examine whether market power exists. In markets where it does exist, prices are likely to be higher than they would otherwise be, providing an indication of unreasonableness.

## D The case studies

### D.1 Case study qualifications

Number	Qualification Title	Qualification Reference	Awarding Organisation
1	CIEH Level 2 Award in Food Safety in Catering	100/5897/7	CIEH
2	RSPH Level 2 Award in Food Safety in Catering	100/5823/0	RSPH
3	RIPH Level 2 Award in Food Safety in Catering	100/5898/9	RIPH
4	EDEXCEL Level 2 Key Skills in Communication	100/0288/1	EDEXCEL
5	City & Guilds Level 2 Key Skills in Communication	100/0275/3	City & Guilds
6	TCL Entry Level Certificate in ESOL Skills for Life (Entry 2)	100/4267/2	TCL
7	Cambridge ESOL Entry Level Certificate in ESOL Skills for Life (Entry 2)	100/3930/2	Cambridge ESOL
8	City & Guilds Entry Level Certificate in ESOL Skills for Life (Entry 2)	100/3741/X	City & Guilds
9	CAA Level 2 Intermediate Construction Award	100/1254/0	CSkills Awards
10	ABRSM Foundation Graded Examination in Music Performance	100/0783/0	ABRSM
11	Trinity Guildhall Level 1 Graded Examination in Music Performance	100/6043/1	TCL
12	TVU Level 1 Graded Examination in Music Performance	100/1989/3	TVU
13	CIEH Level 2 Award in Health and Safety in the Workplace	100/5914/3	CIEH
14	OCNW Level 2 Certificate in Health and Safety in the Workplace	100/3028/1	OCNW
15	City & Guilds Level 2 Progression Award in Health and Safety in the Workplace	100/1900/5	City & Guilds
16	City & Guilds Level 2 NVQ in Health and Social Care	100/4792/X	City & Guilds
17	EDEXCEL Level 2 NVQ in Health and Social Care	100/4795/5	EDEXCEL
18	OCR Level 2 NVQ in Health and Social Care	100/4924/1	OCR
19	EDEXCEL Level 3 BTEC National Diploma for IT Practitioners	500/1595/3	EDEXCEL
20	EDEXCEL Level 3 BTEC National Diploma in Business	500/1480/8	EDEXCEL
21	OCR Level 3 National Diploma in Business	100/3312/9	OCR
22	City & Guilds Level 2 NVQ in Hairdressing	100/3244/7	City & Guilds
23	VTCT Level 2 NVQ in Hairdressing	100/3230/7	VTCT
24	City & Guilds Level 2 Certificate in Electrotechnical Technology	100/3569/2	City & Guilds
25	EDEXCEL Level 3 BTEC National Diploma in Art and Design	500/1810/3	EDEXCEL
26	OCR Level 3 National Diploma in Art and Design	500/2708/6	OCR
27	City & Guilds Level 2 Certificate in Basic Plumbing Studies	100/3356/7	City & Guilds
28	AAT Level 3 NVQ in Accounting	100/2941/2	AAT
29	VTCT Level 2 NVQ in Beauty Therapy	100/4306/8	VTCT
30	City & Guilds Level 2 NVQ in Beauty Therapy	100/4160/6	City & Guilds
31	CACHE Level 3 NVQ in Children's Care, Learning and Development	100/5516/2	CACHE
32	City & Guilds Level 3 NVQ in Children's Care, Learning and Development	100/5513/7	City & Guilds
33	EDEXCEL Level 3 NVQ in Children's Care, Learning and Development	100/5519/8	EDEXCEL

### D.2 Case study awarding organisations

The 15 case study awarding organisations are described below.

#### 1. Associated Board of the Royal Schools of Music (ABRSM)

ABRSM is a charitable company established for the benefit of music education by four of the Royal Schools of Music in the UK. ABRSM's core activity is the operation of an authoritative and internationally recognised system of exams and assessments to encourage and motivate players and singers at all levels through the provision of goals and the measurement of progress. ABRSM reported a turnover in 2007 of £26.0m, an increase from £24.6m in 2006.

ABRSM provides 18 qualifications as at 20th May 2009 as per the National Database of Accredited Qualifications. One ABRSM qualification was selected for the study.

#### 2. Association of Accounting Technicians (AAT)

AAT was incorporated on 26 September 1980 as a not-for-profit organisation. AAT is sponsored and supported by four of the main UK chartered accountancy bodies. AAT reported a surplus of £2.5m in 2007, growing from £891,000 in 2006. The 2007 reported turnover includes a one - off £2.4m gain in the disposal of land and buildings.

AAT provides 14 qualifications as at 20th May 2009 as per the National Database of Accredited Qualifications. One AAT qualification was selected for the study.

### **3. Chartered Institute of Environmental Health (CIEH)**

CIEH is a registered charity. It sets standards, accredits courses and qualifications for the education of members and other environmental health practitioners. CIEH reported turnover of £14.3m for the year to 31 December 2007.

CIEH provides 19 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. Two CIEH qualifications were selected for the study.

### **4. The City & Guilds of London Institute (City & Guilds)**

City & Guilds is a registered charity founded in 1878. It is dedicated solely to vocational qualifications. It holds a number of subsidiary companies including NPTC which is an awarding organisation in its own right. City & Guilds reported turnover for 2007 was £95.2m.

City & Guilds provides 1,590 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. Nine City & Guilds qualifications were selected for the study.

### **5. Construction Skills (CSkills Awards)**

CITB-Construction Skills is an Industry Training Board. Funding is mainly by the construction industry itself, through a statutory levy. Further income is received from public bodies such as the Learning and Skills Council, from the European Social Fund and its own products and services. CSkills Awards is a division of CITB-Construction Skills which is a part of the partnership that makes up ConstructionSkills SSC. Those partners do not have any ownership of CSkills Awards. CSkills Awards provides apprenticeships as well as vocational qualifications. Construction Skills SSC is a partnership between CITB-ConstructionSkills, the Construction Industry Council, and CITB Northern Ireland. CITB-ConstructionSkills reported turnover for the year ending 31 December 2007 was £290m.

CSkills Awards provides 146 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. One CSkills Awards qualification was selected for the study.

### **6. Council for Awards in Children's Care and Education (CACHE)**

CACHE is a charity and a not-for-profit company limited by guarantee. CACHE's core business is as an awarding organisation in the UK. CACHE supplies NVQs and vocational qualifications. CACHE reported turnover for 2007 was £7.9m.

CACHE provides 76 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. One CACHE qualification was selected for the study.

### **7. Edexcel Limited (Edexcel)**

Edexcel was formed in 1996 by the merger of the Business & Technology Education Council (BTEC), the country's leading provider of vocational qualifications, and the University of London Examinations & Assessment Council (ULEAC). In June 2003, the Edexcel Foundation entered into a partnership arrangement with Pearson PLC, the biggest educational services company in the world, to set up a new company called London Qualifications Ltd, which traded as Edexcel. The new company was 75% owned by Pearson and 25% by the Edexcel Foundation. All of the business activities and staff transferred to London Qualifications, which became a subsidiary of Pearson.

Edexcel offers both academic and vocational qualifications and testing to schools, colleges, employers and other places of learning in the UK and internationally. Edexcel reported a turnover of £225m in 2007.

Edexcel provides 1,286 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. Six Edexcel qualifications were selected for the study.

#### **8. Open College of the North West (OCNW)**

OCNW was established in 1975 as a partnership scheme between universities and colleges of further education. It was the first 'Open College'. It is an unincorporated association, regulated by Ofqual and licensed by the Quality Assurance Agency (QAA) for Higher Education. The last accounts for the year ending 31 July 2007 show reported income of £1.2m. The related cost of this was £1.0m (ie surplus making). OCNW provides a range of vocational and functional skill qualifications.

OCNW provides 122 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. One OCNW qualification was selected for the study.

#### **9. Oxford, Cambridge and RSA Exams (OCR)**

OCR is a charity and part of the Cambridge Assessment Group which is a department of the University of Cambridge. OCR was created in 1998 by University of Cambridge Local Examinations Syndicate (UCLES) when it was joined by the RSA Examinations Board. Cambridge ESOL (one of the other case study awarding organisations) is a sister organisation to OCR being also part of the Cambridge Assessment Group. The exam boards under Cambridge Assessment provide assessment to over 150 countries in the world.

The accounts for the year ending 31 July 2007 contain income for 12 months and 10 months of overheads (due to a different year end for the ultimate parent, the University of Cambridge). Surplus for 2007 was £19.2m up from £2m in 2006.

OCR provides 1,200 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. Three OCR qualifications were selected for the study.

#### **10. Royal Institute of Public Health (RIPH)**

RIPH was a registered charity and governed by a Royal Charter and Bye-laws. Turnover for 2007 was reported at £1.4m.

The Royal Society for Public Health (RSPH) is an independent charity formed in October 2008 by the merger of the Royal Society of Health (RSH) and RIPH. For this study however they have been reviewed independently.

RSPH provides 32 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. One RIPH qualification was selected for the study.

#### **11. Royal Society of Health (RSH)**

RSH was a company limited by guarantee and a registered charity. The RSH reported turnover for the year to 31 December 2007 of £1.4m.

The RSPH is an independent charity formed in October 2008 by the merger of RSH and RIPH. For this study however they have been reviewed independently.

RSPH provides 32 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. One RSH qualification was selected for the study.

#### **12. Thames Valley University (TVU/LCM Exams)**

Thames Valley University trades as a charity. London College of Music™ is a registered trade mark used by the university in connection with the awarding of qualifications. TVU reported income of £106m for 2007, which covers the whole of the university's activities.

TVU provides 25 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. One TVU qualification was selected for the study.

### **13. Trinity College London (TCL)**

TCL is a company limited by guarantee and is a registered charity. It was established in 1992. Reported turnover for the year ending 31 December 2007 was £17m.

TCL provides 88 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. Two TCL qualifications were selected for the study.

### **14. University of Cambridge ESOL Examinations (Cambridge ESOL)**

Cambridge ESOL is a not-for-profit department of the University of Cambridge and is part of the Cambridge Assessment Group, Europe's largest assessment agency. Cambridge Assessment was established in 1858 as the University of Cambridge Local Examinations Syndicate (UCLES). Cambridge Assessment is the trading name of UCLES. The consolidated accounts published for Cambridge Assessment for the 10 months to July 2007 showed an income of £188m.

Cambridge ESOL provides 43 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. One Cambridge ESOL qualification was selected for the study.

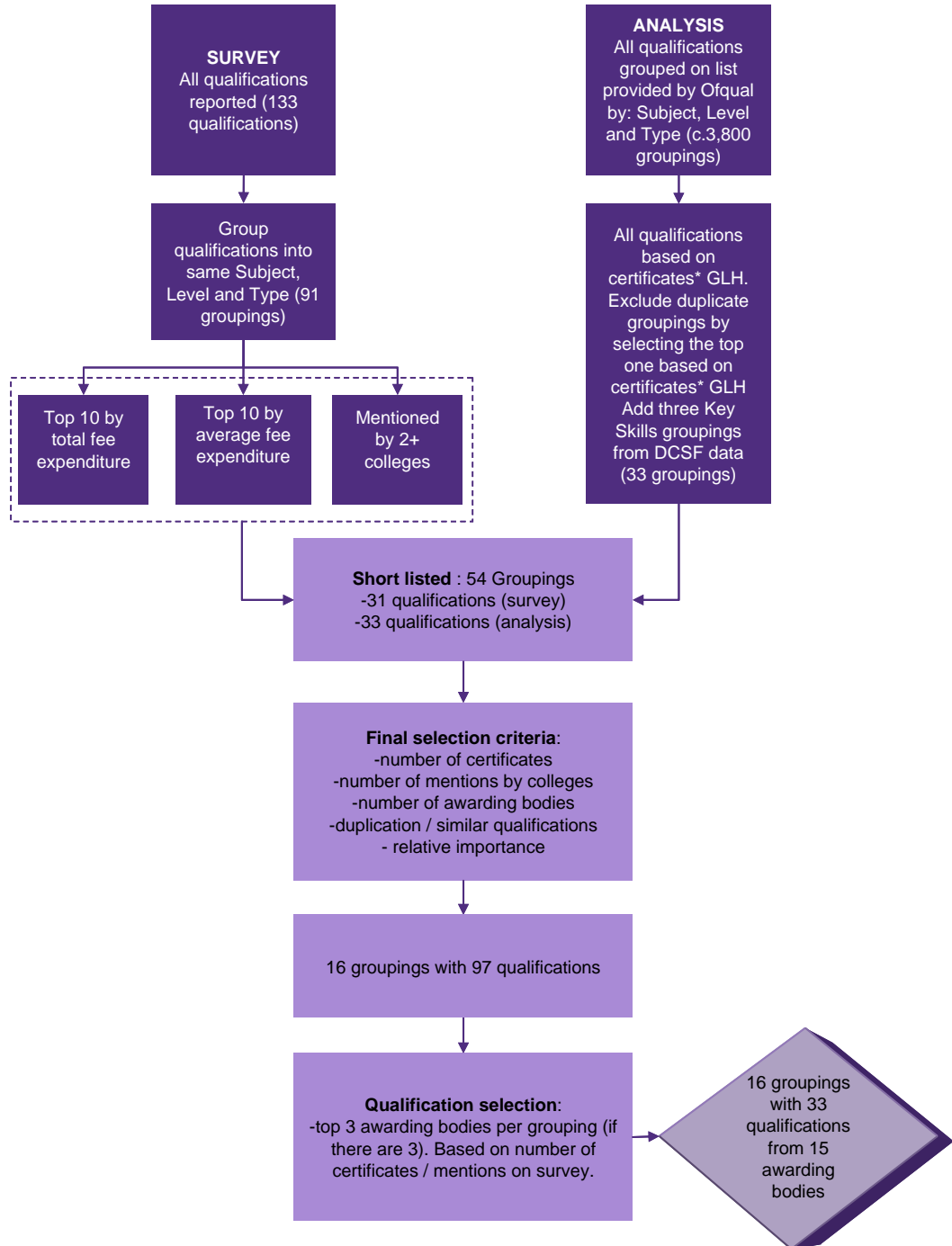
### **15. VTCT (VTCT)**

VTCT is a charity and has been in existence for over 40 years. VTCT reported turnover of £6.5m of income for the year to 31 July 2008.

VTCT provides 134 qualifications as at 20 May 2009 as per the National Database of Accredited Qualifications. Two VTCT qualifications were selected for the study.

### D.3 Selecting the case study qualifications

This rest of this appendix outlines how the 33 case study qualifications and the 15 awarding organisations were selected. The methodology for selection is outlined in the diagram below.



The selection of qualifications included analysis of:

- **data provided by Ofqual**, detailing the number of certificates awarded for each qualification and the guided learning hours for each qualification

- a survey of colleges to provide further evidence to inform the selection.

### Data analysis

Data provided by Ofqual was used to select 30 Qualification Groupings for potential inclusion in the study. In addition, three Key Skills Qualification Groupings were suggested for potential inclusion in the study. OFQUAL data did not exist for Key Skills so data from the DCSF was used.

### Survey of colleges

The survey included 11 questions: five detailed questions asking for quantitative data analysis, two qualitative questions asking for the college's views on the subject and four 'tick the box' questions for administrative purposes – for example, college location.

Colleges were selected to participate in the survey using data received from the LSC<sup>36</sup>, which provided details for 374 colleges in England out of a possible 376 returns (99.47%).

The survey was piloted with one college in the first instance. This college was selected due to its role on the Advisory Group for this study with one further pilot survey held with one other college to complete the data.

A total of 19 colleges responded to the survey, providing a useful source of qualitative and quantitative data. Of the 19 responses, 14 provided information specific enough to be analysed.

### Qualification groupings

Qualifications reported by the survey (and the original data analysis) were analysed initially based on subject, level and qualification type (which are referred to as qualification groupings). For example, the table below groups all qualifications that have:

- The SUBJECT of Health and Social Care
- The QUALIFICATION TYPE of VRQ
- The LEVEL of 2

Within this grouping, there are nine specific qualifications (individual qualifications) offered by five awarding organisations.

Subject	Type	Level	Accredited Qualifications Title
Health and Social Care	VRQ	2	OCR Level 2 National Award in Health and Social Care OCR Level 2 Certificate in Health and Social Care OCR Level 2 National Certificate in Health and Social Care EDEXCEL Level 2 BTEC Certificate in Health and Social Care EDEXCEL Level 2 BTEC First Diploma in Health and Social Care EDEXCEL Level 2 BTEC First Certificate in Health and Social Care ASET Level 2 Certificate in Health and Social Care City & Guilds Level 2 Certificate in Health and Social Care EDI Level 2 Certificate in Health and Social Care

### Creating a shortlist

Using the results from the survey, and also considering the results of data analysis, a shortlist of 54 qualification groupings was produced. Qualifications groupings were included in the short list if they were:

- included in the original data analysis or

<sup>36</sup> College Finance Records 06-071.xls

- reported by two or more colleges in the survey or
- in the top 10 most expensive qualifications reported in the survey: highest total Exam Fee expenditure or
- in the top 10 most expensive qualifications reported in the survey: highest **average** Exam Fee expenditure.

Of the 54 qualification groupings on the shortlist, 33 were sourced from the original data analysis and 31 were sourced from the survey. Ten of these groupings were from both sources.

#### **Selecting qualification groupings from the shortlist**

Some 16 qualification groupings from the shortlist of 54 were selected for further analysis using consideration of the following criteria:

- Number of mentions by colleges from the survey
- The number of certificates awarded using data from Ofqual
- The number of awarding organisations offering the qualification grouping
- Duplication with another qualification grouping (which is the most appropriate to study)
- Relative importance compared to other qualification groupings.

#### **Selecting qualifications**

From the 16 qualification groupings, all of the current qualifications within each group were collated (using the national database at [www.accreditedqualifications.org.uk](http://www.accreditedqualifications.org.uk)). There were 97 individual qualifications in total.

The specific qualifications were then selected based on the following criteria:

- Three separate awarding organisations were chosen for each grouping if possible.
- The qualification and awarding organisation were selected based on the number of certificates and/or the number of mentions they had received on the college survey.

This led to a selection of 33 qualifications across 15 awarding organisations.

## E Financial analysis

### The PKF definition of reasonableness

The definition of fees' reasonableness used by PKF for the 'A levels and GCSEs' study depended on an assessment of the profitability of fees, plus consideration of other factors. The definition was based on an assessment of whether awarding organisations were experiencing normal profits. Essentially, prices are compared against costs to ascertain whether profits earned are similar across the industry and to other benchmarks.

The PKF definition took into account other wider qualitative factors, particularly:

- QCA qualifications priority: where new government initiatives are being introduced, an allowance has been given as the changes to the qualifications have raised costs
- NAA processing improvement priority: the objective of improving quality, particularly accuracy and speed of examination through implementation of new technology (e-marking and e-assessment)
- Awarding organisation business priority: the extent to which awarding organisations offer the full range of subjects at similar prices. The result of this is that often some lower demand subjects are loss-making and some higher demand subjects have higher than normal profits and an allowance is made for this in the reasonableness assessment
- Awarding organisation business assumptions on profitability: account is taken of the different company structures. For example, a charity or not-for-profit organisation may only have the objective of breaking-even, whereas a commercial company would seek to make as high as profits as possible.

However, it did not provide a robust, adequate description of how these qualitative factors were assessed.

### Quantitative profitability indicators

We have used a standard accounting ratio 'Return on Sales' (ROS) to calculate the level of profitability.

$$ROS = \frac{\text{Earnings Before Interest and Tax}}{\text{Turnover}}$$

Earnings Before Interest and Tax (EBIT) is calculated as operational profit after depreciation and overheads but before interest costs (net of receipts) and taxation. We have excluded exceptional items in arriving at the EBIT. The ROS measure excludes tax and interest (payments and receivables) since these two items are likely to distort the true operational performance of the companies. It is a measure of the profit margin on sales and as such items which are liable to distort this view are excluded.

### Key advantages of the profitability indicators

ROS as an indicator of profitability benefits from its relative simplicity and familiarity. This project is dealing with a number of different awarding organisations of different sizes, different company and governance structures). The profit measures must be simple and generic to be able to be used across these different structures.

Some of the advantages of ROS as an indicator of profitability benefits are that:

- it is not distorted by variations in cost of funds
- it is not influenced by different approaches to tax
- it includes overheads and is influenced by the operational efficiency of each entity
- it takes into account depreciation charges which reflects the usage of assets and diminution of their values
- it provides a relative indicator which is independent of the size of the business.

#### Key disadvantages of the profitability indicators

The key drawbacks of using ROS are that:

- depreciation policy may vary from awarding organisation to awarding organisation
- some awarding organisations may be part of larger groups and therefore able to utilise group resources to differing extents
- the EBIT achieved may be dependent upon the age and condition of its assets which is likely to differ between awarding organisation.

Similarly, profitability measures such as Return on Capital Employed (ROCE), which are based in part on an estimation of capital employed, can be depressed when high profitability leads to an increase in the valuation of capital assets which in turn reduces the ROCE. ROS on the other hand is independent of asset values and is a particularly useful measure for that reason. In addition, ROCE is more sensitive to levels of investment, and associated accounting practices with depreciation, accruals and recognition and how they are spread over different accounting years.

#### Other profitability indicators

There are a number of other methods which could be used which have been discounted, such as include internal rate of return (IRR) and other accounting ratios.

The IRR (and Net Present Value) can be calculated from a time series of cash inflows and cash outflows over a period. Typically, in the case of a single product, an initial investment is compared with a latter revenue stream which arises from that investment. A long-time series of data is required for this calculation and has therefore been eliminated as a practical method. The Office of Fair Trading (OFT) in its guidance on profitability analysis set out the advantages and disadvantages of using different measures. For IRR, it states that "*It can sometimes be difficult to estimate the IRR as a result of difficulties in obtaining reliable cash flow data for a sufficiently long time period.*"

Other ratios have been examined as possibilities. They include the certainty-equivalent accounting rate of return (CARR), Tobin's q, the market-to-book ratio and economic value added. These have not been used because they are more complex and require more data to be collected – particularly problematic given the range and type of awarding organisations being considered.

#### Product analysis

This section summarises our methodology for the analysis of costs and revenues for the selected qualification(s). It is based upon common practice used by regulators and a set of key principles, with discussion and consultation at the heart of our approach.

Where cost allocation analysis has already been undertaken by awarding organisations for the purpose of internal budgeting or profitability analysis, we would place a strong emphasis on the approach and the results. Where cost allocation methods do not currently exist, we would aim to obtain awarding organisations views on what they consider to be the most appropriate method and cost drivers to use.

#### *Key steps and processes*

The following steps summarise our approach:

1. **Identification of the direct income and costs** associated with the specific qualification(s) selected. Examples of direct costs include examiner fees, examination centres and direct support costs.
2. **Identification of indirect (or non-attributable) costs** (eg general administration, syllabus costs, IT costs, central office functions).
3. **Identification of key drivers of indirect costs.** To allocate indirect costs to the selected qualification(s) requires identification of cost drivers which are most appropriate for each category of indirect cost.. Examples included:
  - the number of enrolments of the selected qualification as a percentage of total enrolments
  - the number of qualifications units undertaken by students of the selected qualification provided, as a percentage of the total
  - the number of exams taken of the selected qualification as a percentage of total exams takes
  - the number of staff (FTEs) involved in the selected qualification as a percentage of total staff FTEs.

We were particularly keen to understand from awarding organisations which cost drivers they considered to be most relevant to the particular qualification(s) selected.
4. **Attribution of indirect costs** to the selected qualification based on the selected cost drivers.
5. **Sensitivity analysis** using a range of cost drivers to show the range of potential outcomes.
6. **Reconciliation and checking** to test the findings and amend as appropriate.

#### *Key issues and limitations*

The ultimate objective was to calculate the direct profitability of each selected qualification using a range of cost drivers. There are however limitations to income and cost allocation methods, which include:

- the failure to capture any development costs which may have occurred prior to the current financial accounts used in the analysis
- the identification of the most appropriate driver. In many cases there may be more than one driver of income and costs. For example, the number of student enrolments and number of centres may both have a major impact upon examination costs. While we have worked closely with the relevant awarding organisations to identify the most appropriate drivers, there may nonetheless be variations in the final profitability depending upon the drivers chosen
- cross-subsidisation of qualifications. The profit margin on a specific selected qualification may be relatively high. However, it may be used by awarding organisations

to subsidise other less profitable or even loss making qualifications. Therefore the profitability analysis cannot be looked at in isolation rather in the context of the overall offering of the awarding organisation

- the above limitations apply to lifecycle costs also. Awarding organisations may spend a large amount of time and expenditure researching and developing new infrastructure (eg websites/e-learning) and qualifications. These costs need to be recouped via the fees they charge. However, the majority of awarding organisations do not capture these development costs explicitly which inhibits the ability to adjust for them in our profitability analysis
- our analysis looked at the last financial year only. This therefore did not allow for a comparison of previous years or the analysis of trends in the profitability of the selected qualifications
- there was variation in the granularity of data each awarding organisation was able to provide.

## F Glossary of terms

### Glossary for qualification name acronyms

AEA	Advanced extension award
BS	Basic skills
DIP	Diploma
DT	Diploma template
EL	Entry level
ESOL	English for speakers of other languages
FS	Functional skills
FSMQ	Free standing mathematics qualification
GCE	GCE A Level
GCE AS	GCE AS Level
GCSE	General Certificate of Secondary Education
GNVQ	General National Vocational Qualification
HL	Higher level
KS	Key skills
NVQ	National Vocational Qualification
OG	Other general qualification
OQ	Occupational qualification
PL	Principal learning
PROJ	Project
QCF	Qualifications and Credit Framework qualification
VCE	Vocational Certificate of Education
VCE AS subsidiary level	VCE advanced
VRQ	Vocationally related qualification

### Glossary for awarding organisation name acronyms

ABRSM	Associated Board of the Royal Schools of Music
AAT	Association of Accounting Technicians
CIEH	Chartered Institute of Environmental Health
City & Guilds	The City & Guilds of London Institute
Construction Skills	CSkills Awards
CACHE	Council for Awards in Children's Care and Education
Edexcel	Edexcel Limited

OCNW	Open College of the North West
OCR	Oxford, Cambridge and RSA Exams
RIPH	Royal Institute of Public Health
RSH	Royal Society of Health
TVU / LCM Exams	Thames Valley University
TCL	Trinity College London
Cambridge ESOL	University of Cambridge ESOL Examinations
VTCT	VTCT

#### Glossary of other terms

DCELLS	Department for Children, Education, Lifelong Learning and Skills
DCSF	Department for Children Schools and Families
DIUS	Department for Innovation Universities and Skills
LSC	Learning and Skills Council
NQF	National Qualifications Framework
OFQUAL	Office of the Qualifications and Examinations Regulator
QCA	Qualification and Curriculum Agency
QCF	Qualifications and Credit Framework
SSCs	Sector Skills Councils
SQA	Scottish Qualifications Authority



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