

FOCUS ON PERFORMANCE

WORLD BANK SUPPORT TO HIGHER EDUCATION IN LATVIA



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WORLD BANK GROUP



Ministry of
Education and Science
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FOCUS ON PERFORMANCE

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Volume 2: Internal Funding and Governance

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Report 1

INTERNATIONAL TRENDS AND GOOD PRACTICES IN HIGHER EDUCATION INTERNAL FUNDING AND GOVERNANCE

20 December 2016

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Abbreviations

CHE	Centre for Higher Education
CHEPS	Center for Higher Education Policy
CIO	Chief Information Officer
EC	European Commission
ECTS	European Credit Transfer and Accumulation System
ENQA	European Association for Quality Assurance in Higher Education
ERS	Exploratory Research Space
ESG	Standards and Guidelines for Quality Assurance in the European Higher Education Area
EU	European Union
EUA	European University Association
FU Berlin	Free University of Berlin
HE	higher education
HEI	higher education institution
HR	human resources
ICS	intellectual capital statement
ICT	information and communication technology
IT	information technology
KTH	KTH Royal Institute of Technology in Stockholm
NRW	North Rhine-Westphalia
OECD	Organisation for Economic Co-operation and Development
OECD GSF	Organisation for Economic Co-operation and Development Global Science Forum
QA	quality assurance
R&D	research and development
RCB	responsibility center budgeting
RWTH Aachen	Technical University Aachen
TU	Technical University
TUD	Delft University of Technology
UAS	University of Applied Sciences
UDE	University of Duisburg-Essen
UT	University of Twente
UTA	University of Tampere

Executive Summary

Following a first World Bank advisory service in 2013/14 that addressed the Latvian higher education funding model on the system level, a second higher education project with World Bank support addressing, among other things, the internal funding models and governance arrangements of Latvian higher education institutions (HEIs), was started in 2016. The 2013/14 project led to a reform of the Latvian state funding model for higher education in the form of the introduction of a new, three-pillar model including a performance-based pillar, thereby bringing the funding model closer to European best practices. To complement the changes on the system level, the second higher education project turns to the subsequent developments within institutions — in particular with regard to the question how the new performance-based funding and incentive orientation is reflected on the institutional level — and potentials for further development in the fields of internal funding and governance. To have a normative basis for the assessment of the status quo of internal funding and governance in Latvian HEIs, two sets of requirements, one for good internal funding models (see Table 1) and one for good internal governance arrangements (see Table 2), are developed in this report, based on international trends and good practices in the two fields.

Internal funding and governance are key components of the strategic steering capacities of HEIs. In relation to changes of funding models and governance approaches on the system level, various developments within institutions can be observed for both fields in the more recent past. In many countries, among them most European ones, there is a general shift toward output-oriented steering approaches by governments supported by increased institutional autonomy. Institutions responded to these new steering approaches by adapting their internal funding models and governance arrangements accordingly. Despite differences among countries and institutions related to their particular histories and characteristics, more general lines of development can be identified — as can a range of good practices of how institutions can react to the emerging challenges.

Public HEIs are expected to meet policy goals in a cost-effective way throughout European higher education systems. Because internal allocation models are designed to incentivize both revenue growth and cost control, set targets, and fund strategic priorities, they play a key role in HEI attempts to meet this expectation. Internal funding models that work well are able to align with external revenue streams and reflect national goals, thereby increasing the incentive compatibility between institutional directions and policy goals. For that reason, system-level funding, particularly performance-based funding, has been regarded as an important force in shaping the internal allocation models of HEIs.

At the same time, internal funding models are increasingly taking into account institutional strategies and profiles, including those appearing at the level of units (faculties, schools, institutes, departments). International trends show that financial autonomy of institutions can be strengthened through an increased level of resource diversification, also at the level of units. Generation of additional income through multiple new or existing funding sources contributes to balancing the income structure of the institution and units and, thereby reduces the resource dependency on any single source of financing, including state funding.

In many countries, a reasonable level of unit autonomy (control over the income a unit generates) is considered a particularly important prerequisite for sustainable strategic development of the whole institution. The main rationale behind higher autonomy of units is that it is believed to support responsibility, flexibility, efficiency, transparency, and entrepreneurial thinking. Autonomous units are considered to be more responsive to strategic initiatives and to generating, deploying, and allocating their own income streams in a way that supports their cost-effective operation. However, an important prerequisite for granting a higher level of autonomy is the size of a unit. Therefore, the current international trend is to favor bigger unit sizes, with a high level of operative and financial autonomy. Sufficient size of the units allows them to develop their own specific objectives under the broader framework of an institutional strategy.

Many European institutions use block grants and formula funding. Block grants and formula funding support a decentralized budgeting approach by allowing greater freedom for units in their financial decisions. At the same time, funding formulas are expected to lead to an increased level of transparency and legitimization of allocation decisions. Formula funding supports stronger performance orientation, particularly by offering incentives that are able to link institutional goals and resource allocation.

At the same time, increased unit-level autonomy often needs a counter-balance, which can be achieved through the creation and effective use of strategic central funds (reserves). Allocations of these funds are often based on discretionary decision-making processes on the part of the institution's central leadership.

In several countries, performance-based funding is allocated internally primarily to units, but staff salary schemes, including a wider performance component, are used in parallel. Keeping a right balance between allocations to units and individuals is important. When funding is channeled to the unit level to support research and teaching, monetary incentives can simultaneously facilitate development in these areas, thereby also benefiting individuals.

Institutions rarely have a pure budgeting model that relies on a single allocation principle. Rather, institutions rely on hybrid models that combine elements from several allocation principles. Most institutions use a budgeting mix that includes input- and output-based funding formulas plus some discretionary funding that can be used to achieve particular priorities or address financial problems. Nevertheless, most institutions seem to search for a balanced structure in light of the functions of the three-pillar model, that is, between "basic funding" offering stability (Pillar 1), performance-based funding fostering productivity (Pillar 2), and profile/innovation-oriented funding promoting change (Pillar 3).

Internal target agreements are often used to bring further balance between funding streams allocated under the three pillars and goal orientation toward the strategic objectives of the institution and units.

Based on the above, it is evident that there is no single best allocation model.

Institutional culture, history, disciplinary composition, and other factors influence the right allocation model for an institution. Moreover, each model has its own strengths and weaknesses. Institutions in general need to balance among many interests and (temporary) contexts or performance levels of various units while striving for different strategies or pursuing different profiles. Therefore, HEIs should be autonomous in choosing among the many alternatives of funding models and options.

However, based on a detailed analysis of the aforementioned developments and good institutional practices in reacting to them, general normative requirements for “good” internal funding models were developed.

These requirements provide a broad framework for the assessment of internal funding models, and are derived from and backed by the following sources of information:

- System-level criteria for “good” funding models the World Bank team used in its analysis “Higher Education Financing in Latvia: Analysis of Strengths and Weaknesses” (2013–2014)
- International, particularly European, experiences, good practices, and standards on internal funding models based on findings from the recent research literature
- The team members’ professional expertise in the field.

The team identified the six (A–F) major requirements shown in Table 1, which are broken down to subsections. Chapter 2 of this report contains the development of those requirements based on the sources of information mentioned.¹

A. Strategic orientation	A.1. Aligning internal funding model with external revenue streams and reflecting national goals
	A.2. Promoting institutional strategies and profiles
	A.3. Promoting unit-level objectives
B. Incentive orientation	B.1. Creating performance rewards and sanctions
	B.2. Providing clear and nonfragmented incentives
	B.3. Avoiding undesired side effects
C. Sustainability and balance	C.1. Combining top-down and bottom-up approaches
	C.2. Providing a sufficient level of stability
	C.3. Guaranteeing continuity in development
	C.4. Balancing the overall model architecture
	C.5. Promoting diversification of unit-level funding sources
	C.6. Balancing the key institutional missions

Table 1 General requirements for a “good” internal funding model

¹ The structure of Table 1 deviates from the structure of chapter 2, because the requirements derived from the analysis in that chapter were rearranged for greater clarity.

D. Transparency and fairness	D.1. Ensuring transparency
	D.2. Supporting the perception of fairness
E. Level of autonomy and flexibility	E.1. Guaranteeing financial autonomy and academic freedom
	E.2. Implementing an adequate level of regulation
F. Link to governance and management; practical feasibility	F.1. Increasing reliability and availability of data
	F.2. Ensuring administrative efficiency
	F.3. Ensuring coherence with other governance approaches and university culture
	F.4. Ensuring the ability of leadership to act

Internal governance arrangements can be considered the backbone of every higher education institution’s capacity for coordination and strategic development. Major developments in this field have been triggered by changing approaches toward the governance of higher education systems, namely a shift toward more indirect forms of steering higher education systems centered on the autonomy of HEIs. Adding to this are growing challenges for institutions to thrive in increasingly volatile, competitive environments. As a result, institutions experience increasing pressure to develop capacities for acting strategically as integrated actors, and many institutions have indeed developed such capacities.

Institutions have increasingly determined the direction of their future development. Institutional strategies and action plans have become the main instruments for this purpose. Promoting the overall quality of strategies and their impact, strategy development processes comprising a thorough analysis of institutional strengths and weaknesses and their relation with the institutional environment, and the involvement of internal stakeholders have emerged as particularly important. In addition, increasing attention has been given to processes of strategy implementation and monitoring implementation progress. Institutions have also become engaged in increasing the fitness for purpose of their internal governance arrangements.

Another important aspect of internal governance is arrangements related to academic freedom and integrity, and to accountability. Institutions have established measures for preventing and dealing with academic misconduct, as an important component of their attempts to enhance accountability toward their environment. Under the general heading of accountability, quality assurance processes, especially, have gained in importance. In addition, information and data needs resulting from strategic steering activities and new accountability requirements have been given more focus.

Questions concerning internal cooperation and participation in relation to strategic development capacities have emerged under the heading of good internal governance. Recent shifts in rights and responsibilities among different bodies and actors in institutions have led to a fundamental challenge related to the design of internal governance arrangements — that is, finding the right balance between the responsibility of collegial bodies and personal responsibility of leaders on different institutional levels. As part of the same overarching change in internal governance approaches, new ways of involving external and internal stakeholders in the internal governance of HEIs have evolved.

Good internal governance also concerns the differentiation of functions and the distribution of powers within institutions. A key challenge for institutions in that respect is separating strategic and management tasks, framed by a suitable balance of powers and adequate checks and balances. In addition, institutions also need to find the right balance between powers on the central and lower institutional levels, that is, the adequate degree of devolution. Designing internal governance structures and processes so they are efficient has become an important and challenging task for institutions as well. Changes in governance arrangements have also reached the level of the individual manager and administrator, where new activity profiles together with new skill demands have emerged.

Despite similar developments in many countries, there can be no one-size-fits-all solution for designing internal governance arrangements. Higher education systems have different histories, traditions and values, regulatory frameworks, and overall approaches to governance. Similarly, institutions exhibit particular historical traits, and traditions and values, and differ in, among other things, size, composition, and profile. Both types of particularities influence which way of designing internal governance structures and processes would be best.

However, based on a detailed analysis of the aforementioned developments and good institutional practices in reacting to them, general normative requirements for “good” internal governance arrangements were developed. These requirements offer a broad framework for the assessment of internal governance arrangements and are based on:

- international, particularly European, experiences, good practices, and standards for designing internal governance structures and processes derived from findings from the recent research literature
- the World Bank team members’ professional expertise in the field.

Using these sources, the team has identified four (A–D) major blocks of requirements (see Table 2). The development of those requirements is presented in chapter 3.

A. Strategic development and governance	A.1. Having in place clear and precise institutional strategies aligned with institutional strengths/weaknesses and their environment
	A.2. Having in place action plans that structure and support the strategy implementation process
	A.3. Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process
	A.4. Developing measures for the implementation of strategies
	A.5. Monitoring the strategy implementation process and adapting instruments/objectives if necessary
	A.6. Securing and monitoring fitness for purpose of governance structures
	A.7. Accompanying institutional developments with change management

Table 2 General requirements for “good” internal governance arrangements

B. Autonomy and accountability	B.1. Securing academic freedom
	B.2. Maintaining academic integrity
	B.3. Anchoring accountability measures and quality assurance in governance structures
	B.4. Establishing adequate monitoring procedures and management information systems
C. Good governance 1: Cooperation and participation	C.1. Balancing responsibility of collegial bodies and personal responsibility and maintaining a cooperative approach
	C.2. Involving external stakeholders in institutional governance and securing their proper conduct
	C.3. Developing appropriate ways of involving internal stakeholders on different institutional levels
D. Good governance 2: Differentiation of functions and distribution of powers	D.1. Separating strategic and management tasks framed by checks and balances
	D.2. Equipping central leadership with sufficient and adequate competences
	D.3. Securing efficiency and transparency of governance structures
	D.4. Establishing an adequate level of devolution
	D.5. Ensuring staff development and developing human resource strategies

The two sets of requirements, one for good internal funding models and one for good internal governance arrangements, will be taken up by a second report under the current higher education project to assess the status quo of internal funding and governance in Latvian HEIs. Together with the outcomes of the status quo assessment, the outcomes of the report at hand will serve as the basis for recommendations for the further development of internal funding and governance by Latvian HEIs to be presented in spring 2017 in a third report.

1 Introduction

Following a first World Bank higher education advisory service in 2013/14 that addressed the Latvian higher education funding model on the system level, a second higher education project with World Bank support addressing,² among other things, the internal funding models and governance arrangements of Latvian higher education institutions, started in 2016.³ The 2013/14 higher education project led to a reform of the Latvian state funding model for higher education in the form of the introduction of a new, three-pillar model including a performance-based pillar, bringing the funding model closer to European best practices. To complement the changes on the system level, the second higher education project turns to the subsequent developments within institutions — in particular with regard to the question of how the new performance-based funding and incentive orientation is reflected on the institutional level — and potentials for further development in the fields of internal funding and governance.⁴

To devise a normative basis for the assessment of the status quo of internal funding and governance in Latvian higher education institutions, and for recommendations addressing potentials for further development, two sets of requirements, one for good internal funding models and one for good internal governance arrangements, are developed in this report. This report is based on the research of the World Bank Latvia higher education financing team⁵ on international trends and experience with internal funding and governance and good practices in the field. Both topics were approached from the perspective of institutional capacity for strategic steering. The relevant research literature (scholarly articles, policy reports, consultative papers, and so forth) was analyzed,

² The term “project” is subsequently used for this World Bank higher education advisory service.

³ Historically, the second higher education project is therefore anchored in financing reform, and the financing work under the second project is linked to earlier work. Financing is thus discussed first in this report, while governance — which was introduced as an additional theme to the first project — follows in the later section of the document.

⁴ The Legal Agreement between MoES and the World Bank stipulates that Phase 1 of the new engagement focuses on “university-internal governance and performance-based financing in Latvian HEIs’ envisaging three outputs: one on international trends and practices, one on the status quo in Latvian universities (this report), and related recommendations. The discussion presented in this report is based on information provided by MoES and individual HEIs, including in the context of in-depth interviews during site visits. These interviews were structured by criteria developed in close consultation with MoES and related questionnaires. The report primarily focuses on performance-based funding (that is, Pillar 2 funding) since incentives for institutional performance are primarily set through that pillar, while Pillar 1 contains base funding provided by MoES and Pillar 3 funding is considered to cover European Structural Funds for higher education at the system level. A comprehensive discussion of these two funding sources and their implications on the institutional level would have been beyond the scope of this report.

⁵ Members of the World Bank higher education financing team are Dr. Nina Arnhold, Senior Education Specialist and Task Team Leader, World Bank; Adjunct Professor Jussi Kivistö, University of Tampere, Finland; Vitus Puttmann, Consultant, World Bank; Professor Hans Vossensteyn, Director of the Center for Higher Education Policy (CHEPS), the Netherlands; and Professor Frank Ziegele, Director of the Center for Higher Education (CHE), Germany.

complemented by the expertise and experience of the World Bank team's members in the field and their perspective on successful examples. Those different sources of information were combined in the analysis to identify normative requirements that effective and efficient internal funding models and governance arrangements must fulfill. While comprehensive cross-country data existed for the system-level analysis of the first higher education project, such data on internal funding models and governance arrangements do not exist; practices vary greatly among and even within countries. Therefore, case examples are used to highlight some of the points taken from the reviewed literature and to provide insights into practices considered promising by the World Bank team's members.

The first phase of the second project, focusing on internal funding and governance, will produce three major outputs. The two sets of requirements developed in this report will be taken up by a second report in order to assess the status quo of internal funding and governance in Latvian higher education institutions. In methodological terms, the second report relies on the study of available documents and detailed information on individual institutions, information obtained during in-depth interviews primarily conducted during site visits to institutions, and workshops and verification meetings. The report at hand is made available to the public at the same time as the second report on the status quo in Latvia (in December 2016). Building on both outputs, the team will prepare recommendations for the further development of internal funding and governance by spring 2017, which will be published in a third report.⁶ This first phase will be succeeded by a second phase in 2017/18 that will address questions of academic selection, promotion, and remuneration. These topics are thus discussed only to a limited extent in this report.

⁶ During the first phase, another analytical output was developed, namely a note on Latvian doctoral education and promotion, which was prepared by Dr. Andrée Surssock, EUA Board Member and World Bank Consultant.

2 Internal Funding

2.1 General Developments

Basic Considerations on Funding of Higher Education Institutions

Higher education institutions (HEIs) serve societies in many ways. They prepare knowledgeable and well-skilled graduates, engage in basic and applied research, and provide a range of services to their economic and social environment. As economic entities, however, HEIs are expected to transform *inputs* (human, financial, and physical resources) through teaching, research, and service activities into quantifiable and measurable *outcomes* such as skilled labor market entrants, patentable knowledge, and civic-minded citizens. **This means that HEIs (like many other organizations) use more than one type of input to produce more than one type of output.** Some of outputs are tangible, such as degrees awarded, but some are less tangible, such as the societal impact of research. In economic terms, HEIs are multiproduct organizations characterized by joint production of various teaching and research outputs, so that different activities are to some extent dependent on each other (for example, Garvin 1980; Johnes and Taylor 1990; Kivistö 2007).

Despite this relatively simple setting, the underlying dynamics of production technology of modern HEIs is complex. Unlike for-profit firms, HEIs are economically one-sided rather than two-sided. Their *costs* (for example, related to staff and premises) follow a market logic of supply and demand. That does not apply to the *outputs* of HEIs, which distinguishes them from for-profit firms. The outputs of teaching and learning processes, for example, are not sold and bought in markets, especially in the case of public HEIs. That makes it difficult to determine the market value of those outcomes. Therefore, HEIs face challenges in evaluating their outputs in relation to the costs of the inputs used to make them (Massy 1996; Jongbloed and Vossensteyn 2001; Kivistö 2007). Because of the joint nature of higher education products and the interdependence of resources, the internal modification of production technology is relatively easy to accomplish inside institutions, but extremely difficult to control externally. Moreover, HEI production technologies are not identical, but rather differ greatly in many respects across the fields of study and science.

The nature of HEIs, like economic entities, among other things, sets important boundary conditions for designing the internal allocation mechanisms, which in turn play a key role in supporting the operation and activities of

HEIs as production units. The two central functions of budgeting are to keep a balance between revenues and expenditures, and to determine the “right” mix of inputs and outputs to achieve the best possible results. Therefore, budgeting creates an institutional framework for acquiring resources (inputs) from different sources and for distributing them among organizational subunits — faculties, departments, research centers, and so forth — in order to realize teaching and research activities and products (outputs), which can again lead to the acquisition of additional resources (inputs), for example, through the commercialization of research results.

Budgeting maintains organizational identity and promotes the coordination of collective action, and helps to set and communicate institutional priorities, given that there are never enough resources to satisfy every unit-level and individual need (Lepori, Usher, and Montauti 2013; Lasher and Greene 2001). As such, budgets are crucial signs showing what an HEI is de facto committed to do. Therefore, budgeting plays an integral part of strategic decision making and implementation of institutional strategies, both of which require selective allocation of limited financial resources (Jarzabkowski 2002).

Internal allocation models and budget processes can be redesigned to set performance targets, fund strategic priorities, and incentivize revenue growth and cost control, in so far as there exists a strong institutional commitment to do so. Therefore, budgets must be aligned with strategic priorities and institutional plans. This occurs when strategic planning is not used as the basis for developing budgetary goals and assumptions (Murpy and Katsinas 2014). In such situations, budgets might reinforce the wrong objectives, or no objectives at all. Strategically disoriented budgets tend to lock in damaging cost structures, underfund strategic priorities, and create harmful incentives both in terms of revenue generation and spending. Therefore, institutions should think critically about how their resource allocation choices reinforce (or obstruct) their strategic priorities (Education Advisory Board 2014). For instance, the link between strategic development plans and the allocation of basic funding (Pillar 1) can be made more explicit by linking the staff numbers fixed in an institutional development plan with funding per staff (which would lead to a reallocation in Pillar 1 if strategic plans and the respective staff numbers related to the plans were to change).

European Trends in System-Level Funding Models

At the system level, funding is more than just a mechanism to allocate financial resources to HEIs; it is an integral part of a wider body of policy instruments used to maximize the desired societal output with limited public resources. Governance and funding are therefore often two sides of the same coin. For instance, questions on how much autonomy and monitoring HEIs need in order to meet societal expectations is an important funding issue when it comes to autonomy in internal resource allocation, but at the same time it constitutes a larger governance issue in terms of the balancing of responsibilities between HEIs and the state (Jongbloed 2010). In many countries, growing accountability requirements set by the governments have been accompanied by granting HEIs more institutional autonomy. At the same time, the efficiency of funding in terms of the capacity of HEIs to meet policy goals in a cost-effective way has become increasingly important throughout European higher education systems (Bennetot Pruvot, Claeys-Kulik, and Estermann 2015).

In particular, the following general trends can be observed in state allocations to HEIs: formula funding has gradually become more widespread, outputs start to play a more important role in formulas, state funds are allocated to institutions as block grants, and the significance of performance contracts (target agreements) has grown, although mostly only as a secondary and complementary mechanism (see Figure 1 and Figure 2).

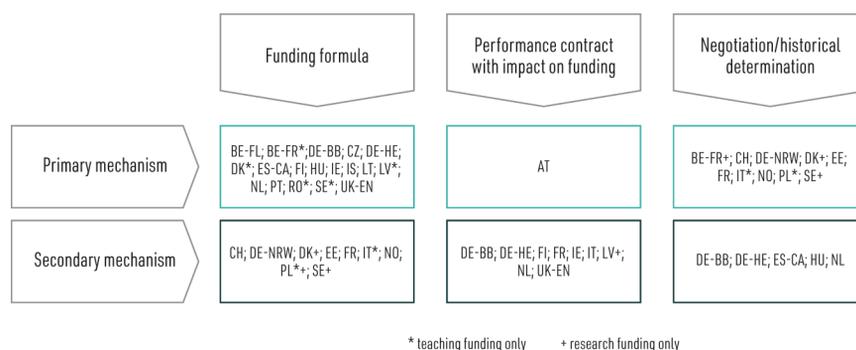


Figure 1 Overview of allocation mechanisms of public funding

Source: Bennetot Pruvot, Claeys-Kulik and Estermann 2015, 26.

Note: AT = Austria; BE-FL = Flanders in Belgium; BE-FR = French speaking Community in Belgium; CH = Switzerland; CZ = Czech Republic; DE-BB = Brandenburg in Germany; DE-HE = Hesse in Germany; DE-NRW = North Rhine-Westphalia in Germany; DK = Denmark; EE = Estonia; ES-CA = Catalonia in Spain; FI = Finland; FR = France; HU = Hungary; IE = Ireland; IS = Iceland; IT = Italy; LT = Lithuania; LV = Latvia; NL = Netherlands; NO = Norway; PL = Poland; PT = Portugal; RO = Romania; SE = Sweden; UK-EN = England in United Kingdom.

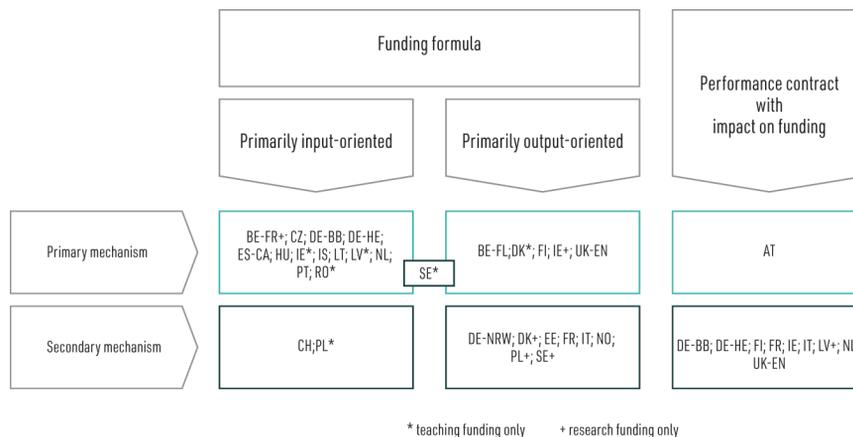
A recent study by the European University Association (EUA) concludes that most formulas include a combination of input- and output-related indicators as well as several other indicators linked to specific policy goals (such as internationalization, gender aspects, interaction with society). In countries where funding formulas for teaching and research are distinct, formulas for teaching funds are in most cases primarily input-oriented (for example, number of staff required for teaching certain numbers of students), while formulas for research funds are primarily output-oriented. For systems that have one formula incorporating indicators for teaching and research, the formula is primarily input-oriented, although some examples of very strong output-orientation can also be found, such as Finland (Bennetot Pruvot, Claeys-Kulik, and Estermann 2015).

The most common method of allocation remains a primarily input-based formula, often combined with other mechanisms such as target agreements, negotiated budgets, or historical allocations (see Figure 2). However, a majority of European higher education systems consider their basic funding allocation mechanisms to be at least partially performance-based for teaching (via graduate-related criteria). In performance-based research funding, most common output-based research indicators include research assessment/evaluation results (used, for example, in the UK, France, Hungary, the Czech Republic), external/international/EU funding obtained (for example, Finland, some German states, Poland, Ireland), or research contracts obtained (for example, France, Italy, Portugal, Romania), doctoral degrees obtained/theses completed (for example, Norway, the Netherlands, Belgium), and measuring publications/citations (for example, Hungary, Norway, Sweden). The term “performance-based funding” is understood very differently across Europe, however, often without a clear distinction between the “input” or “output” criteria composing the funding formula (Bennetot Pruvot, Claeys-Kulik, and Estermann 2015).

Figure 2 Performance elements in public funding for universities

Source: Bennetot Pruvot, Claeys-Kulik and Estermann 2015, 39.

Note: AT = Austria; BE-FL = Flanders in Belgium; BE-FR = French speaking Community in Belgium; CH = Switzerland; CZ = Czech Republic; DE-BB = Brandenburg in Germany; DE-HE = Hesse in Germany; DE-NRW = North Rhine-Westphalia in Germany; DK = Denmark; EE = Estonia; ES-CA = Catalonia in Spain; FI = Finland; FR = France; HU = Hungary; IE = Ireland; IS = Iceland; IT = Italy; LT = Lithuania; LV = Latvia; NL = Netherlands; NO = Norway; PL = Poland; PT = Portugal; RO = Romania; SE = Sweden; UK-EN = England in United Kingdom.



As was already concluded in the World Bank assessment “Higher Education Financing in Latvia: Analysis of Strengths and Weaknesses” (2014), the current higher education state funding model in Latvia was found to be in line with the status quo of most of the European systems, particularly with respect to the first-pillar funding (basic funding).⁷ Now, after introduction of the performance-based funding component as of 2015, the Latvian higher education funding system also corresponds more fully to European practices in the case of second-pillar funding. Overall, the Latvian higher education funding model is in line with European developments in the following three respects.

First, the primary mechanism for allocating funding is an input-based funding formula of study places. However, compared to other countries using an input-based formula for funding education, the Latvian model still more resembles a “price model” than a “distribution model.” In the price model, the budget is calculated by multiplying the prices/defined standard costs by the number of students. In the distribution model, the budget cap is given and the allocated sum is calculated by dividing the budget by the (relative) number of students per institution (cf. Ecker, Leitner, and Steindl 2012). Currently, the Latvian model allocating Pillar 1 funding (for education) is a mixture of these two approaches. Although the allocation logic follows the distribution model (budget is “capped”), the thinking behind it still follows the idea of prices (the gap between “minimum” and “optimal” value of a study place). For research funding, a formula is applied that includes mainly input-based variables (infrastructure costs, wages for scientific personnel, and a coefficient that incorporates performance-based criteria) (World Bank 2014).

Second, performance-based funding (under Pillar 2) is clearly a secondary-level funding mechanism due to its significantly smaller proportion compared to the size of the Pillar 1 funding. The indicators currently used in the second-pillar funding (employed young scientists, international R&D funding, attracted R&D contract funding, attracted R&D funding/subsidies from local municipalities, attracted funding for creative and artistic projects) are, in principle, in line with current European practices.

⁷ For a detailed discussion, see pages 18–22 of the World Bank report “Higher Education Financing in Latvia: Analysis of Strengths and Weaknesses” (2014).

Third, like in many other European countries, target agreements in Latvia have an impact on HEI funding, which currently, in terms of the proportion/volume of funding, takes place (mostly) through the allocation of state-funded study places.

Overview of Developments in Internal Funding Models

Unlike on the system level, comparative international studies focusing on internal funding models or their degree of similarity with the system-level funding model have not been conducted. However, a general overview can be given by combining different studies on individual countries.

In some studies focusing on single-country contexts, system-level funding has been regarded as an important force in shaping the internal allocation models of HEIs (see, for example, Jongbloed and van der Knoop 1999). Despite the lack of comparative studies, it can be suggested that the general international trend in internal budgeting has been to move away from incremental (also known as “historical budgeting”) and line-item budgeting toward the more frequent use of block grants.

In line-item budgeting, funding is allocated to specific items of expenditure that constitute the major inputs of the production processes, including costs related to staff salaries, facilities, and other major and minor operating expenses. After a budget period, the budgeting authority of an HEI, such as the financial department, reviews the expenditures to find out whether the funds were spent on the purposes for which they were appropriated. This review is based on the questionable assumption that allocating funds item by item also promotes their appropriate and effective use (for example, Massy and Hulfactor 1993; Sheehan 1997; Hughes 2003). Line-item budgets are usually incremental, although not all modes of incremental budgeting are based on line-item allocation, and not all line-item allocations are by their nature incremental (for example, “zero-based” budgeting could be used too).

Incremental budgets mean that the previous budget base of a budgeting unit is incremented or reduced (that is, “decremental” budgeting) depending on the wider institutional budgetary conditions (Massy 1996; Ziegele 2008). Incremental budgeting is an attractive choice for many institutions because it is relatively easy to implement, provides budgetary stability, reduces conflicts between units, and allows units and institutions to plan ahead multiple years, due to the high level of predictability attached to the model. However, while incremental budgeting has served HEIs well in times of stable environments and constant growth, it appears to be ill-suited to meet the current demands for improved performance, efficient resource allocation, and complex, rapidly changing operating environments (Education Advisory Board 2014).

In line-item budgeting, much of the administrative attention is given to increases or decreases in expenditure categories, because the base budget has often become too complex to determine whether the allocated funds are still serving the institutional goals. At the same time, items of expenditure within a budget are rigid in the sense that units have little or no flexibility to move resources among expenditure categories. Moreover, often units are not allowed accumulate surplus and carry it forward, or use surplus funds for other uses without the permission of a budget authority, thereby creating further administra-

tive and operational inefficiencies (for example, Massy 1996; Hughes 2003; Kivistö 2007; Ziegele 2008; Education Advisory Board 2014).

Line-item budgeting also tends to favor centralized budgeting approaches, where budget authorities can insulate operating units by holding each unit's budget base immune to institutional revenue fluctuations as long as this is financially possible. Incremental budgeting historically makes equal “bets” across an institution rather than channeling resources to areas with the greatest potential for academic impact or financial return. Similarly, when faced with deficits, institutions with line-item budgeting must often deploy unsustainable across-the-board cuts because there is no objective criteria to evaluate the level of performance or goal orientation of units. Therefore, when making budget adjustments, representatives of institutional leadership (rectors, deans, budget managers) often must balance their arguably subjective understanding of the needs and priorities of budgeting units, and often use simplistic models such as eliminating professorships from units when professors retire or leave the institution. Thus, a line-item approach does not create financial incentives for individuals or operating units to grow the institutional revenue base, engage in activities to cut costs or, more importantly, align activities consistently with institutional goals. On the contrary, a line-item approach leads to situations where operating units think they “own” their base funding levels and come to view most of their costs as fixed (for example, Massy 1996; Casper and others 2001; Education Advisory Board 2014).

With block grants and formula funding, many institutions have attempted to overcome the depicted challenges associated with line-item allocations. When allocated as a “lump sum,” block grants cover several categories of expenditure, thereby giving units more flexibility and a greater level of autonomy in determining how budgeted funds are to be spent (cf. Salmi and Hauptman 2006). It seems, however, that the introduction of formula funding has been more widespread at the level of higher education systems, and much less so for internal budgeting inside HEIs (Lepori, Usher, and Montauti 2013).

The size of the block grants can be determined in various ways, for example, by negotiation, based on historical trends in base funding (another type of incremental budgeting), or on an ad-hoc basis (for example, targeted or earmarked funding for strategic development or for covering the costs based on unexpected financial difficulties). Part or all of the block grant can also be allocated through a funding formula, that is, an algorithm based on standard input-, throughput, or/and output-based criteria or cost measures to calculate the size of the grant (Bennetot Pruvot, Claeys-Kulik, and Estermann 2015). Formula funding is usually a more decentralized approach than line-item budgeting, and gives greater freedom for unit level; once allocated, units can decide how they spend or internally allocate the resources. Benefits of well-designed formula funding are related to an increased level of transparency and legitimization of allocation decisions, because allocation is automatic and the criteria equal for all units. Moreover, by offering incentives that link institutional goals and resource allocation, formula funding supports stronger strategic and performance orientation (cf. Ziegele 2008).

However, formula funding, like all other allocation mechanisms, has several weaknesses. For instance, to be effective, formula funding requires a reliable management information system, the set-up costs of which can be high and

which can create substantial administrative work. In addition, formulas are retrospective in character (staff and student numbers or costs are from previous years and past performance) and thereby lack an orientation for development, change, and future. Input-driven formulas can also lock in unit costs, making productivity improvement difficult and drawing attention away from institutional goals. However, strong output orientation can lead to the emergence of harmful gaming and to suboptimization, which often involves producing more output quantity with lower output quality (for example, Massy 1996; Kivistö 2007; Barr and McClellan 2011). To avoid undesired side effects, the impacts of an internal funding model should be closely monitored.

Block grants can also create challenges for the strategic steering of an institution. Because the resources are allocated internally to decentralized units, there is a danger that leaders have no financial discretion to invest in strategic priorities. Therefore, institutions should create central funds (to support innovative projects, stimulate research, fund strategic programs, provide seed funding to create readiness for external research income, and so forth), as a counterbalance to decentralized lump sums. In reform processes, the two components often come as a “package deal,” that is, units get more financial autonomy and central leaders get some strategic room to maneuver (the role of central funds is discussed further in section “2.2 b) Financial Autonomy and Sustainability”).

Few if any institutions have a “pure” budgeting model. Institutions rely on hybrids rather than pure ideal types, and therefore have a range of allocation approaches for different kinds of revenues and costs. This is understandable, since ideal types seldom provide solutions to all an institution’s budgeting challenges (for example, Barr and McClellan 2011; Education Advisory Board 2014). Most institutions use a budgeting mix that includes input- and output-based funding formulas plus some discretionary funding that can be used to achieve particular priorities or solve financial problems. Moreover, the overall architecture of internal funding models differs greatly among institutions, but often is composed of several types of appropriations that closely resemble the “three-pillar model.” These include (1) base funding intended to cover most or all of the costs associated with staff, facilities; and equipment; (2) performance-based funding allocated through a formula; (3) several types of earmarked grants or funds for specific purposes (usually allocated through ad-hoc procedures, negotiation, or competition); and (4) specific funding arrangements for administrative and support units (usually historical/incremental allocations).

2.2 Main Trends and Good Practices

Whereas the previous section provided an overview on general developments of internal funding models, the following section discusses particular aspects of those developments. Particularly important dimensions, which are covered in detail in the following, are funding models’ strategic orientation and incentives; the financial autonomy and sustainability of institutions and organizational subunits; the transparency and feasibility of funding models; and issues related to the balance and context of funding models.

a) Strategic Orientation and Incentives

Institutional Revenues and Internal Allocations / Integration of Teaching, Research, and Third Mission in Internal Funding Models

The internal incentive structures of HEIs should be compatible with the external revenue streams of the institution. This compatibility means basically the necessary level of alignment of external and internal financial incentives, particularly with respect to the state funding model. Therefore, balanced internal funding models can align the internal funding model with external revenue streams and reflect national goals.

Alignment is important because it presumably has a direct impact on the awareness and behavior of units and individuals to be engaged with actions that promote coordinated efforts to secure a sustainable financial basis for the whole institution. Decoupling the logic of revenue generation and internal incentives increases the risk of misguided organizational behavior and unsustainable levels of revenue generation (cf. Jongbloed and van der Knoop 1999). Because budgets can be considered links between financial resources and human behavior, internal funding models and the budgeting process play a substantial part in aligning the incentives derived from institution-external revenue generation and internal incentives guiding organizational behavior (for example, Ziegele 2008).

The trend now is that internal funding models consider institutional strategies and profiles, including those appearing at the unit level (faculties, schools, institutes, departments). For instance, in cases where state funding dominates institutional revenue, HEIs must decide on the appropriate balance between incentivizing attempts to maximize state revenue and actions aimed at strengthening institutional profiling, which could be at odds with the goals of state funding, since state funding formulas treat different universities equally (Ziegele 2008). However, often the internal allocation does not accurately reflect the external revenue generation, but redistributes the money (that is, cross-subsidization occurs among units). As a practice, this is understandable, because, for instance, the “price per graduate” in a state formula is calculated/determined as an average for all HEIs. However, it is most likely that the HEI-specific price (resulting from the respective cost situation) will deviate from the national average. This can easily lead to internal tensions between “winning” and “losing” units. Therefore, in many systems, institutional leadership is expected to play a crucial role with regard to understanding and communicating the rationale for the internal allocation, as it has to balance institutional priorities, secure maximum public funds, and at the same time consider the costs of different institutional and strategic activities (Bennetot Pruvot, Claeys-Kulik and Estermann 2015). Both extremes — appropriating financial resources on a purely income-oriented basis, and working solely on a principle of institutional profiling without considering the financial realities — are likely to be problematic and unrealistic options (Ziegele 2008).

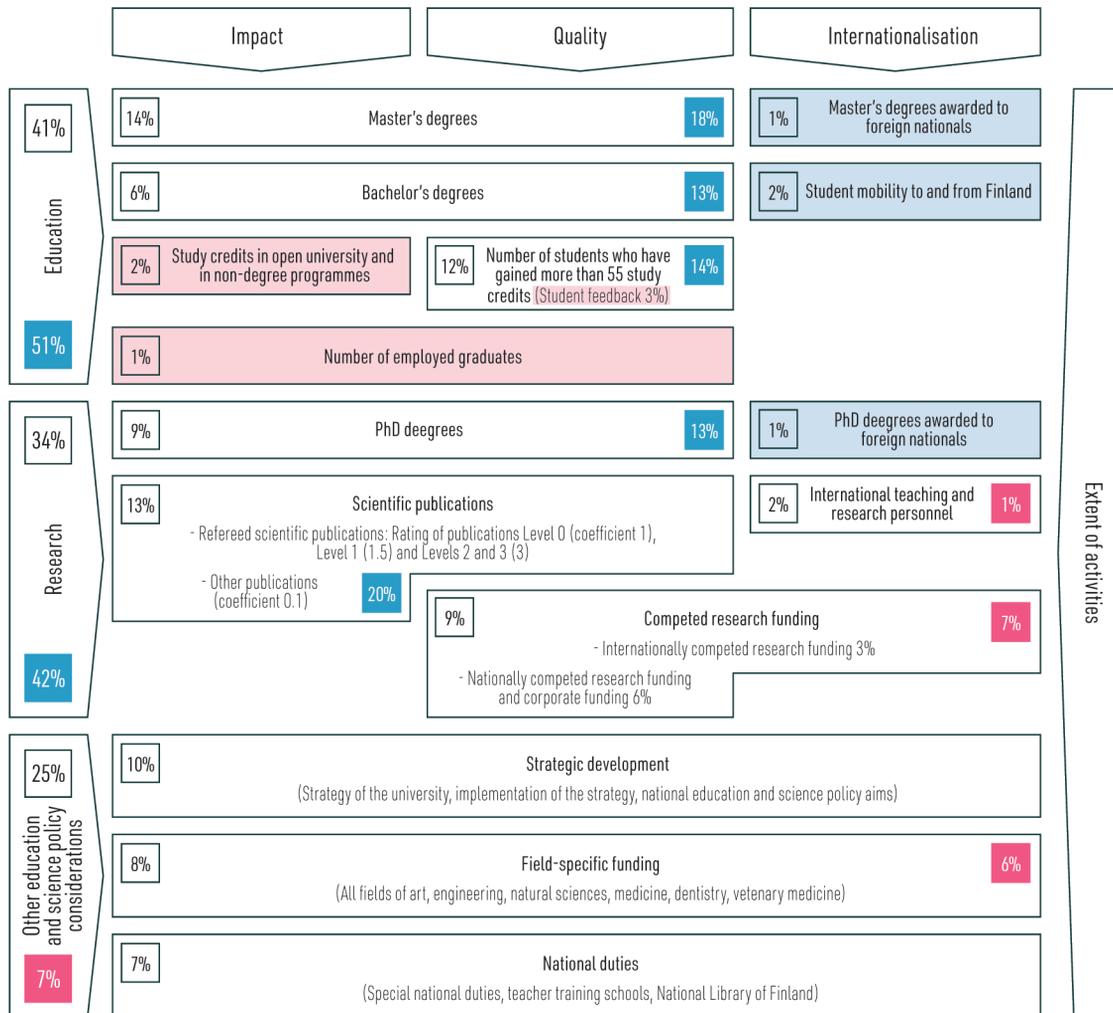
Some studies have shown that although HEIs reshape their internal allocation to be more in line with system-level incentives, especially in the case of performance-based funding, they do not copy the national funding schemes internally. Instead, many HEIs implement internal allocation models that

acknowledge institutional specifics (for example, Jongbloed and van der Knoop 1999; Lepori, Usher and Montauti 2013; Kohtamäki 2014). However, based on available evidence, a clear trend cannot be distinguished on how closely institutions have aligned their internal funding models with external revenue streams, and state funding, in particular. External and internal allocation instruments are not necessarily the same, however. Under the same state funding model, some institutions can follow internally a more negotiation- and tender-based approach, while others might prefer automatic, formula-based allocations. For instance, in Finland, which for two decades has applied a strong performance-based funding system (over 70 percent of the basic funding is performance-based), there still exists great diversity in internal funding models both across universities and with respect to aspects of implementation of the national model. A study conducted by Kohtamäki (2014) found that Finnish universities gave different weights for both teaching and research indicators compared to their weighting in the national funding models, and at the same time used a diverse set of indicators, of which not all were identical with the national funding model. Furthermore, many of the universities applied sizable base funding components for unit-level allocations (mainly historically determined) to create a greater level of internal stability than the national formula would warrant. A similar situation appears to be present in the Netherlands, where most universities apply different internal allocation models that to a lesser or greater extent diverge from the national public funding model. **Well-designed internal funding models are, therefore, able to create performance rewards and sanctions that are in accordance with the institutional culture and mission, while also addressing national priorities and some more specific university priorities.**

The internal funding model of the UTA uses some elements of the national funding formula (see Example 1), but it uses different weighting and partly different indicators: relatively higher weights in the internal model are highlighted with blue boxes, whereas lower weights are highlighted with red boxes. Blue-shaded boxes are identical in their weights in the national and institutional model, whereas the red boxes existing in the national funding model are absent in the internal model. Some of indicators are slightly different; for instance, the publication indicator is less specific in the internal funding model than in the national model, in which publications are ranked in four categories, each with different weights. Also, in addition to an output-based formula, part of the funding is allocated as core funding and strategic funding, as well as other funding to cover all or some of the expenditure of the central management and administration and support university services. Compared to the national allocation model, the UTA internal model is built to be more stable. It contains indicators and weightings that create more fair and equal conditions for different schools (equal to faculties) to gain funding through the internal formula. For instance, “number of employed graduates” is not included in the internal formula, because it would not treat schools equally (for example, School of Medicine graduates have significantly higher employment rates than graduates of the School of Social Sciences and Humanities), whereas Bachelor’s degrees, which treat all schools more equally, are funded with a higher weight compared to the national formula.

Example 1 University of Tampere (UTA) internal allocation model

Figure 3 Finnish state funding model for universities vis-à-vis the internal funding model of the University of Tampere



- In addition to the above depicted formula, the UTA allocation model includes the following components:
 - Base funding for academic units (historical allocation)
 - Funding for administrative services for all units, the library, the language center
 - Strategic funding and the funding of designated for national duties (negotiated and earmarked funding)
 - Other expenditure (for example, expenses of the university Board, Rector, Open University)
 - Division of the accumulated surplus (optional).

Source: Authors based on Finnish Ministry of Education and Culture 2015 and University of Tampere 2016.

Other relevant examples can be seen in the Netherlands (see Example 2). When allocating the state funding internally, the University of Twente (UT) and the Delft University of Technology (TUD) differ in several respects. For instance, by following the indicators set in the state funding, funding is allocated using bachelor's and master's degrees as indicators in the TUD, but not in the UT. The TUD

allocates a significant amount of research funding by using bibliometric indicators as allocation drivers, whereas UT, in line with the national funding model, uses no bibliometric indicators in its internal allocation formula. The TUD seems to put a much higher emphasis on teaching in the internal formula compared to the UT.

These differences in internal allocation models stem from a different philosophy between the institutions. Whereas the UT adheres to a large strategic budget that can be distributed by the research institutes themselves, the TUD puts a stronger focus on academic performance in which the achievements of individual academics, departments, and faculties are calculated in a detailed way. The latter approach can lead to stronger annual fluctuations. As for teaching, at the UT, substantial fluctuations in student numbers two years before the budget year generated too many imbalances in annual faculty budgets, a more stable funding model was introduced in 2013/14 providing most of the funds for the courses provided and only a small component related to student numbers. Regarding research, the UT has — in absolute and relative terms — a substantially lower historically determined “strategic research component,” which makes earning as many premiums on PhDs awarded much more important than at the TUD. The TUD argues that a focus on academic articles by definition also stimulates PhD research, because these PhD students produce a relatively high number of articles together with their supervisors.

Example 2 Internal allocation models of universities in the Netherlands

Table 3 Dutch state funding model for universities vis-à-vis the internal funding model of the University of Twente (above) and of Delft University of Technology (below)

UT		2014	% in yr	% in yr
Components	Drivers	Budget (in k€)	2014	2015
Education part:				
ECTS premiums	ECTS volume (course credits)	30,473	65%	65%
Add-on per study program	Number of first-year students	11,720	25%	25%
Education stimulus		4,688	10%	10%
Subtotal		46,881	100%	100%
Research part:				
Infrastructure Nanolab	Fixed amount	1,000	2%	2%
Premiums PhDs	Number of PhDs	11,720	18%	22%
Premiums designer certificates	Number of certificates	1,482	2%	0%
Premium research contracts	Research council grants, other competitive funds, EU grants in 3 cost groupings (1 : 1.4 : 2.4)	15,620	24%	0%
Education related component	Education-related research (budget BA-MA ECTS = 30%-70%)	15,620	24%	18%
University research stimulus		5,207	8%	4%
Strategic institute budget	Management contracts (fixed % per inst.)	15,620	24%	24%
Additional institute budget	Contract per institute	0	0%	31%
Subtotal		66,325	100%	100%

TUD		2014	
Components	Drivers	Budget (in k€)	% of total Budget
Education part:			
Performance indicators:			
1. SEC Premium	ECTS credits; 0.2 points per ECTS credit		
2. Add-on per program	Number of first-year students (1 point/st)	5,160	2.3%
3. Bachelor degrees	2 points per BA degree		
4. Master degrees	2 points per MA degree		
Research part:		7,224	3.2%
Performance part		90,128	39.7%
1. PhDs	Number of PhDs	18,920	8.3%
2. Education rel. component	BA and MA degrees	16,856	7.4%
3. Premium research contracts	10% premium for every € of competitive grants (in 2010 research councils only)	34,056	15.0%
TUD incentives			
1. Publication in ISI journal	4–10 points		
2. Publication in peer list	4 points		
3. Scientific book	>80 pages: 4 points		
4. Scientific book chapter	4 points		
5. National scientific book part	1 point		
6. Conference proceeding	>3 pages: 1.5 points	54,696	24.1%
7. Other scientific publication	1 point		
8. Chief editorship sc. book	6 points		
9. Chief editorship proceedings	3 points		
10. Patent	4 points		

Source: Authors based on University of Twente and Delft University of Technology annual financial reports.

Currently, the state basic funding in the Netherlands is allocated to universities through the following formula: The funding model teaching (about one-third of funding) is 65 percent based on weighted number of students and graduates (with discipline-specific weights), 28 percent basic budget for education provision (historical funding), and 7 percent based on performance contracts (related to quality of teaching). The funding model for research (two-thirds of funding) is 15 percent based on weighted number of graduates, 20 percent based on the number of PhD degrees conferred (about €90,000 per PhD), 5 percent for research schools (multi-university collaboration), and 60 percent basic/strategic budget for research provision (historical funding). The University of Twente (UT) provides basic teaching budgets to modules of bachelor study programs (15 ECTS workload each) with a higher price for engineering than social sciences, and only partially related to the number of students (most of the module funding is a fixed price). Master's programs are funded on the basis of completed study credits (at different prices for engineering and social sciences). Large strategic budgets are given to large multidisciplinary research institutes, which allocate funds to academic units on the basis of performance negotiations. Some institutes/faculties have competitive funds for appointing PhD candidates and postdocs on promising innovative research projects. PhD premiums (number of PhDs) from the government are directly transferred to the units. The units can also obtain small premiums per full-time-equivalent researcher funded from competitive EU resources. The Delft University of Technology (TUD), in contrast, allocates most of its teaching funds on the basis of degrees awarded, with minor premiums per new entering student and credits earned. Research funding is largely driven by numbers of publications and external research contracts. PhD premiums are low.

The idea of integrating system-level, performance-based funding into internal funding models is simple. Funds should flow to units where performance is manifest: performing units should receive more income than lesser performing institutions, which provides performers with a competitive edge and stimulates less performing institutions to improve (Herbst 2007). However, notwithstanding this simplicity, designing an effective model for HEI internal performance-based funding has several aspects that add complexity, including the definition of good performance, selection of performance indicators, weighting of indicators, number of indicators, and measurement methodology (see for example, Ziegele, Tumbas, and Sedlak 2010).

When responding to state performance-based funding, institutions might want to adjust some of the performance indicators in a way that better serves these institutions' own strategic approach, institutional culture or disciplines, or other specific institutional features. For instance, a sophisticated and multi-dimensional bibliographic performance indicator in the system-level model can be simplified for the purposes of the internal funding model to cover only a few broader types of publications to be rewarded (as shown in the UTA example). Similarly, a system-level model rewarding the acquired competitive research funding from specific sources (such as national competitive research grants or EU funding) can be broadened in the internal model to include all sources of third-party revenue, especially if the research income structure of the internal units is diverse. In this way, the internal models can support the institution internal diversity and flexibility, and at the same time promote incentives that are in line with the national funding model. These more categorical performance indicators also allow the possibility for the units to define to a certain extent their own rewards on lower levels of resource allocation (that is, at the level of departments operating under the faculties, or study programs/research units operating under the departments). As a rule, allocation models at lower organizational levels tend to require greater levels of stability because they are more vulnerable to annual fluctuations in expenditures, other revenues, and measured performance (though these could be leveled out, for example, with a multiannual budgeting approach).

Weighting of indicators is another important aspect to be considered, because the institutional objectives behind the appropriation of funds should be manifest in the indicators and their weighting (Ziegele 2008). Compared to external state funding, institutions often adjust the weighting of indicators in their internal funding formula for various reasons. For example, institutions might want to incentivize some specific activity over another (for example, awarded doctoral degrees might have lesser weight because most of the faculties already perform well in this respect, but at the same time acquiring competitive research funding is rewarded with a higher weight because most of the faculties are doing more poorly in that respect). Weighting might also be geared toward supporting implementation of the institutional strategy. For instance, research-intensive institutions might put more weight on research-driven performance indicators than indicators rewarding educational activities (for example, awarded Bachelor's degrees or study credit points). Sometimes cost-oriented weighting is also needed to accommodate differences across the fields, particularly between more expensive (sciences, arts) and less expensive (social sciences, humanities) fields and disciplines (Ziegele, Tumbas, and Sedlak 2010; Hicks 2012).

Internal stakeholders of an institution should be aware of the type and number of indicators to be incorporated into the funding formula. The number of indicators used in a formula model determines the level of the model's transparency and the presumed effects of its incentives. When a model has been recently developed, there is often a tendency toward greater complexity involving numerous indicators in an attempt to take the interests of various units into consideration. The problem with this approach is that the financial effects of individual indicators become fragmented or even conflicting. The number of indicators therefore should be balanced between the effect of incentives/transparency and the reflection of heterogeneous performance and objectives (Ziegele 2008). Compared to the lump-sum allocations, performance-based funding formulas can incentivize disintegration of teaching and research activities by offering distinct funding streams for teaching and research activities. Even though performance rewards are not usually earmarked to support the performance they were appropriated for, they still can guide institutional and unit-level thinking in that direction. Therefore, institutions should acknowledge the need to balance the number and weighting performance indicators according to institutional strategies, and they should preferably use an integrated funding model for their internal units instead of two distinctive funding models for teaching and research. Finally, based on international best practices, institutions need to pay attention to how they handle instabilities related to measuring annual performance. Often multiyear averages (for example, three-year averages) are used to overcome annual fluctuations in measured performance (Ziegele, Tumbas, and Sedlak 2010).

One of the important issues surrounding performance-based funding is the object/level of allocation. Should performance-based funding be allocated as grants to incentivize units such as faculties, schools, or departments, or should allocations and incentives be passed on to individuals in the form of salary bonuses? **In several countries, performance-based funding at HEIs is allocated to units, but at the same time staff salary schemes include a wider performance component/bonus, which is in line with the incentives set by the allocation model.** The same applies, for instance, to HEIs in German states, where the 2002 framework legislation initiated the introduction of performance components in salary schemes (leaving, however, significant scope to individual states and partially also institutions to define performance in accordance with state-level and institutional objectives and to design specific aspects of the model). Also in the Netherlands, the performance bonuses that could incidentally be awarded to excellently performing staff are widely used by some universities, faculties, or departments that are able to attract additional resources, whereas in other departments/universities, the use of salary bonuses is limited.

Unit-level allocations instead of salary bonuses can be supported with several arguments. For instance, performance (for example, increased level of competitive research funding) is often directly and indirectly an outcome of a series of actions of multiple individuals. Therefore, it would not be fair to reward only one individual or a group of individuals who are primarily responsible for the realization of something that can be considered, in most cases, organizational performance. Second, units such as faculties and departments are more than just organizational platforms of academic work. They coordinate and direct the work of individuals, provide guidance, organize administrative support, facilities, and equipment, and on so on, thereby justifying their mediating role between the outputs and rewards.

Moreover, findings from several studies suggest that financial incentives may create a “crowding out” effect where extrinsic rewards (such as salary bonuses) under certain conditions “crowd out” the intrinsic motivation (genuine, noninstrumental interest toward academic work) (for example, Frey 1997; Frey and Jegen 2001; Andersen and Pallesen 2008). This could imply that financial rewarding does not necessarily improve the performance of employees who are motivated by the task itself. However, under certain conditions, the introduction of external rewards could also lead to “crowding in,” that is, enhancing the intrinsic motivation. It has been suggested that crowding out occurs when rewards are perceived as “control,” but crowding in is possible when the rewards are seen as “supportive” (cf. Jacobsen and Andersen 2014). Even though the research evidence on the impact of salary rewards on performance is still in many respects inconclusive, designing schemes where state performance-based funding would be channeled directly to high-performing individuals might contain motivational risks in addition to the unfairness aspects discussed above. Rewarding those dimensions of academic work that are not “extra” but can be considered a normal part of the work, are particularly more likely to trigger crowding-out effects. These could include paying rewards per written publication, and piece rate rewards per student supervised or number of classes taught. Individualized rewards are also built on medium- to long-term contingencies. The staff is expected to become more experienced and thus to perform better, but even under stagnant performance the bonus cannot be easily withdrawn, since this would likely have a demotivating impact. Individual salaries can therefore only stagnate or increase, which creates challenges for financial planning and resource building.

Finding the right balance is the key to designing appropriate schemes for allocating performance-based funding. When funding is channeled to the unit level to support research and teaching, monetary incentives can simultaneously facilitate development in those areas, and thus correspond better with intrinsic motives (Ziegele 2008). Moreover, when internal allocation of performance-based funding is shared with units and individuals, the requirement for fairness can also be better addressed. Finally, performance-based funding assumes that it can fluctuate with performance levels. Thus, applying performance-based bonuses/salaries at the individual level should be handled with care and as a complementary element of salary systems when appropriate. It needs to be designed and implemented carefully to minimize the potential crowding-out effects. For instance, team-oriented incentives or a model that does not reward work or performance at a detailed level, could have positive performance effects. However, performance bonuses are likely to be problematic when they are used like an individual formula funding and promote disintegration of teaching and research.

b) Financial Autonomy and Sustainability

Institutional Financial Steering Capacity

International trends show that financial autonomy of institutions can be strengthened in many ways, including through promoting internal freedom of institutions to mobilize and manage resources in a flexible manner. Mobilization of additional income through multiple new or existing funding sources (for example, student contributions, philanthropy, endowment funds, com-

mercial activities, different types of service-related income) again contributes to balancing the income structure of the institution, thereby increasing its financial sustainability. Therefore, autonomy can be considered as an important aspect for the sustainable financial development of institutions because it helps to reduce the resource dependency of institutions on any single source of financing, including state funding (Estermann and Bennetot Pruvot 2011).

Resource diversification makes it possible for institutions to plan their own future without undue dependence on single funding sources (Taylor 2006). Although not being a sine qua non condition, resource diversification often leads to better possibilities for building and maintaining financial reserves, that is, central funds, which are not allocated as part of the operating budget of units, but are held at the institutional level. Central funds are often needed for the effective promotion of institutional strategy and profile, such as supporting and directing new strategic initiatives, institution-wide development activities, overall strategic development of the institution and subsidizing non-revenue-generating activities critical to HEI missions. Central funds can be essential for incentivizing collaboration across units, but they can equally well be used as financial buffers (“rainy day funds”) to fill in revenue shortfalls during temporary difficulties in acquiring revenue or unexpected expenditure demands. As such, central funds are an important prerequisite for financial autonomy of HEIs as a whole. The need to make transformative changes requires often significant investments for which only the center, not individual units, can provide adequate funds. Without central funds, the opportunities for HEI leadership to strategically manage the institution are restricted (Ziegele 2008; Education Advisory Board 2014).

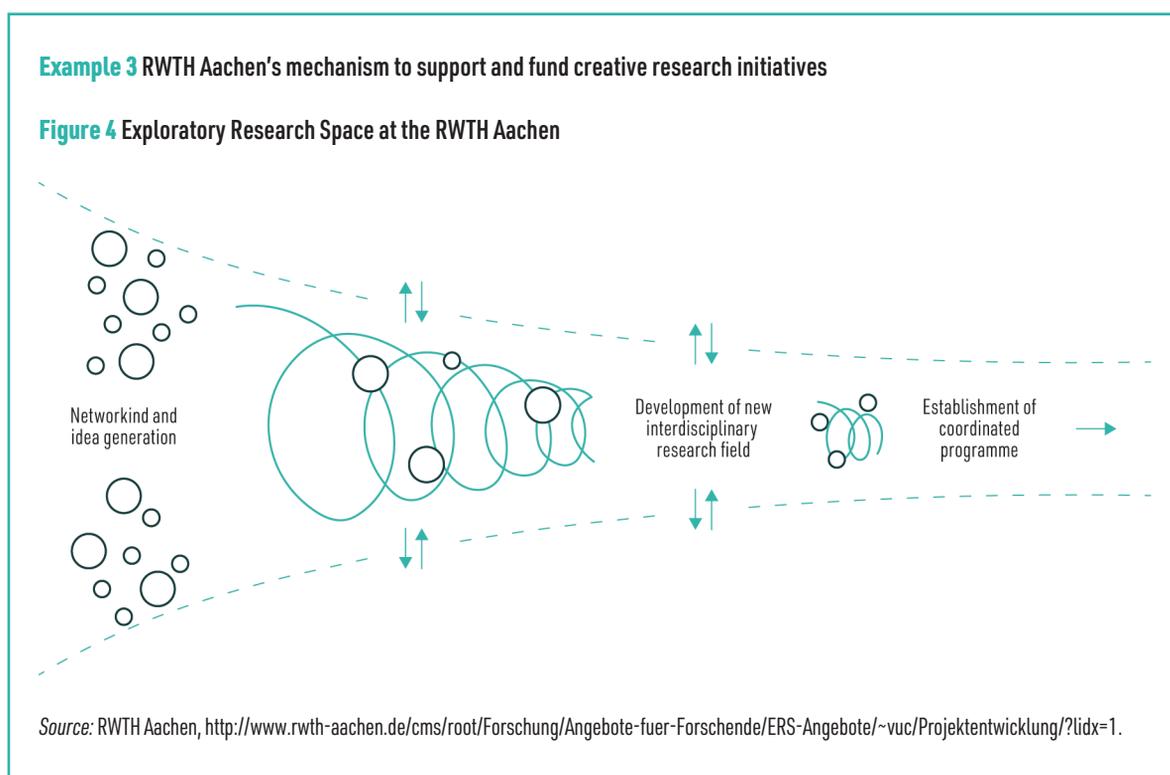
In principle, international examples show that there are effective strategies (more revenue, less costs) for the accumulation of central funds. On the side of increasing the revenues, strategies related to student contributions could include, for example, changing a mix of enrolments by increasing the percentage of students paying higher fees (often international students), increasing tuition fees for existing students, or increasing enrolments while maintaining current tuition fee levels (Hauptman and Nolan 2011). Alternatively, an institution could, for example, incentivize the units to be more active in seeking competitive research revenues by offering seed funding for promising research areas and groups, co-funding or match funding for already established research projects, developing business activities by investing in technology transfer offices, developing institutional capacity in fundraising by hiring fundraising staff, and so on. Seed funding often creates a kind of upward loop: provision of start-up funding for new initiatives creates additional revenues from new activities, which further contributes to the possibility of offering additional seed funding previously not available. These strategies often benefit from the fact that the central administration is able to capture at least a share of the revenues either by deducting a certain percentage of the institutional revenues or taxing the revenue collected by units.

Example 3, below, shows how the Technical University (RWTH) Aachen in Germany uses an “Exploratory Research Space” (ERS) scheme as a strategic internal funding instrument to fund new research initiatives. ERS, an in-house funding mechanism, promotes and funds interdisciplinary research projects and provides a platform for scientists who join forces to develop innovative, challenging research ideas involving a higher risk than conventional ventures

and who seek to realize their ideas in “seed fund” or “boost fund” projects.⁸ As such, ERS offers an example of a competitive process with a multiphase approach in evaluating the promising research initiatives to be funded by the university. With the “pathfinder projects” researchers get some funding (seed funding) for innovative new ideas. In the second phase, the seed fund projects are developed into more comprehensive, interdisciplinary project proposals, which are funded by the RWTH Aachen’s “boost fund.” These proposals create the foundation for the success of the “project houses,” whose activities serve to primarily build networks over the boundaries of involved disciplines. In the meantime, efforts are made to develop the project houses further into “research centers,” which should contribute to sharpening RWTH Aachen’s profile and visibility, and which eventually become financially self-sufficient through external funding (RWTH Aachen n.d.).

Example 3 RWTH Aachen’s mechanism to support and fund creative research initiatives

Figure 4 Exploratory Research Space at the RWTH Aachen



Institutional leadership can also introduce budget reductions and cost-savings measures aimed at recapturing funds from units and to be directed to the central funds. Examples of these measures include one-time across-the-board cut from budgets, continuous decremental/decreasing budgeting (cutting a certain percent of each unit’s budget every year, for example, 1 percent), temporary budget freezes (including recruitment freezes), targeted reductions, and restructuring. As a cost-saving measure, freezes are often an interim step institutional leadership have at their disposal while still determining possible long-range measures. Across-the-board cuts and decremental/decreasing budgeting are technically the simplest and most expedient way of recapturing funds, since

⁸ For more information on ERS, see <http://www.rwth-aachen.de/cms/root/Forschung/Angebote-fuer-Forschende/~ohy/ERS-Angebote/?lidx=1>.

they provide flexibility to units on where the cuts can be made. At the same time, they are also equitable, since all units are treated alike. Declaration of a budget freeze is a softer way to recapture funds. It can also be an effective way to get the attention of the staff to the financial situation of an institution in the case of financial difficulties.

Targeted reductions rest on a premise that some activities, programs, or units are central to institutional purposes, whereas others are desirable but less important from the perspective of institutional strategy. Institutional restructuring can include a large scale organizational restructuring (unit mergers, staff reductions), but it can also include establishing new processes and procedures aimed at improvements in efficiency (for example, introducing a centralized purchasing policy, outsourcing some of the services). Since recapturing funds through cost savings is likely to cause more organizational upset, the least drastic measures should always be used first whenever possible. When savings cannot be avoided, voluntary cutback measures developed by staff should precede the involuntary ones. However, when facing serious difficulties, institutions should focus on more sustainable strategies with a high financial impact such as controlling the allocation of vacant positions or imposing a tax on tuition to direct a share of funding to central discretionary budgets (Barr and McClellan 2011; Education Advisory Board 2014).

The decision process on how central funds are allocated is very important, since their allocation is mainly based on discretionary decisions. These can be based either on negotiation between the institutional leadership and the units, competitive bids (for example, strategic funding for new research initiatives) from individuals and units, or on using formulaic approaches to support some specific activity (for example, doctoral education). Often strategic funding is allocated within the context of performance agreements (for details see “2.2 d) Balance and Context”). Ensuring transparency is very important for staff morale, especially if central funds are to be accumulated primarily with cutbacks and cost savings. Therefore, good internal funding models can make clear to all how the decisions are made and why, who has decided, and based on which criteria.

Borrowing is one option for HEIs to acquire financial resources. The main reason for borrowing is that it permits institutions “to build now and pay later” (Massy 1996, 122). In principle, two types of borrowing can be distinguished: (1) Borrowing for projects or purposes, which will generate an incremental income stream at least equal to debt service (that is, the resources that are required to cover the repayment of loan interest and loan principal for a particular time period). One example on this could be loans taken for erecting new innovative multidisciplinary research facilities that will also be used for conducting sponsored research, which again is expected to generate new income or savings (for example, through energy savings), which can be used directly for covering the debt service. (2) Borrowing for purposes that do not directly result in additions to institution’s revenue, such as general-purpose buildings, extension of library capacity, or the like. These purposes may further indirectly support HEI’s mission and thus its revenue-generating potential over time. However, the link between these revenues and the costs accrued from debt service is not explicit (Massy 1996). Both kinds of borrowing can further the missions of institutions by leveraging their available assets, but from the perspective of financial risks, the first type of borrowing is significantly less risky than the second one.

Based on an EUA study (2011) on the autonomy of HEIs, only in a minority (7 out of 28) of European systems, HEIs were unable to borrow on the financial markets due to restrictions set by the state, but in only six systems were HEIs able to do so without restrictions (Estermann, Nokkala, and Steinel 2011). **Despite the relatively high number of systems in which HEIs are allowed to borrow (with or without restrictions), there seems to be no information available about the frequency (that is, how many institutions borrow), the scale (that is, how much is being borrowed), or the nature of the borrowing (that is, for what purposes and from where).** This is a surprising finding that might lead to a conclusion that either the European HEIs do not use their freedom to borrow or that their borrowing does not constitute a significant source of financial activity. Either way, this might imply that the risks associated with borrowing are considered to be too high compared to the expected benefits. In its recent statement, EUA appears to have taken a position against borrowing, at least in so far as it is considered an alternative financing mechanism replacing nonrepayable public funding. This EUA position is backed by arguments that address the sustainability aspects, particularly: “loan schemes are not helping to address the investment gap in university education and research as they just shift the problem of scarce resources to the future and create debt that harms the financial sustainability of non-profit institutions like universities” (EUA 2016, 3).⁹ Although borrowing might be an option when facing, for instance, temporary liquidity challenges, institutions in general must also bear with their own assets the full risks associated with the loans. In the case of borrowing, it is crucial to develop a detailed and careful plan on how to recover the cost of repayments through additional income or savings.

Unit-level Financial Autonomy

Unit-level autonomy is an important prerequisite for the sustainable strategic development of units. The current international trend is to favor bigger unit sizes, with a high level of operative and financial autonomy (for example, Lopez 2006; Taylor 2006; Lepori, Usher, and Montauti 2013). It is believed that sufficient size of the units allows them to develop their own specific objectives under the broader framework of an institutional strategy, and that large units are better able to make use of financial flexibility. Like on the system level, an increased level of autonomy of units is often accompanied by a higher level of intra-institutional accountability (Lopez 2006).

In general, centralization and decentralization of financial authority is one of the most important decisions HEIs face, and it often has direct implications related to the locus of control in the institution. Therefore, adequate balancing of the top-down and bottom-up approaches is an important requirement for internal funding models.

In centralized funding models, resources are allocated and the use of resources is authorized by the central institutional management. Technically speaking, an institution that has only one budget under which all funds are pooled at the central level, can be considered as a strongly centralized allocation model.

⁹ <http://www.eua.be/Libraries/publications-homepage-list/one-year-of-efsi-whats-in-it-for-universities-an-eua-review>

Centralized resource allocation locates all decisions on a budget at the central level, and stringent controls are typically in place to assure that the management of the budget throughout the fiscal year is congruent with the budget approved. Benefits of the centralized model are related to the efficiency of control and coordination, and therefore it is often used during times of financial difficulties — a centralized budget lends itself to midyear adjustments either as a result of unforeseen challenges or emerging opportunities. Moreover, centralized allocations may be associated with longer-term strategic goal setting, because resources can be more easily deployed to invest in potential growth opportunities. Resource-intensive exercises, such as establishing new units, are more difficult to implement in a decentralized model. Cross-subsidization of less viable activities is also easier in a centralized model when the activities are perceived to be important for the institutional strategy. Centralized resource allocation, however, is naturally associated with lower levels of departmental autonomy. This can lead to a lower unit level responsiveness to strategic initiatives, since centralization offers neither autonomy nor much bottom-up incentives to control costs. This might have a further demoralizing effect on the unit-level leadership and staff who are responsible for organizing teaching and research activities, because budget decisions are not done by those “product owners” (Jarzabkowski 2002; Barr and McClellan 2011).

In contrast, in a decentralized resource allocation model, units such as faculties or departments have control over their own budgets, accompanied with a responsibility for their own strategic direction, income-generation, and financial viability. The main rationale behind decentralization and higher unit-level autonomy is that in such a model, units are considered to be more responsive to strategic initiatives within their disciplines and to generate, deploy, and allocate their own income streams in a way that supports their cost-effective operation. Similarly, when units are held responsible for many or all of their costs, like office space, equipment, and support staff, they become more economical about it. In particular, the unit’s ability to reallocate expenditures and decide on how set targets are achieved, the possibility to carry forward unspent funds (or part of them), the ability to build financial reserves on the decentralized level, and the possibility to decide on the required volume of support services, have been considered as the major strengths of the model (Jongbloed and others 2000). As such, decentralization is believed to support a higher level of responsibility (due to budget “ownership”), transparency, and entrepreneurial thinking at the unit level. At the same time, decentralization has been criticized mainly for the difficulties in its practical implementation, possible duplication of administrative and support services (for example, requirements for developed information management systems, financial analysts and other support staff), coordination challenges among decentralized units, and difficulties in aligning unit objectives to the institutional strategy. In any case, the prevailing international opinion seems to be that the benefits of decentralization in most cases outweigh its projected disadvantages (see, for example, Jongbloed and others 2000; Lopez 2006).

One of the most frequently mentioned examples of financial decentralization is known as responsibility center budgeting (RCB) (also known as revenue-center budgeting and responsibility center management) (see, for example, Barr and McClellan 2011; Education Advisory Board 2014). The strengths of RCB are most suited to large, complex, research-intensive universities, because it requires units that have the possibility of maintaining a sufficient revenue base with multiple income streams. RCB models often give a college, faculty,

or department control over the income it generates (including setting the level of fees, deciding on enrolment, allocating the global revenue base available to it) and the expenses it incurs. Decisions about optimal balances between costs and revenue are made by the units, which also set their priorities and link plans and budgets. RCB has a highly decentralizing effect because it locates many decisions involving the generation and management of resources to the unit level. However, RCB as a concrete budgeting practice has many variants. For instance, some HEIs attribute all expenses but only some income, while others deploy RCB in some divisions but not in others (Lang 1999; Barr and McClellan 2011).

Rather than using “pure” centralized and decentralized approaches, most institutions use hybrid models by mixing elements from both approaches to find an appropriate balance for their internal budgeting structure. Size of the institution, organizational structure, history, culture, and other factors often play an important role in finding this balance.

c) Transparency and Feasibility

Aspects Related to Transparency and Fairness in Internal Allocations

One of the most common objectives of internal funding models is to increase transparency. Transparency continues to be one of the primary concerns for the financial administration of an institution, which often struggles to communicate the reality of budget constraints and the urgency of change to the academic community (Education Advisory Board 2013). Transparency is particularly important, because it fosters the sense of fairness and, equally important, trust. Again, the level of trust often has clear implications for the morale and motivation of the staff in working toward common institutional goals.

Transparency requires that the institutional funding model is understandable in the sense that it is clear why one unit receives more or less funding than others. For instance, funding formulas legitimize allocations, since they make the underlying allocation criteria measurable and thus transparent. Formulas automate the connection between the objectives (measures of the formula) and the appropriation of funds in a way that removes the discretionary room for non-transparent maneuvering, such as bargaining or lobbying influence. With formulas, which are relatively simple and include a restricted number of indicators, it is clear who is receiving how much money and for what reason, leading to high levels of trust and the possibility of more conflict-free collaboration. Some institutions support this by internal reporting to their units providing information about financial mechanisms and their effects. Well-designed formulas should also consider the cost and other differences among disciplinary fields to also ensure a sense of fairness (Ziegele 2008). An important prerequisite is, however, that various internal stakeholders are familiar with the formula and are capable of acting on it.

Another way to increase transparency is the use of written performance/target agreements that are accessible to the public. Target agreements should demonstrate a structure — a “form” or framework that can be developed for this purpose (by the central administration), which prescribes the wording of agree-

ments, determining a standard formal framework in which individual contents can be entered as relevant by the recipients of funding (Ziegele 2008).

Transparency and fairness also need to be considered when deciding on the overhead to be attributed to the central administration to finance administrative services. Although the institutional administration and support services do not directly generate revenue for the institution, they provide necessary services that benefit the entire institution. Spreading the overhead costs associated with general administration equitably among revenue-generating units is challenging from the perspective of transparency and fairness, because it is often difficult to measure which units benefit most from the services. Standard mechanisms used to allocate the cost of general administration to units are overhead charges, which can be categorized as revenue taxes, expense taxes, other taxes, and cost pools. Charging units a tax on the revenue they generate (for example, research grants, tuition fees, internal grant allocation) is probably the most common approach applied everywhere. An advantage of a revenue tax is that it connects the revenue generation to the increased expenses (for example, research projects increase the need for more and better library services and legal advice), and in a way supports the equitable redistribution (those who have more, pay more). Cost pools are groupings of individual costs by services (for example, maintenance, ICT support), which are then used to make cost allocations (overhead) to units according to the proportion they are using the services. Central taxes are easier to administer than cost pools; however, they provide a lower level of transparency (Education Advisory Board 2013, 2014). Various universities in different higher education systems show a great diversity in internal “taxing” or “overhead levy” practices. For instance, at the University of Twente in the Netherlands, faculties can set their own rules, but in most cases charge a certain fixed amount of “overhead levy” per full-time-equivalent staff funded by external resources.

The treatment of unit-level surpluses is an important issue that is crossing the boundaries of institution- and unit-level autonomy and interests. Standard alternatives related to the treatment of unit surpluses are that units either can keep or cannot keep a surplus. However, “gain sharing” is a common way through which institutions can encourage the units to seek out savings and at the same time capture some of these funds to a central institutional fund. Under a typical gain-sharing plan, units can carry forward a large portion of their surplus into the next budget year, but not the whole surplus. Setting the carry-forward share too low recaptures more resources to the central funds, but is also likely to lead to inefficiencies by encouraging wasteful end-of-year spending, to limit the possibilities to save for unit-level long-term goals, and to create disincentives for entrepreneurial behavior and additional revenue generation in the future. Setting the carry-forward share too high encourages unit-level savings, but produces fewer resources for the central fund. Therefore, finding a right balance between unit-level and institutional interests in this matter is also important. In U.S. institutions, for instance, a typical share of surplus that units carry forward reportedly ranges from 50 to 80 percent (Education Advisory Board 2014).

Another important aspect of increasing the legitimization of a funding model is to offer effective channels for communication and participation, which has also become a trend in many systems, not least because of the possibilities offered by digitalization and advances in using ICT tools. In particular, effective communication with internal stakeholders is crucial when initiating a process that is leading the development of a new or revised funding model for the institution.

During this process, all established channels of communication within the HEI should be used to form a coherent campaign. For instance, the process and the results could be reported in a magazine or news bulletin or key documents posted on the intranet. Interactive workshops and webinars could be organized, and surveys and polling could be used to detect the variety of opinions. Developing a new model or revising the existing one should be organized in a participatory way, since whoever has an opportunity to participate in developing the model is more likely to identify with it (Ziegele 2008). For that reason, it is desirable to extend active participation in any change process beyond the project or working groups, who are usually in charge of developing a new model. The involvement of unit-level leadership (deans, heads, council/board members) is crucial, but opportunities for regular staff involvement should be offered as well. However, involving too many people in designing a model can also present challenges, thereby requiring effective coordination and division of labor (for example, participation of different groups and people in specifically demarcated subareas). In any case, promoting participation should not be a formality, but a necessity. Asking for concrete suggestions, for example, can sometimes lead to new and unexpected insights, which can have an impact on the development of a new model. Even if most of the specific ideas presented cannot be implemented, it is important that people have a genuine opportunity to be heard and are offered a chance to present their views (Ziegele 2008; Barr and McClellan 2011).

Aspects related to Administrative Efficiency and Availability/Reliability of Performance Data

The development and administration of funding models can be costly and time-consuming, and the development, collection, and maintenance of required data could demand intensive institution-wide efforts. All funding models come at administrative cost, but there are differences in how much and why resources are needed for the implementation of these models. For example, the development and administration of performance-based funding schemes may require substantial resources, especially when the measurement requires labor-intensive design of indicators, data collection and cleaning, validation efforts, establishing data warehouses, or time-consuming indicator calculations (cf. Hicks 2012). Sometimes there can also be conflicts between the use of available standardized measurement data versus the data that is customized to serve the needs of an institution. For instance, existing bibliometric approaches may not be able to treat different faculties in a fair way, and therefore institution-specific indicators need to be developed. An institution then needs to reserve resources for constructing its own publication indicator to create allocations that are more balanced. Similarly, introducing internal target agreements might require a lot of planning, preparation, and assessment in order to have a more customized approach for the specific needs of specialized units (for example, research institutes). However, formula funding has the potential to reduce the cost of negotiations by creating automatic allocations.

Similarly, revenue diversification strategies, although beneficial for institutions, will incur several types of transaction costs. For instance, it has been proposed that the more revenue sources there are, the more challenging becomes the coordination of resource use within and among organizational units. Moreover, while the intensive diversification of revenue sources can be used to address the potential volatility challenges, these processes can also create

additional administrative cost, which in turn may necessitate the hiring of more administrative support (Froelich 1999; Morris and Rip 2006; Raudla and others 2015). Different sources of third-party funding are often related to different modes of accounting and rules regarding the use of earmarked funding, which could make internal budgeting complicated. An important issue that is likely to emerge in the context of project-based funding of academic research is how to cover these transaction costs and on whom they should fall (units vs. central administration) (Raudla and others 2015). In decentralized allocation models like RCB, it is often the unit that is primarily responsible for covering the increase in administrative costs, but in more centralized models, they often fall on the central administration. However, even though through increased resource diversification institutions become dependent on multiple stakeholders, HEIs can shift the balance among the stakeholders according to the changes in the dynamics of “the stakeholder market” to optimize revenue diversification.

In some countries where institutions are applying a version of RCB at the faculty level, there has been a clear trend to centralize the administrative services to be treated as an independent budgetary unit (for example, Finland, the Netherlands, plans in Norway). These university-wide shared services take care of the financial administration, study administration, research support services, and HR services of the units, but in operational and budgetary terms they are external to units. There can be different practices in charging the administrative overhead cost depending on the institution, but one measure used during the transition phase is to cut the unit budgets and transfer these cuts to the budget of shared administrative services. Although shared services create several types of coordination challenges (as is often typical for matrix structures), they also create flexibility in allocating administrative staff from one unit to another based on demand for their services. Units are often charged with revenue-tax type overheads (as a part of the full-cost model), thereby also linking the cost of administrative services and the revenue streams from research grants and services incurring these costs.

d) Balance and Context

Finding an Appropriate Balance among Three Pillars

According to international best practices, the overall architecture of the funding model should also be balanced in light of functions of the three-pillar model, that is, between “basic funding” offering stability (Pillar 1), performance-based funding fostering increased/improved results and greater productivity (Pillar 2), and profile/innovation-oriented funding promoting change (Pillar 3) (Ziegele 2008, 2013). What is considered a legitimate balance is, of course, related to the institutional profile, type, and strategy of an institution.

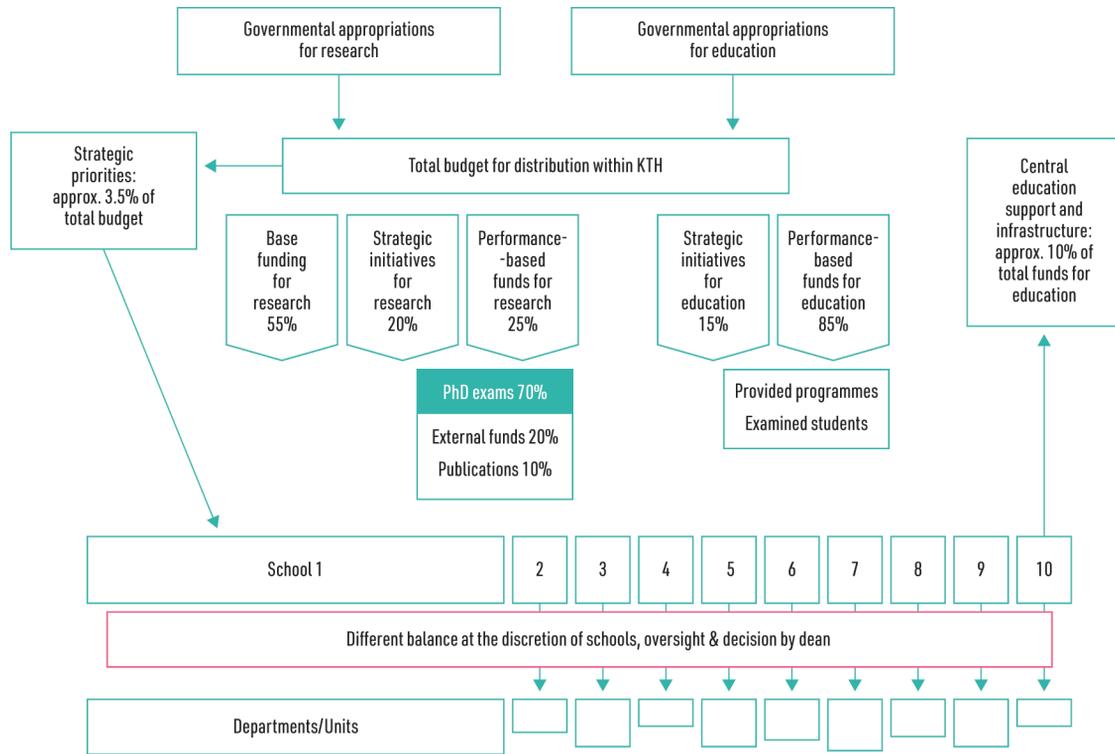
For instance, research-intensive universities often choose excellence in research as one of their primary strategic objectives. This means that the institution should be able to offer a sufficient level of core funding (allocated ex ante via incremental or formula funding, with or without using target agreements), in order to support the relatively stable planning horizon for the basic, non-project-funding-related research. At the same time, stable basic funding ensures that institutions possess the required capacity to be engaged in seeking competitive funding (Pillar 1).

To increase or maintain the level of research productivity, institutions may want to create financial incentives that reward units for their success in research. These rewards should be in addition to Pillar 1 funding, meaning that the possible lack of performance-based funding does not undermine the possibilities or capacity provided by the basic funding, but serves as add-on funding to be allocated (ex post) for those who have been productive in their research activities (Pillar 2). For research universities, the capability to attract funding based on competition and research excellence is a sign of excellence. Therefore, research institutions often want to support those projects, groups, or individual researchers who possess either the potential or demonstrated merits with seed funding (allocated ex ante via target agreements or by competitive bids from central funds) that can serve as a stepping stone for acquiring competitive funding, that is, research grants from national research funders (science councils, academies, private foundations, and so forth), international research funders (for example, the EU), or from a range of commercial research funders (Pillar 3). In that case, balance among the three pillars would therefore mean that the university is able to develop its current and future activities through three pillars in a way that supports (based on achieved results geared toward research excellence) its mission, strategy, and profile as a research-intensive university.

KTH Royal Institute of Technology in Stockholm, Sweden (KTH) is an example of a three-pillar funding model implemented in a research-intensive university (see Example 4). Almost two-thirds of the KTH revenue budget relates to research. KTH is organized into 10 schools under which departments, centers, study programs, and other units operate. Funding is allocated from the central level to schools, which then distribute the funding internally to the departments and other units as they see fit. Funding allocated to schools for research is composed of sizable base funding (approximately half of the funding for research) to provide a sufficient level of stability. Approximately 25 percent of the funding is performance-driven based on doctoral exams, and amounts of acquired external funding and produced publications, thereby corresponding to Pillar 2 funding. About 20 percent is allocated as strategic initiatives (Pillar 3) in accordance with KTH strategies. For instance, during 2016, priority was given to research infrastructure, faculty development, and interdisciplinary initiatives, preferably among the schools. Moreover, KTH has also invested in establishing a tenure track system that is also financed with strategic funding. For education, unlike for research, there is no clearly distinguishable Pillar 1 type of funding. In contrast, Pillar 2 funding (performance-based funds) for education covers as much as 85 percent of the allocation based on, for example, number of examined students. In addition to the streams for research and teaching, smaller amounts of Pillar 3 type funding (3 to 5 percent of the total budget) are kept at the central level. This funding can be allocated, for example, for co-financing EU projects, and for covering expenditures for needs that emerge during the budget year. The KTH model also builds on performance contracts (also called target agreements) among the schools and the rector. These contracts are negotiated and agreed upon annually, and significant differences in planned or actualized performance will have a certain impact on school budget allocations (Melin and others 2016).

Example 4 Three-pillar internal funding model in KTH Royal Institute of Technology in Stockholm

Figure 5 KTH three-pillar funding model



Source: Melin and others 2016, 7-11.

Possible imbalances in the model result from either over- or underemphasizing the role of any of the three pillars. The imbalance among pillars can be caused by weak design of the internal funding model, imbalances in the sources of institutional revenues, or both. For instance, a high reliance on project-based funding (Pillar 3 external funding) can lead to volatility of funding, resulting in fluctuating revenues from year to year (or even within one year). These revenue imbalances often add constraints in balancing the internal allocation model. For example, Pillar 3 internal funding (strategic central funds) can no longer be used as seed funding for new initiatives because it is allocated as “temporary survival funds” to compensate deficiencies that should under normal conditions have been taken care of with Pillar 1 funding (see Raudla and others 2015).

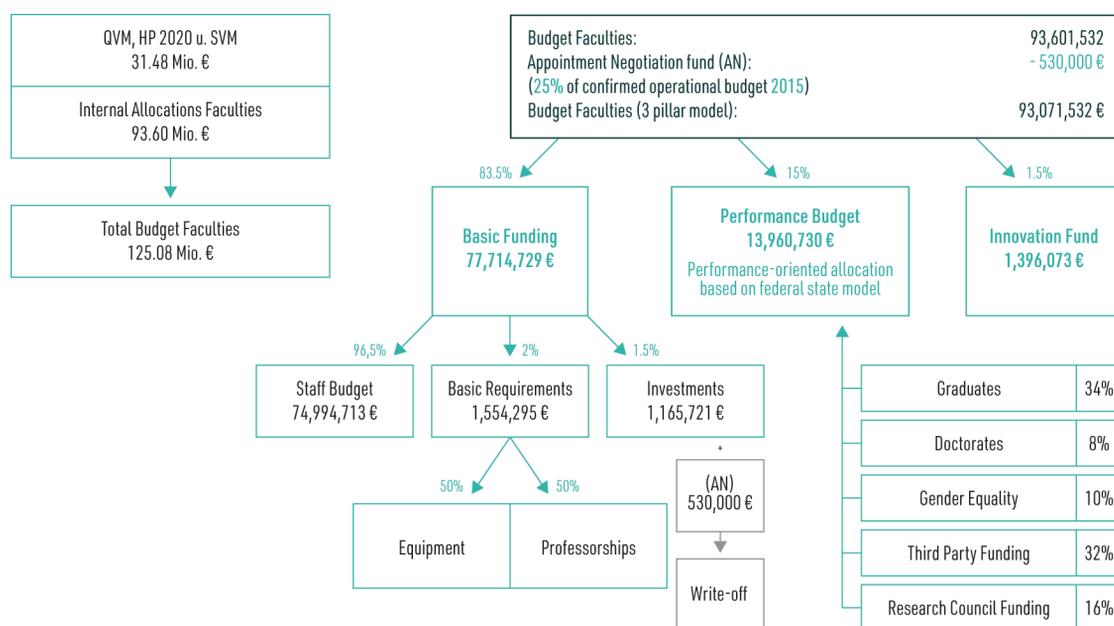
Internal target agreements are often used in allocating Pillar 1 and Pillar 3 funding, and sometimes in allocating Pillar 2 funding, to balance the model architecture (see Example 5). In Pillar 1 funding, target agreements are effective in communicating the institutional objectives to the unit level, which then needs to reflect its whole spectrum of activities in terms of research and teaching as an exchange for the basic allocation (allocated either in incremental or formulaic form). Allocations from central funds can be made through target agreements (Pillar 3 funding). Often in these cases the appropriation of funds is based on

an application procedure. HEI management invites tenders for a pool of a certain volume; units can apply for funding, for example, for innovative research projects, new educational initiatives, or third mission activities. The objectives of these projects could be set out in target agreements; that is, target agreements have a selective content (they relate to a small number of priority fields), they are geared toward innovation and structural development, and are negotiated on a voluntary basis (since each unit is free to choose whether it wants to compete for funds) (Ziegele 2008). Institutions usually decide to take one of the two options — either a comprehensive target agreement justifying lump-sum funding under Pillar 1, or project-based, focused funding under Pillar 3.

Example 5 Target agreements at the University of Duisburg-Essen

- The University of Duisburg-Essen (UDE) is a public university located in two cities, Duisburg and Essen, in the German state of North Rhine-Westphalia (NRW). It was founded in 1654 and reestablished on 1 January 2003 as a merger of two universities. With 12 departments and close to 40,000 students, it is among the 10 largest German universities.
- The strategic development of the institution is laid down in the UDE strategic plan, which is based on the higher education development plan of the state of NRW. UDE signs Target Agreements with NRW's Ministry of Innovation, Science and Research which, among other things, cover the number of study places foreseen, although the allocation is historical.
- University-internally, UDE also works with Target Agreements. Since 2005, the Rectorate has signed Target Agreements with all faculties and central bodies of the institution covering a three-year period. The overarching idea is that the strategic plans of faculties and other units should be attuned to the overall strategic directions of the institution.
- Major aspects covered by the agreements are core tasks related to teaching and learning, research initiatives, measures related to strengthening the profile of UDE, and specific activities related to the Target Agreements between UDE and the state. Other aspects covered relate to gender and quality assurance. After conclusion of the three-year period, the respective units report back on the achievement of the agreed targets.
- The process is further supported through evaluations of all faculties and central units, which take place every six years.
- The amount of funding attached to Target Agreements is very small – only 1.5 percent under Pillar 3 "Innovation Funds." UDE allocates 83.5 percent under Pillar 1 (Basic Funding) and 15 percent under Pillar 2 (Performance Budget).

Figure 6 Target agreements within the three-pillar model in the University of Duisburg-Essen



Source: Authors based on UDE Dezernat Hochschulentwicklungsplan, Memo on Target Agreements and Strategic Development, March 2016 (all unpublished documents).

Continuity Aspects related to Funding Model

When institutions are further developing an existing funding model or transitioning to a new model, maintaining a sufficient level of continuity is essential, because too frequent, rapid, or substantial changes in a funding model are likely to cause difficulties in the process of adapting to a new model. Implementation of the new or revised allocation model should always be preceded by a comprehensive and systematic evaluation of the impacts of the old/existing model. The timing of evaluations is often fixed when the changes are implemented; the promise to evaluate outcomes of changes after a certain timespan increases trust in and acceptance of the reforms. The results of this evaluation should feed into the process of revising the old model or developing the new one. Often organic development of the new model is a better option than radical revision of the existing model. This means that a new model adopts some elements from the old model side-by-side with the new elements to be introduced. For example, formula-based funding taking into account the number of enrolled students could be revised to include a targeted number of awarded degrees before actually transitioning to measure the actual number of awarded degrees. The state funding model can also play a significant role in securing the continuity of internal funding models. The state should keep its funding modalities stable and fixed for a certain period (for example, three to four years) and communicate the foreseen changes in the formula to institutions well in advance. In the case of performance-based funding, for instance, institutions should know for how long the performance indicators in the formula are valid in order to properly align their internal funding model to the incentive structure provided by the state model. Changes in the state allocation formula or in the institutional allocation model that are too sudden and unpredictable are likely to increase the possibility of noncompliance on the part of the institutions with the incentives established in the model. Annual budgetary changes can be limited to a few percent.

Continuity is also maintained by taking care of a reasonable level of unit financial stability. Unit-level operations and performances are subject to stronger periodic fluctuations than those of the institution as a whole. Smaller units with smaller budgets, particularly, often have less potential for smooth adaptation to a revised model. According to international best practice, there are alternative/complementary strategies to increase the level of continuity during the early years of model implementation. First, institutions can introduce a concept of a “learning year” to familiarize units with new allocation methods of the core budget. During this year, no real allocations are made, but units receive a calculation of how much funding they would have received if the new or revised model were 100 percent effective. The “learning year” can be followed by phased implementation (for example, a four-to-five-year period) when the amount of funds subject to the new allocation formula is increased through predetermined increments (for example, 20 to 25 percent increases in a year). After phased implementation, institutions can still keep “stop-loss measures” that set a limit on how much units can gain or lose in terms of resources in a single year. In some specific cases, a “hold-harmless period” can also be applied during which reallocations from the central funds are used to hold unit budgets to pre-implementation levels for a fixed period of time (cf. Education Advisory Board 2014). As an objective, securing a reasonable level of continuity should not, however, lead to a situation where the implementation of the new allocation model is put on hold, purposely delaying its complete implementation.

2.3 Requirements for “Good” Internal Funding Models

Based on the various notions mentioned above, it is evident that there is no single best allocation model that works for all institutions. Institutional culture, history, disciplinary composition, and other boundary conditions (for example, state budget cuts) influence the right allocation model for an institution at any given time. Moreover, each model has its own strengths and weaknesses. All “pure” models will need to be supplemented with additional elements or practices to mitigate their natural disadvantages or temporary fluctuations. Institutions in general will have to balance among many interests and (temporary) contexts or performance levels of various units while striving for different strategies or pursuing different profiles. Therefore, HEIs should be autonomous in choosing among the many alternatives of funding models and options. For instance, they should be able to choose a mix among the three pillars, backward-looking versus forward-looking, and types of performances rewarded, and the potential level and use of surpluses.

Rather than proposing what a “best funding model” would be, this section provides an outlook for the general normative requirements for “good” internal funding models, and provides a broad framework for the assessment of internal funding models. The requirements, introduced in the following sections, are derived from and backed by the following sources of information:

- System-level criteria for “good” funding models the World Bank team used in its analysis “Higher Education Financing in Latvia: Analysis of Strengths and Weaknesses” (2013–2014)
- International, particularly European, experiences, good practices, and standards on internal funding models based on findings from the recent research literature (as described in earlier sections)
- The team members’ professional expertise in the field.

From these sources, the team identified the six (A–F) major requirements shown in Table 4. In the following, each of these requirements will be broken down to subsections and described in more detail.

A. Strategic orientation	A.1. Aligning internal funding model with external revenue streams and reflecting national goals
	A.2. Promoting institutional strategies and profiles
	A.3. Promoting unit-level objectives
B. Incentive orientation	B.1. Creating performance rewards and sanctions
	B.2. Providing clear and nonfragmented incentives
	B.3. Avoiding undesired side effects

Table 4 General requirements for a “good” internal funding model

C. Sustainability and balance	C.1. Combining top-down and bottom-up approaches
	C.2. Providing a sufficient level of stability
	C.3. Guaranteeing continuity in development
	C.4. Balancing the overall model architecture
	C.5. Promoting diversification of unit-level funding sources
	C.6. Balancing the key institutional missions
D. Transparency and fairness	D.1. Ensuring transparency
	D.2. Supporting the perception of fairness
E. Level of autonomy and flexibility	E.1. Guaranteeing financial autonomy and academic freedom
	E.2. Implementing an adequate level of regulation
F. Link to governance and management; practical feasibility	F.1. Increasing reliability and availability of data
	F.2. Ensuring administrative efficiency
	F.3. Ensuring coherence with other governance approaches and university culture
	F.4. Ensuring the ability of leadership to act

A. Strategic orientation

The incentive structure of the internal funding model must be compatible with the external revenue streams of the institution, and particularly with the state funding model. This means that the external financial incentives and the logic of institution-level revenue generation need to be translated into appropriate internal incentives through the internal funding model. Having an incompatible internal incentive structure will significantly increase the risks of misguided organizational behavior and is likely to result in unsustainable institutional revenue generation. Alignment also means that the internal models reflect and contribute to the objectives and priorities of national and institutional higher education and research objectives.

➤ **Requirement A.1. Aligning internal funding models with external revenue streams and reflecting national goals.**

In addition to the external funding structure of an institution, internal funding models need to consider institutional strategies and profiles in line with the national policy goals and priorities. Internal models should support these objectives by incentivizing unit-level actions directed toward the implementation of the institutional strategy. This also requires internal procedures to reflect, discuss, and adjust the alignment of funding procedures and strategic goals — albeit without compromising the continuity in development (see C.3.).

➤ **Requirement A.2. Promoting institutional strategies and profiles.**

Academic subunits such as faculties, schools, institutes, and departments often develop their own specific objectives under the broader framework of an institutional strategy. Unit-level specification and differentiation should also be promoted by the internal funding model to the extent they are sufficiently con-

nected to the realization of the broader institutional mission and strategic goals. Therefore, the funding model should allow for the development of unit-level specializations by *granting* sufficient freedom and *directly* supporting at least some of the unit-level objectives.

➤ **Requirement A.3. Promoting unit-level objectives.**

B. Incentive orientation

The internal model should reward high performance and at the same time sanction the subpar performance of the units. However, performance measurement should respect existing institutional cultures and subject- or discipline-specific prerequisites by allowing for a reasonable level of diversity and flexibility in performance measurement (diversity in indicators and their weighting) to the extent it does not endanger the perception of fairness (criterion D.2.). This also means that the rewards and sanctions applied in the allocation on higher levels leave the potential for the units to define to a certain extent their own rewards on lower levels of resource allocation.

➤ **Requirement B.1. Creating performance rewards and sanctions.**

Unclear, conflicting, or too many priorities tend to result in overly complex internal funding models, fragmenting the incentives. Therefore, the model should be kept as clear and simple as possible so it can be understood by all parties. For instance, in performance-based funding, there should not be too few indicators (as this could be seen as unfair), but also not too many indicators (as this could lead to fragmented incentives).

➤ **Requirement B.2. Providing clear and nonfragmented incentives.**

It is possible that units react to incentives in a way that leads to undesired effects (for example, quantity at the expense of quality). The effects of the internal funding model should therefore be monitored by the institution to detect possible undesirable side effects.

➤ **Requirement B.3. Avoiding undesired side effects.**

C. Sustainability and balance

The institutional funding model should reflect an appropriate mix between top-down (institutional level) and bottom-up (unit level) approaches in allocations. Institutional priorities set the broader frame for direction and profile of the whole institution, but there should be room for unit-level initiatives. What can be considered “a right mix” between the two approaches may differ according to the size, history, culture, and mission, as well as the (performance) developments within a particular institution. This is closely related to the notion within the university about the division of financial powers, which also must combine central and decentralized competencies.

➤ **Requirement C.1. Combining top-down and bottom-up approaches.**

The internal funding model needs to ensure a sufficient level of stability for the units, thereby ensuring their capacity to fulfill their core academic and administrative tasks. Unit-level operations and performances are subject to stronger periodic fluctuations than those of the institution as a whole, and smaller units with smaller budgets might have less potential to generate financial flexibility

depending on the funding model in use. Stability can be maintained with a sufficient base funding component (often based on student and staff numbers), which units can build on incrementally. Promoting stability also requires that the cost differences, especially among academic fields, are considered to the extent it is reasonable and justified when determining the level base funding (for example, by using a moderate number of subject-specific coefficients/weights). Stability in indicator-based systems could be addressed particularly by applying multiyear averages or choosing indicators with high stability. Stability is also maintained by financial planning and building reserve funds.

➤ **Requirement C.2. Providing a sufficient level of stability.**

A funding model can generate the desired effects if its features remain stable over a substantial period of time. If the model is subject to constant changes, then the units would expect these changes and not adapt to the incentives. If there is insufficient time after a change in funding models before the next change is made, then there is little chance to work with the model productively and evaluation of its effects is not possible. If there are changes, they should be based on a careful evaluation of the model's impact.

➤ **Requirement C.3. Guaranteeing continuity in development.**

In a typical “three-pillar” funding model there should be a legitimate balance between “basic funding” (Pillar 1), “performance-oriented funding” (Pillar 2), and “profile/innovation-oriented funding” of future developments (Pillar 3).

In line with these pillars, internal funding models could set incentives in two ways: money can either be provided to initiate or support planned future performance (ex-ante funding, Pillars 1 and 3) or else past performance is measured and linked to funding (ex-post funding, Pillar 2). The share of ex-ante and ex-post components in the model should be balanced in a way that incentivizes units to develop their current and future activities as seen appropriate by the institutional- and unit-level leadership.

➤ **Requirement C.4. Balancing the overall model architecture**

Funding models should promote and incentivize revenue diversification strategies of the units to the extent it is reasonable, considering the mission and status of the units. Additional third-party revenue for units should create more possibilities to develop unit-level operations and increase the financial sustainability of the units (see also criterion D.2.). For instance, premiums on the acquisition of third-party funding can be a mechanism to achieve this.

➤ **Requirement C.5. Promoting diversification of unit-level funding sources**

Internal funding models should promote the core missions of higher education institutions (that is, teaching, research, and third mission) in a balanced way, as well as the integration of these different missions.

➤ **Requirement C.6. Balancing the key institutional missions**

D. Transparency and fairness

Funding models should be understandable in the sense that it is clear why one unit receives more or less funding than another. When discretionary funding decisions are made (for example, targeted funding for some units), all parties should know how these decisions are made and why, who decides, and based on which criteria. Also, funding for nonacademic units, such as central administration

of the institution, maintenance services, and other support services, should be allocated in a transparent manner that justifies the costs they accrued to the benefits they produce. Transparency could also require reporting activities to accompany the funding model.

➤ **Requirement D.1. Ensuring transparency**

Internal funding models should lead to a perception of fairness (with the above-mentioned transparency as a precondition). Fairness depends on the perceptions actors have about the allocation criteria. Especially in the case of base funding, allocations should not merely perpetuate the historical distribution of funds among units, especially if this distribution is based on decisions made a long time ago with no connection to current circumstances. Also, unit-level efforts to accumulate third-party funding should not lead to cutting the level of resources allocated through the internal funding model. Moreover, to promote efficiency and a sense of fairness, units should also be able to keep a fair share of the overheads of third-party funding and own revenues. When cross-subsidization among the units is practiced (that is, some units' "losses" are covered by other units' "wins"), this should be done in a transparent manner and backed with reasonable and well-communicated justification. In general, the perception of fairness could be increased by providing legitimization for allocation criteria (for instance, through explicit strategic fit of allocation and institutional goals).

➤ **Requirement D.2. Supporting the perception of fairness.**

E. Level of autonomy and flexibility

Financial autonomy means that units should be able to spend their money flexibly and according to their own decisions to the extent it is technically possible (lump-sum budgeting/block grants). Units should also be able to keep any accumulated surplus at the end of the financial year and pass it on to the following year (or at least they should have a reasonable percentage of the surplus to guarantee the incentive to generate income). Moreover, funding mechanisms should not be used to restrict academic freedom of units or individuals by, for instance, influencing the content of teaching or preselection of certain research topics, publications, and dissemination activities as desired outcomes.

➤ **Requirement E.1. Guaranteeing financial autonomy and academic freedom**

Financial autonomy should not lead to a situation without any financial rules. Rules should help prevent the misuse of funds and they could also set common standards. Regulation needs to create transparency and foster trust, but it should not restrict the necessary flexibility.

➤ **Requirement E.2. Implementing an adequate level of regulation**

F. Link to governance and management; practical feasibility

Internal funding models must rely on trustworthy reporting and accurate performance data. The development of the internal funding model might require improvements in reporting procedures, or in procedures collecting new or enhanced data. For instance, new performance information may need to be gathered if new performance-oriented elements are introduced, or new cost data may be

needed to support a field-oriented differentiation of funding. Such models can be introduced only if the necessary data are available.

➤ **Requirement F.1. Increasing reliability and availability of data**

Efficiency (that is, the minimization of transaction costs) of a funding model is an important criterion that has to be balanced against other priorities.

The development and administration of funding models can be costly and time-consuming, and the development, collection, and maintenance of required data could demand intensive institution-wide efforts. For example, the level of precision employed to measure performance must be balanced with the efficiency of developing and monitoring the indicator(s).

➤ **Requirement F.2. Ensuring administrative efficiency**

Internal funding models should not be undertaken independently of the broader steering environment in which institutions are operating, but should be based on a coherent institutional approach that takes into account other aspects of the national steering system in general, and the combination of policy instruments of governance, in particular (legislation, regulations, quality assurance). This includes providing operational support to institution-internal bodies such as student councils, in accordance with the legislation. Also, special cultural features of a university, such as the intensity and internal acceptance of negotiation-oriented vs. parameter-based approaches, should be considered.

➤ **F.3. Ensuring coherence with other governance approaches and university culture**

The strategy-oriented design of a funding model is possible only if the university leadership is empowered to make the necessary decisions.

➤ **F.4. Ensuring the ability of the leadership to act**

3 Internal Governance

In the following analysis of international trends and good practices in the field of internal governance, special emphasis will be placed on the capacity of higher education institutions for strategic development, their approaches toward establishing accountability, their design of relations between members within and outside of institutions, and the differentiation of functions in institutions and the related distribution of powers. Defined broadly, internal governance encompasses “internal management structures, decision-making arrangements and leadership roles and the relationship between these internal functions and the role of governing bodies” (Middlehurst 2004, 259). The focus on the distribution of functions and powers and on structures and processes behind the legitimated determination of institutional strategies and policies distinguishes internal governance from management (cf. Eurydice 2008), which comprises the effective and efficient attainment of institutional objectives on a day-to-day basis under already established rules — even though there are various connections and a certain degree of overlap between the two.

Any discussion of internal governance must consider the importance of framework conditions, including when addressing instances of good internal governance. The characteristics of higher education systems and institutions not only influence the freedom of institutions to design their internal structures and processes, but also what a good design itself would be in a given case. Features of higher education systems that are relevant in this respect include their histories, traditions, and values, their basic regulatory framework, and their overall approach toward governance on the system level. The ensuing autonomy of institutions is of particular importance, which — even though not an end in itself — is supposed to lead to improved outcomes such as higher-quality programs or more and better research results. This refers, first, to the institutions’ freedom in influencing their internal governance structures and processes. However, autonomy related to academic matters, funding, and human resource management are relevant in this context as well, because they influence the institutions’ latitude in designing governance arrangements and the related internal framework conditions. Institutions also exhibit particular historical traits, traditions, and values, and differ in, among other things, size, composition, and profile. Since both types of particularities influence which way of designing internal governance structures and processes would be best, there can be no one-size-fits-all solution.

Nevertheless, similar developments in various, especially European, countries and related discussions on general functions of internal governance arrangements and options for their appropriate design have presented possibilities for identifying cornerstones and innovative approaches of good internal governance that are worth considering for all higher education institutions.

3.1 General Developments

The development of internal governance arrangements cannot be examined adequately without considering the overarching developments of governance approaches on the level of higher education systems. Against the backdrop of a general reorientation of public management approaches under the heading “New Public Management,” and criticism of traditional modes of higher education institution governance related to their fit, with increasingly complex, international and competitive environments, fundamental changes in how higher education systems are governed emerged in many countries (cf. Antonowicz and Jongbloed 2015; Krücken 2011). Focusing on the developments in Europe, four major shifts can be observed (Krücken 2011):

- 1) The replacement of direct regulation and steering of higher education institutions by the state with indirect ways of influence, especially by defining objectives and leaving the way in which these are attained at the discretion of institutions
- 2) A proliferation of actors other than the state that assume governance functions, ranging from quality assurance agencies and (other) intermediary bodies to governing boards
- 3) The growing importance of the supranational, European level as a layer of higher education governance, among others related to developments such as the Bologna Process
- 4) Competition among higher education institutions and academics becoming a relevant element of higher education governance.

Even though, in the following discussion, the relevance of all four of these major shifts will be considered for internal governance arrangements, the development of system-level governance approaches away from direct state influence via legislation toward indirect forms of steering, for example, via performance-based funding allocations, has the most far-reaching implications. The gradual withdrawal of many European governments from exerting direct influence on higher education institutions in favor of indirect steering approaches focused on determining objectives has a certain type of higher education institutions as a complement (cf. Antonowicz and Jongbloed 2015; de Boer and File 2009; Eurydice 2008; Middlehurst 2004). What is required are institutions that are autonomous, albeit embedded in systems of accountability, and capable of acting strategically as integrated entities. Developments in this direction can be observed in many European countries but are particularly pronounced in some, among them the Netherlands (see Example 6). This overall shift has been strongly promoted by different actors on the supranational level, among them the European Commission as part of its Modernization Agenda (EC 2006, 2011; cf. de Boer and File 2009) and the European University Association (cf. Estermann and Nokkala 2009). It is nevertheless important to take into account that despite the fact that the trends outlined above can be observed in various countries, there are differences in their specific effects, in the ways in which they are taken up, and in the pace of development among countries (cf. Krücken 2011).

Example 6 University governance reforms in the Netherlands

The Netherlands is one of the European countries where the modernization of university governance is particularly well advanced, an outcome of several major reform steps from the early 1970s to the late 1990s. A first fundamental change occurred in 1970. Previously, the internal governance model of universities consisted of a senate staffed with professors responsible for the academic governance component and a board of curators for the administrative component, whose members were appointed by the government. In 1970, university councils were introduced as the universities' major decision-making body. They were staffed with democratically elected representatives from all internal stakeholder groups, that is, academics, nonacademic staff and students, and external stakeholders. The decisions of this new body were then implemented by an executive board, comprising the rector. A newly established board of deans, with mostly an advisory function, formed the third component of the new structure. Similar structures were established on lower institutional levels.

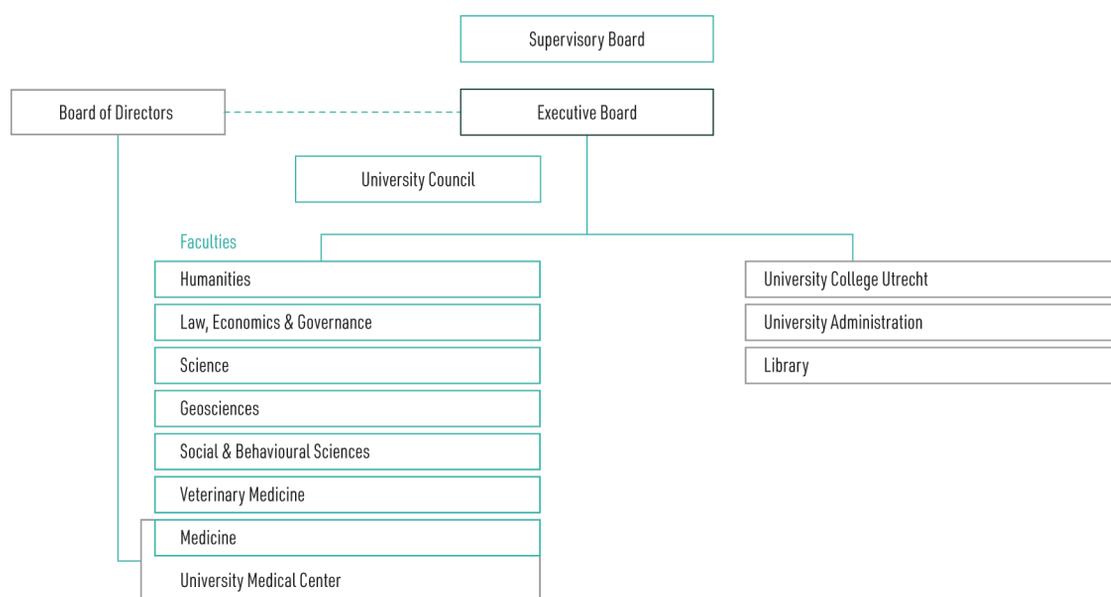
In 1985, a ministerial policy document introduced the idea of indirect steering by the state, which influenced the legal decisions in the following years. The policy document foresaw a restricted role for the state vis-à-vis the universities, focused on determining broader framework conditions and granting greater autonomy and latitude for self-steering to the universities. Among the rationales behind this new perspective were increasing the universities' responsiveness to their environment, their responsibility for performance, and their effectiveness and efficiency.

The new perspective on university governance culminated in the 1997 "Act on the Modernization of the University Governing Organizations," which led to a fundamental transformation of universities. New internal governance structures emerged (see Figure 7), based on a shift of competences from the government to universities. Key elements of this change comprise:

- the establishment of a supervisory board with external members appointed by the government, which appoints the executive board and assumes a supervisory and control function, among others by approving institutional strategies, budgets, and annual reports
- a revision of the role of the executive board, which became the main decision-making and management body of universities
- a revision of the role of the university council, which now has mostly an advisory role and consists exclusively of staff and student representatives
- a strengthened position of deans or faculty boards as the most important decision-making instances on the faculty level (implying a mostly advisory role for the faculty councils).

In addition, the previous system of electing leaders was replaced by a system of appointments, ranging from the executive board, which is appointed by the supervisory board, down to the program directors, which are appointed by the deans.

Figure 7 Internal governance structure of Utrecht University



Source: Utrecht University; <http://www.uu.nl/en/organisation/governance-and-organisation>.

The developments in the Netherlands illustrate the connection between changes of system-level and institution-level governance. Especially the shift toward more indirect forms of steering by the state beginning in the 1980s has had a clear impact on internal governance. This shift induced the need for more efficient governance structures that increase the universities' potential for proactive, strategic development – to which the current governance arrangements in the Netherlands are one potential solution.

Source: Authors based on Antonowicz and Jongbloed 2015.

The development of higher education institutions in the direction of corporate, strategic actors with an increasingly greater resemblance to other types of more integrated organizations affects internal governance arrangements in many ways. As a result of the development of higher education system governance and promoted by the idea that more autonomous institutions with certain internal structures can increase their performance, efficiency, and responsiveness to external demands, a transformation of internal governance structures occurred in many institutions that can be described as a shift from academic self-governance and the responsibility of collegial bodies to more managerial self-governance and individual responsibility (cf. de Boer and File 2009; Eurydice 2008; Middlehurst 2004): Overall the “university as an organization is transforming into an organizational actor, i.e. an integrated, goal-oriented, and competitive entity in which management and leadership play an ever more important role” (Krücken 2011, 1). This general development can be broken down into five key elements (Krücken 2011) the implications of which for internal governance will be spelled out in the remainder of this report:

- 1) The formation of more hierarchical decision-making structures on all institutional levels at the expense of the powers of collegial decision-making bodies, which brings with it a new focus on leadership in higher education
- 2) The increasing relevance of accountability (within an overall context of increased autonomy and accountability of institutions), not only of individuals but also of institutions as a whole
- 3) The growing importance of institutional objectives defined by institutions themselves and set out in related documents
- 4) The differentiation of organizational structures via the establishment of organizational units for various (new) purposes
- 5) The increasing significance of management professionals within institutions.

Again, differences among higher education systems and institutions exist with respect to the specific impact of these developments. As will become clear, however, similar ways of dealing with this change and innovative approaches toward tackling the related challenges with a broader applicability can be observed.

A comparison of the abovementioned general developments with current developments and the state of higher education in Latvia suggests that the associated changes in internal governance are (becoming) relevant in Latvia as well — and, therefore, also the approaches and practices discussed below. Especially since the introduction of a performance-oriented funding pillar into the state funding model, a shift toward a more output-oriented steering approach can be observed in Latvia. Perceiving the abovementioned general developments of internal governance as a necessary complement to changes on the system level, it appears that similar changes within Latvian higher education institutions could benefit the coherence of the overall governance approach in the country, in addition to the potential benefits connected to them in terms of enhanced performance and institutional efficiency.

Latvian higher education institutions already enjoy a comparatively high degree of autonomy, and have for some time. In a comparison of the autonomy of institutions in 28 European higher education systems in 2010 (Estermann and others 2011), Latvia ranges in the “medium high” group in terms of organizational

autonomy¹⁰ (see Table 5). This implies that there is autonomy for institutions to design internal governance structures and processes according to their needs, but not being in the “top cluster” implies that restrictions from outside are also relevant for the efforts of Latvian higher education institutions to shape their internal governance arrangements.

Rank	System	Score
1	United Kingdom	100%
2	Denmark	94%
3	Finland	93%
4	Estonia	87%
5	North Rhine-Westphalia	84%
6	Ireland	81%
7	Portugal	80%
8	Austria	78%
	Hesse	78%
	Norway	78%
11	Lithuania	75%
12	The Netherlands	69%
13	Poland	67%
14	Latvia	61%
15	Brandenburg	60%
16	France	59%
	Hungary	59%
18	Italy	56%
19	Spain	55%
	Sweden	55%
	Switzerland	55%
22	Czech Republic	54%
23	Cyprus	50%
24	Iceland	49%
25	Slovakia	45%
26	Greece	43%
27	Turkey	33%
28	Luxembourg	31%

Table 5 Organizational Autonomy of Higher Education Institutions in Europe, 2010

Source: Estermann and others 2011, 53.

¹⁰ Latvia ranged in the “medium high” group in financial autonomy as well, in the top cluster in terms of staffing autonomy, and in the “medium low” cluster in academic autonomy (Estermann and others 2011).

3.2 Main Trends and Good Practices

a) Strategic Development and Governance

Strategy Development and Implementation

Determining directions for the future development of higher education institutions is among the key functions of internal governance, a function gaining in importance under system-level governance approaches centered on institutional autonomy. Increasing institutional autonomy has been identified as one of the cornerstones of developments in the field of higher education governance in recent years. For the benefits expected from this shift to materialize, institutions have to engage in setting the course for their development. The engagement of institutions in strategic planning has also been promoted by new challenges they face, among others continuous changes in their environment, including policy objectives, and declining funds. And indeed, institutions in many countries have intensified their engagement in strategic planning activities, in particular via the development of institutional strategies.

Institutional strategies are at the center of strategic steering activities of higher education institutions, but have to meet different requirements to be able to fulfill this function adequately. Serving as the main point of reference for institutions' strategic planning, institutional strategies spell out plans and related objectives, in many cases complemented by action plans defining specific steps toward their implementation. For both strategies and action plans, clarity and precision are basic preconditions if they are to serve as guidelines for the activities of institutional units and members (cf. Hanover Research 2013). A common problem with institutional strategies, however, is that they are rather generic and do not contain clear priorities (cf. Hofmann 2005). The objectives defined in strategies have to fit the institution in question, that is, its profile and mission, its particular circumstances and its strengths and weaknesses, and be designed in a way that secures the commitment of the institutions' members. Additional conditions for the functionality of strategies and action plans are that they are harmonized with other institutional strategies and regulations, contain a realistic time frame for implementation, and comprise a sound combination of both short-term and long-term goals (cf. Hanover Research 2013).

Key to attaining strategies that are fit to underpin strategic steering activities is the way in which they are developed (cf. Hanover Research 2013). Adapting strategies to the circumstances and characteristics of institutions requires an in-depth knowledge of their activities and environment. A first key step of any strategy development process therefore is an analysis of institutional strengths and weaknesses and their relation with the institutional environment and its potential future changes. The fit between strategies and institutions can be promoted by the involvement in the strategy development process of a wider range of an institution's members and stakeholders from the institutional environment (for details see "3.2 c) Good Governance 1: Cooperation and Participation"). This allows for the representation of different interests and opinions, and can promote the commitment early on. Engaging diverse stakeholders in the strategy development process also opens up the possibility for connections among different parts of an institution to be integra-

ted into the strategy and can support better cooperation among these parts during the strategy implementation process. The involvement of higher education institution members can be implemented in different ways, comprising a diverse composition of the team responsible for the strategy development process, regular exchanges within the wider community of an institution as part of the development process, and an active internal information policy accompanying the entire process. Among the specific instruments that can be used for these purposes are full assemblies of an institution's members, open-space workshops, world cafés and leadership retreats, and surveys and websites developed solely for the purpose of strategy development. In the European practice of strategic management, there are many good examples for the use of strategy tools in higher education institutions. However, their implementation sometimes leads to imperfect or partial models, where for instance institutions do not implement the strategy process as a continuous management cycle. Even though such experiences can also be of value for institutions, this report focuses primarily on examples of good practice.

Beyond the day-to-day management-related aspects of the implementation of strategies, three overarching issues relevant for ensuring that strategies influence the development of institutions are the plans for their implementation, their relation with budgets, and the support their implementation receives from staff members. Guiding the implementation process, action plans can serve as an important instrument by determining relevant aspects such as the timeline of the entire process, the individuals responsible for parts of the strategies, the resources required for attaining objectives, and the ways in which the attainment of objectives is measured (Hanover Research 2013). Regarding the second overarching issue, the relation between institutional strategies and funding is two-fold (Hanover Research 2013). On the one hand, the financial means available should be accounted for when developing strategies to make sure that the implementation of objectives is realistic from a financial perspective. The budgets and the allocation of funds, on the other hand, can be guided directly by the strategic plans. As has been discussed, gearing activities of units and individuals toward implementing strategies and their objectives can take place in different ways. A precondition for many of the potential measures is that those responsible for the strategy implementation process strive to maintain the momentum within the institution and the motivation of all internal stakeholders involved (Hanover Research 2013).

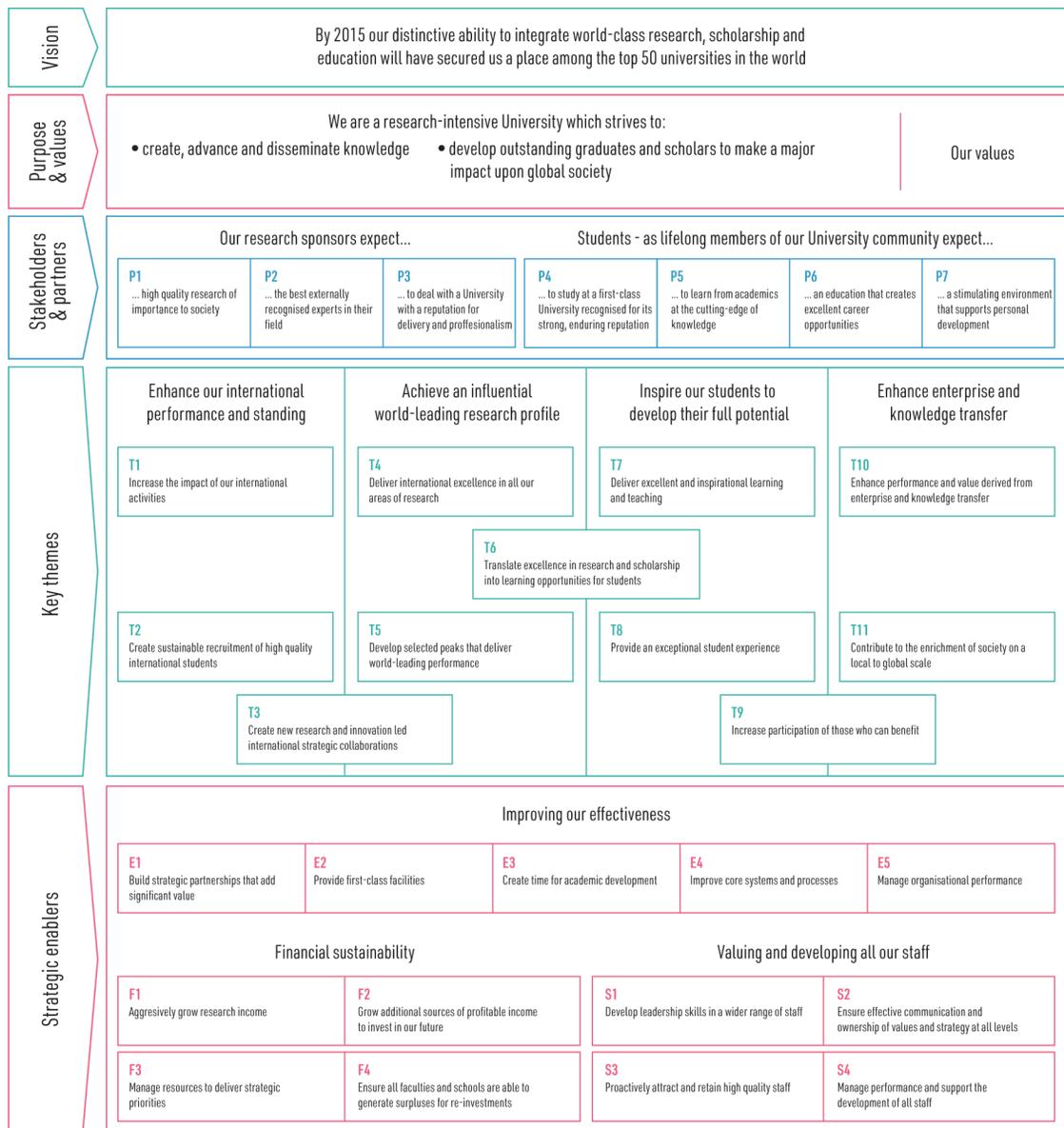
Complementing the processes of strategy development and implementation, a close monitoring of the implementation process and ensuing actions are required for successful strategic development (cf. Hanover Research 2013). Obtaining a clear picture of the state of the implementation process regularly is important for two reasons. Institutional decision makers must be able to identify where efforts would have to be intensified to reach strategic objectives, and where adjustments of plans and objectives could be necessary due to changes in the institutional environment or unforeseen obstacles. To promote the adaptation of institutional members' activities on all institutional levels to the implementation progress, monitoring procedures can also comprise targeted information, reporting, and discussion events related to the progress and reasons for success or a lack thereof.

Designing processes of strategy development, implementation, and monitoring as parts of an overarching project to promote the strategic development capacities of institutions bears great potentials, but requires the right framework conditions and actions — as the case of the University of Leeds reveals (see Example 7).

Example 7 The strategy process at the University of Leeds

To prepare the institution for successful development within an increasingly competitive environment, a comprehensive strategy process was initiated at the University of Leeds in the early 2000s. As a big, research-intensive institution facing the challenge of maintaining its current position within an increasingly competitive environment, the University of Leeds, United Kingdom, started a process of reassessing its vision for the future and preparing its implementation in the early 2000s. The overarching objective was to establish a shared understanding related to the future development of all parts of the university to trigger a joint response to changing circumstances. As a first step, a vision for the future of the university was developed through a consultative process based on an intense investigation of the current state of the institution. This vision then served as the major point of reference for the strategy process.

Figure 8 The Strategy Map of the University of Leeds



Source: Donoghue and Kennerley 2008, 7.

Two instruments were used for the entire strategy process: a strategy map and the balanced scorecard approach. Using a strategy map was supposed to lead to a clear, easily understandable overview on the strategy that could, among other things, be used for internal communication processes. The scorecard approach was chosen to establish a basis for measuring the performance related to the implementation of the strategy (for details on the scorecard approach see Example 14). Via the strategy map (see Figure 8), a connection was established between the overarching vision, institutional values, and the expectations of external stakeholders on the one hand, and broader themes for the implementation of the strategy, objectives and key factors contributing to attaining the defined goals on the other. During the entire strategy development process, particular attention was given to the measurement of objectives, also to support institutional leaders with managing the strategy implementation process. The scorecards, for instance, were used to define key outcomes, contributing to the accountability and ownership of internal stakeholders, and to internal monitoring and evaluation processes related to strategy implementation.

Five key success factors for promoting strategic development capacities of higher education institutions were identified in the course of the strategy process. The strategy process of the University of Leeds was designed based on relevant findings from the research literature and good practices in the field, also taking into account approaches in sectors other than higher education. This background knowledge coupled with the experience with the strategy process itself led to the identification of the following five key success factors for efforts to improve the strategic development capacities of higher education institutions:

- **Leadership:** Throughout the entire strategy process, top-level support is needed; in addition, leadership on all institutional levels is required for the interpretation of the strategy within specific contexts, setting priorities accordingly and ensuring actions on the unit level in line with the overall strategy.
- **Strategy development:** Starting from a shared vision, a consultative approach with broad participation of the institution's members is important for a high-quality strategy and for creating ownership.
- **Alignment:** An overall alignment of institutions with their strategy has to be established; for this, teams responsible for key themes can establish horizontal coordination, which complements vertical coordination via line management.
- **Communication:** Systematic efforts of communication around the entire strategy process are needed to increase the awareness of internal stakeholders (from a general understanding to specific implications) and promote the ownership and engagement of individuals; in this, communication approaches should not aim at the transfer of information exclusively, but also at convincing institutional members of the value of the strategy.
- **Governance:** The implementation and monitoring process requires governance to obtain a clear understanding of the progress of the implementation process, including potentials for improvement.

Source: Authors based on Donoghue and Kennerley 2008.

Fitness for Purpose: Alignment and Adaption of Governance Structures & Anchoring and Connecting Higher Education Missions

Like internal funding models, internal governance structures and processes are not an end in themselves but serve different purposes, first and foremost the strategic development of institutions. This makes their fitness for purpose the overarching objective for their design. The fact that there is no one-size-fits-all solution implies that each institution has to adapt its governance structures to the system-level framework in which it is acting, to the ever changing environment it faces, and to its own profile and ambitions for the future. Especially to the extent institutions strive to be — and are requested to be — responsive to their environment and the demands of external actors, governance structures have to be sufficiently adaptive, flexible, and able to generate innovative solutions. As discussed, institutions in many countries have gained autonomy to influence their internal structures, clearing the way for targeted adaptations.

Adaptions of internal governance structures to secure their fitness for purpose can apply to different parts of an institution, to its “steering core,” its “academic heartland,” and its “developmental periphery” (Clark 1998; cf. Middlehurst 2004). Changes cannot only apply to what might be considered internal governance in a narrow sense — that is, the “steering core,” consisting of leadership roles and decision-making structures — which will be at the center

of the discussion of international trends and good practices in the last two sections (see “3.2 c) Good Governance 1: Cooperation and Participation” and “3.2. d) Good Governance 2: Differentiation of Functions and Distribution of Powers”). Changes can also apply to the academic structures of an institution, the “academic heartland,” and to structures that are not at the center of decision-making processes but add greatly to the overall responsiveness of institutions, the “developmental periphery.”

A prominent trend related to the academic structures of institutions that can be observed in various countries is a shift toward bigger units (Middlehurst 2004). Many institutions see a benefit in using internal potentials for synergies, in both academic and financial terms, and in developing units with a critical mass, especially in research. Changing external demands that require transdisciplinary responses from higher education institutions have led to the need to promote cooperation across academic disciplines and structures within institutions. Against this backdrop, many institutions have started to rearrange their internal structures by establishing bigger units. A similar, albeit less formal way of attaining some of these goals is the establishment of virtual structures within institutions such as research platforms. Reverting to specific cases of major restructurings of academic units allows for identifying their potential as well as critical aspects worth considering during related planning and implementation processes — as will be done for the Technical University Dresden (see Example 8) and the Osnabrück University of Applied Sciences (see Example 9).

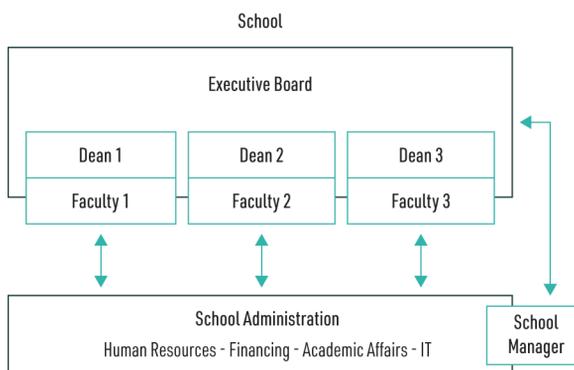
Example 8 The internal restructuring process at the Technical University Dresden

A comprehensive internal restructuring of academic units has been undertaken by the Technical University (TU) Dresden to realize synergies in the fields of teaching, research, administration, and infrastructure. As part of a broader development concept for the TU Dresden, Germany, 14 faculties were gradually transformed into five schools during a process that started in 2012. The objectives behind this transformation were to use synergies, increase interdisciplinarity, provide units with greater autonomy, and enhance their strategic and operative scope. A particular feature of this undertaking is that the restructuring covers administrative functions more broadly. The new schools not only carry out those administrative tasks that were formerly performed by the faculties, but also receive competences from the central-level administration.

A special feature of the internal restructuring is the elaborate process designed to ease the transition to the new model. The process comprises three phases that gradually fade in the new structure. In the first phase, lasting one year, the new unit structures were established virtually, that is, first elements of the new structure were introduced in the form of a board consisting of the faculties’ deans and a manager responsible for the school (see Figure 9) without actually changing the rights and responsibilities of the faculties. This allowed the faculties to adapt their processes internally to the new structures. In the second, current phase, responsibilities are being transferred from the faculties and the university’s central level to the school administrations. On completion and positive evaluation of this phase, a third phase is foreseen that would transfer the remaining responsibilities from the faculties to the schools. The entire process has been accompanied by an active change management, including individuals responsible for the change process and regular meetings of the rectorate and the faculty representatives.

Source: Authors based on Dresden Concept (2011).

Figure 9 School structure at the Technical University Dresden



Source: Authors based on Dresden Concept (2011, 46).

Example 9 The internal restructuring process at the Osnabrück University of Applied Sciences

At the Osnabrück University of Applied Sciences (UAS), the internal restructuring of academic units was used both to strengthen the position of units and to promote their integration into and connection to the strategic development of the institution. In addition to merging eight departments into four faculties, the deans of the newly established faculties were simultaneously assigned to the position of vice-presidents of the Osnabrück UAS, Germany, with responsibilities for certain portfolios, such as teaching, research, and open access. For the promotion of strategic objectives related to the portfolios, central units acting under the vice-presidents were also established. There were two objectives behind this approach: to establish bigger units, strengthen the position of deans, and promote their professionalization on one hand, and to generate a direct tie between the deans and the institutional strategy by integrating them into the institutional leadership on the other. That way, a strong management board was created and the internal alignment of strategies strengthened.

Several of the proliferating challenges and demands that higher education institutions are confronted with today have been taken up by institutions as a distinguished element of their profiles, and have led to adaptations of the “developmental periphery” of institutions in the form of new structures, bodies, and individuals with an explicit mandate to guide institutional activities in these areas (cf. Krücken 2011). Among the examples for such fields of activity are internationalization efforts, outreach activities, regional engagement, and knowledge and technology transfer. Anchoring these functions in the internal governance structures is in many cases an attempt to institutionalize relationships with external actors and provide a link between them and the core of institutions, and to establish new support structures for internal stakeholders (cf. Middlehurst 2004), especially if the required skills have not been present within institutions before. One of the approaches toward institutionalization is the assignment of such a function to members of the central leadership, such as the establishment of the post of vice-rector for internationalization. Other approaches are the establishment of entirely new units such as technology transfer offices and the establishment of matrix structures. Together, different possibilities for anchoring institutional functions and profile elements can lead to a substantial institutional transformation, as the example of the University of Strathclyde shows (see Example 10).

Example 10 Knowledge exchange at the University of Strathclyde

Having designated knowledge exchange as a key component of its institutional mission, the University of Strathclyde has integrated this objective into its governance structures in various ways. The combination of academic excellence with relevance for the society and the economy is part of the mission of the University of Strathclyde, United Kingdom. The resulting emphasis placed on knowledge exchange activities is also visible in the internal governance structures, namely through:

- an associate principal for research and innovation
- a deputy associate principal for research and knowledge exchange and for research, knowledge exchange, and innovation
- a vice-dean for knowledge exchange within each faculty
- a strategic committee covering research and knowledge exchange
- a service unit for research and knowledge exchange services, supporting institutional members with, among other things, licensing processes and the creation of spin-out companies.

Source: Authors based on the website of the University of Strathclyde; <http://www.strath.ac.uk/>.

In the face of these possibilities for improving the fitness for purpose of governance arrangements — several more of which will be addressed below — and a constantly changing institutional environment, continuous monitoring and related adaptations of internal governance structures and processes

have become an ongoing task for higher education institutions and one that deserves to be anchored in internal governance arrangements (cf. Middlehurst 2004). From a certain scale onward, change is nothing that institutions can accomplish in passing. A commitment of the institutional leadership to manage change processes is required. This includes taking into account factors that can promote or inhibit the implementation of change, as well as efforts to promote the uptake of reforms by an institution's members, among others through an intense internal communication and targeted incentives.

b) **Autonomy and Accountability**

Protection of Academic Freedom and Assurance of Academic Integrity

The freedom of teaching and research lies at the heart of higher education. Securing it within reasonable limits is among the functions that adequate internal governance arrangements have to fulfill. Even though academic freedom is anything but easy to define, it is a crucial precondition for higher education institutions and systems to function properly (cf. Altbach 2001). Broadly defined, academic freedom refers to “the freedom of individual academics to study, teach, research and publish without being either subject to or to cause undue interference” (Kivistö 2007, 72). Securing academic freedom is the responsibility of all higher education stakeholders, including higher education institutions. The institutions' responsibility has, for example, been reasserted within the Magna Charta Universitatum signed by more than 800 universities from over 80 countries.¹¹ The Standards and Guidelines for Quality Assurance in the European Higher Education Area (ESG) also mention academic freedom as a relevant issue to be supported by broader quality assurance policies (ENQA 2015).

Having said that, the relationship between internal governance and academic freedom differs from those of other functions like strategy development in that it cannot be confined to a distinct institutional locus but is connected to governance arrangements as a whole (cf. Berdahl 2010). This makes it all the more challenging to define specific practices in securing it. Still, different key challenges that merit being taken into account for sound handling of academic freedom by institutions under the developing governance frameworks discussed above can be identified (cf. Altbach 2001). These challenges relate to the change of governance structures themselves if the influence of the faculty (as opposed to leadership personnel and management staff) on academic matters decreases significantly, and to the growing interconnections of institutions and academics with outside actors, for example, via research sponsored by companies (cf. Berdahl 2010). Even though none of these changes necessarily implies a restriction of academic freedom, institutions are well-advised to take into consideration these and other potential tensions related to academic freedom within their governance structures in order to design and implement appropriate safeguard measures.

In the same way that institutions are responsible for securing academic freedom, they must also ensure that this freedom is not misused by academics. Preventing and dealing with academic misconduct is an important component

¹¹ <http://www.magna-charta.org/magna-charta-universitatum>.

of institutions' attempts to enhance accountability toward their environment (cf. Berdahl 2010) and a means to prevent harm to society and science in general (cf. OECD GSF n.d.). Higher education institutions are not the only actors responsible for academic integrity, but nevertheless have an important role to play. The mechanisms they can deploy comprise prevention as well as sound handling of cases of malpractice (OECD GSF n.d.). For adequate prevention, it is important to consider the reasons behind academic misconduct and to adjust instruments accordingly (OECD GSF n.d.). Among the potential preventive measures are the adequate education of researchers, open discussions on the issue within institutions, and transparency surrounding the processes and outcomes of investigations into supposed cases of misconduct (OECD GSF n.d.), ensured, for example, via a code of practice (see Example 11). In handling potential instances of malpractice, it is first important to differentiate between different types of misconduct and to assign suitable ways of reacting to each of them. The two basic steps in these cases generally are the investigation and, potentially, follow-up measures. An adequate investigatory procedure requires an accurate examination of the facts of the matter at hand, which might require a certain type of expertise on the part of those involved in the process, and adequate formal regulations concerning the process (cf. OECD GSF n.d.). The overarching objectives should be "fairness and consistency" (OECD GSF n.d., 6), which can be promoted by processes that (OECD GSF n.d.):

- are based on clear and publicly available principles, rules, and procedures
- exhibit and convey fairness, for example, by assigning different tasks within the process to different, independent bodies and actors
- do not intrude on academic activities more than necessary, possibly promoted by regular assessments and adaptations of the process
- account for the links between administrative procedures and legal procedures that might become necessary at a later stage.

Two basic, adequate forms in which these processes can be organized are bodies responsible for misconduct within institutions and bodies established on the national level. The former approach has the advantages of potentially assuring a coherent practice throughout the entire institution and increasing the trust of academics in the processes, but might bear problems related to conflicting interests within one institution (OECD GSF n.d.). National-level bodies also have advantages, namely a more stable supply with resources and a stronger influence on related matters vis-à-vis governments (ibid.), and potentially a more consistent approach across institutions.

Example 11 The code of practice and procedure for academic integrity of the University of Oxford

At the University of Oxford, United Kingdom, academic integrity is addressed by a code of practice and procedure. The code of practice and procedure related to academic integrity in research at the University of Oxford formulates expectations toward all those connected to the institution involved in research. These expectations pertain to the standards of ethics and integrity related to research, among others best practices in research, ethical and legal obligations, and potential conflicts of interest. The code also defines misconduct, sets out the responsibilities of university members, and covers the confidentiality related to investigations in potential instances of misconduct. A procedure for the handling of potential instances of misconduct is also defined. The aspects covered include the specific steps of the procedure as well as the relation of university-internal procedures with potential other procedures (for example, legal ones).

Source: Authors based on University of Oxford n.d.

Establishment of Accountability and Quality Assurance Mechanisms

In line with broader developments in the field of governance, instruments establishing accountability toward external entities, particularly quality assurance mechanisms, have gained in importance for institutions. Among the key trends in the field of governance discussed above was a reciprocal relationship between institutional autonomy and accountability. Accountability can be defined as “the obligation to report to others, to explain, to justify, to answer questions about how resources have been used, and to what effect” (Trow 1996, 310). It is important to distinguish at least two basic dimensions of accountability (Kivistö 2007), namely legal and financial accountability, and academic accountability. The first dimension, legal and financial accountability, addresses whether higher education institutions actually do what they are supposed to do according to the legislation, and whether they spend funds provided by governments on those activities for which they were foreseen. The second dimension, academic accountability, addresses the activities of higher education institutions directly, such as their efforts to promote processes of teaching and learning, and research. With increasing autonomy in different areas, institutions also face more demands for accountability in general and for compliance with specific accountability measures in particular. In this context, quality assurance mechanisms have emerged as one of the most important accountability instruments, no more so than in Europe, where they are ascribed considerable importance under the Bologna Process.¹² In Europe, this connection is also laid out in the main reference document on quality assurance, the “Standards and Guidelines for Quality Assurance in the European Higher Education Area (ESG),” which states that a “successfully implemented quality assurance system will provide information to assure the higher education institution and the public of the quality of the higher education institution’s activities (accountability)” (ENQA 2015, 7).

While external quality assurance (covering both accreditations and external evaluations) has received significant attention in this context, the ministers of Bologna Process signatory countries have agreed that “the primary responsibility for quality assurance in higher education lies with each institution itself” (Berlin Communiqué 2003).

Quality assurance within institutions, especially if seen as part of a broader “quality culture,” has become connected to internal governance in various ways. Quality assurance and the related standards cover a far broader range of issues than those that are relevant in the context of internal governance. A first look at the connection between internal governance and quality assurance via the outcomes of a EUA project on quality cultures (Loukkola and Zhang 2010) reveals a variety of approaches followed by institutions (see Figure 10). The relationship between quality assurance and internal governance arrangements can be captured comprehensively when considering not only quality assurance in a narrow sense, but also in the institutional “quality culture,” a concept and objective that has gained importance in the European quality assurance discussions in recent years. This concept goes beyond the mechanisms of quality assurance, which are supposed to promote a quality culture (ENQA 2015), by “complementing the structural dimension of quality assurance (quality management handbooks, process defini-

¹² Even though the following discussions focus on quality assurance related to processes of teaching and learning, quality assurance mechanisms addressing other activities of higher education institutions exist as well (cf. Loukkola and Zhang 2010).

tions, instruments, tools) with the dimension of values of an organisation, relating to the commitment of its members, the underlying values, skills and attitudes” (Vettori 2012). It remains debatable, however, to what extent institutions have already managed to establish such a comprehensive quality culture, even though various attempts can be observed (Hofmann 2005). The ESG provide a starting point for considering quality assurance in relation to internal governance arrangements by stating as one standard that: “Institutions should have a policy for quality assurance that is made public and forms part of their strategic management. Internal stakeholders should develop and implement this policy through appropriate structures and processes, while involving external stakeholders” (ENQA 2015, 11). According to the ESG, such a policy serves as the basis for establishing coherence in institutional approaches toward quality assurance, furthermore paving the way for the establishment of a comprehensive quality culture.

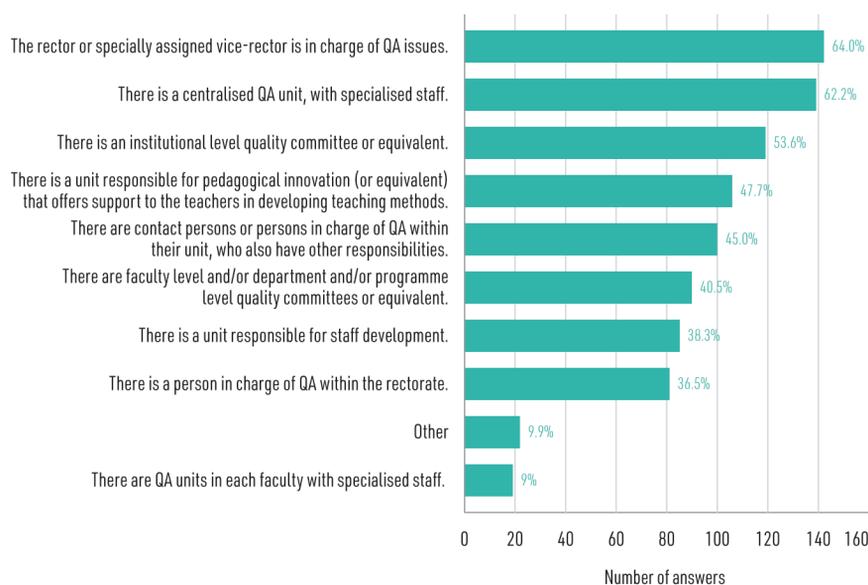


Figure 10 Structures supporting internal quality assurance

Source: Loukkola and Zhang 2010, 20.

Internal governance arrangements and an institutional quality culture interact on all institutional levels. The development of a comprehensive quality culture is dependent on the engagement of all internal stakeholders from the institutional leadership to the lower institutional levels, and on an institutional leadership on all institutional levels that finds the right balance between steering and setting frameworks on the one hand, and securing the broad involvement of internal stakeholders on the other (Sursock 2011; see also Example 12). An additional requirement is that institutions (Sursock 2011):

- ensure student engagement by caring for a good relationship between them and the units which they are part of
- enable quality assurance officers to be mediators who connect different parts of an institution, from the central leadership to individual academics
- establish a link between quality assurance and staff development as well as data and information management
- find the right balance between closed feedback loops on the one hand, and efficient, streamlined structures on the other.

Example 12 The attempt to establish a quality culture at the University of Zagreb

One institution that is actively trying to develop a quality culture is the University of Zagreb, Croatia, a case that provides insights into the related practical challenges. The attempts to establish a quality culture by the University of Zagreb must be seen in the light of the size (over 80,000 students; 29 faculties) and the decentralized character of the institution, with highly autonomous faculties. The university's quality culture is based on a policy that mandates the responsibility of the institution for quality in education, research, and knowledge transfer, and that quality assurance processes must be rooted in an adequate organizational structure. One important feature of this policy is that it makes preserving the academic values an overarching objective.

To attain the envisaged adequate structure, a committee and an office for quality assurance have been established on the central level. Additional support is provided by a vice-rector of the university. A committee for quality assurance has been established on the faculty level, as well, and the main procedures in the field have been harmonized across the entire institution. Even so, faculties can still adapt some of the quality assurance procedures to their particular circumstances. Through this structure, a variety of internal and external quality assurance processes are realized, including biennial reviews of quality assurance and audits by the national agency. Nevertheless, these structures and processes leave room for further developing a quality culture related to, among other things, awareness raising and increasing the engagement in quality assurance of all the individuals in the institution.

Source: Authors based on Divjak 2013.

Fundamental questions concerning internal governance arrangements apply to internal quality assurance and to the establishment of a quality culture.

In both internal governance and quality assurance, questions of effectiveness and efficiency, and of the right mix between bottom-up and top-down elements, appear. With respect to quality assurance:

“The most effective internal QA arrangements are those that derive from effective internal decisionmaking processes and structures. Having clear accountability lines and clarifying responsibilities at all levels ensure that the quality assurance system is kept as simple as possible while closing the feedback loops and this should, if anything, reduce bureaucracy by limiting data collection, reports and committees to what is absolutely necessary. It is crucial to identify who needs to know what and, furthermore, to distinguish between what is necessary vs. what would be nice to know. In addition, students and staff feel at home, first and foremost, in their faculties and departments. This argues in favour of an optimal balance between the need for a strong institutional core and a degree of faculty responsibilities, between the need for an institution-wide QA approach and some local variations in faculties.” (Surssock 2011, 9)

This implies that key discussions on internal governance related to efficiency and finding the right balance between powers and responsibilities on different institutional levels are particularly relevant for processes of quality assurance, and could be an important point of reference when deciding how to anchor quality assurance within higher education institutions. Discussions on internal governance might also profit from taking into consideration related developments and approaches in the field of quality assurance.

The relationship between internal and external quality assurance has emerged as an important element for institutions to consider.

In Europe, the ESG establish a direct link between external and internal quality assurance by setting the standard that institutions “should undergo external quality assurance ... on a cyclical basis” (ENQA 2015, 15). In addition to all benefits that institutions can derive from external quality assurance in terms of information on improvement potential and new insights into their institution, it also serves as an information link to the public. An important

issue institutions need to consider in that respect is that the relation between internal and external quality assurance can lead to conflicts. Given that internal quality assurance approaches have to be adapted to the characteristics of the institution in question, conflicts with external requirements can appear (Surssock 2011). This requires that institutions constantly assess the relationship between the two elements, which can change over time (see Example 13), and engage actively in related exchanges on establishing a fit between the two (Surssock 2011).

Example 13 The development of quality assurance in Germany

The basic approach to quality assurance in Germany changed over the years, leading to shifts in the relation between the internal and external aspects of quality assurance. Starting from a quality assurance system focused on *program accreditation*, a largely externally controlled system where external agencies took the lead in quality assurance emerged in Germany. This system often resulted in a lack of ownership within institutions (and units), some of which did not sufficiently define their quality goals and related improvement measures.

As a reaction to these shortcomings, program accreditation was complemented by the option of *institutional accreditation*, and institutions are currently free to choose between the two approaches. Institutional accreditation assesses the internal quality assurance systems of institutions – a crucial step toward increased internal responsibility for quality assurance. There is currently a debate about developing the system further, namely toward audits, which would shift the focus from an *assessment* of the institutions' quality assurance systems to potential *improvements*. This would once more increase the institutions' responsibility for their quality assurance processes and, potentially, the ownership by the institutions' members, and could gear internal quality assurance provision more closely toward the specific profile and needs of the respective institution.

Establishment of Monitoring Procedures and Management Information Systems

To fulfill the responsibilities of internal funding models, strategic steering activities, and new accountability requirements, higher education institutions need more and better data and information on their internal processes. There is an increasing orientation toward the outcomes of institutional activities, and toward evidence-based decision-making, leading institutions to need better knowledge about their inner processes, among other things, to prove to their environment the scope and quality of their activities. In other words:

“The modernization of higher education (HE) has forced the institutions to store, manage and use existing information and knowledge stores in a better way in order to meet new accountability, effectiveness and efficiency requirements.” (Pircher and Pausits 2011, 8)

Many institutions have already started to implement a wider set of instruments that deal with the abovementioned challenges, but scope for developing approaches of information and knowledge management further remains (Pircher and Pausits 2011). This is especially true with respect to more comprehensive systems and data warehouses that integrate the various data sources that already exist within institutions (cf. Hillmer 2008). For information systems to function well under the new circumstances (cf. Pircher and Pausits 2011), they need to be efficient (different subsystems need to be connected and integrated) and to enable direct support for management, decision-making-related tasks, which requires up-to-date, accurate data that can be analyzed and compiled in different, useful ways. Information systems also need to be underpinned by an adequate IT infrastructure (cf. Pircher and Pausits 2011). One approach to promote this via adapting institutional governance structures consists in installing a Chief Information Officer (CIO), who is responsible for the development and management of information systems, as many institutions have already done (Pircher and Pausits 2011).

As a part of efforts to satisfy new information needs, a range of reporting and information instruments have been developed by different institutions that are aligned with the specific requirements of higher education institutions.

Among these instruments are balanced scorecards (see Example 14) and intellectual capital statements (see Example 15). The main purpose of these instruments is to create transparency and to enable the identification of need for action related to institutional performance (cf. Hillmer 2008). Related to these instruments, two practical issues are important to consider: the design of the reporting procedures in general, and the development of suitable indicators. Key questions that need to be answered to adequately design the overall processes relate to the information and reports derived from them, namely (Hillmer 2008):

- what their content should be
- how the content is supposed to be presented
- who receives the data (for example, top-level management or lower institutional levels or both) and what this implies for the content to be presented
- when are data supposed to be delivered.

With respect to the specific indicators, issues similar to those discussed for internal funding models arise. These include the importance of specific objectives as a basis for indicators, the relation between indicators and what they are supposed to measure (which is especially relevant in the case of quality), the balance between too few and too many indicators, and differences between units and fields (cf. Hillmer 2008).

Example 14 Academic scorecards at the Münster University of Applied Sciences

Being among the German higher education institutions that relatively early experimented with innovative approaches of strategic steering and quality assurance, academic scorecards have become an important instrument at the Münster University of Applied Sciences (UAS). Based on the balanced scorecard instrument used for management purposes in many enterprises, an academic scorecard was developed at Münster UAS, Germany. This instrument builds on the notion that quality is not an absolute but a relative concept, which refers to the degree of goal attainment. Academic scorecards define the objectives for the institution as a whole, and for each unit, in the form of a table. In the table (see, as an example, Table 6), institutional and unit-level objectives are presented in a precise manner. Overarching objectives, specific targets, actions, measures, and target values are differentiated. As part of the strategic steering approach of the institution, the scorecards then serve as the basis for monitoring goal attainment and related managerial discussions and interventions. The academic scorecard is not an isolated information instrument but an approach to structure and guides the whole strategy process.

Table 6 Extract of the institution-level academic scorecard of the Münster University of Applied Sciences

Strategic objective	Specific target	Action
Education		
Improve higher education entrance	Maximize number of able potential students	Implement counseling concept "Wegweiser"
Supplement educational offers	Promote work-integrated programs	Implement concept for institutional development
Research		
Strengthen research	Support young researchers	Maintain doctoral school
Strengthen transfer activities	Support exchange processes	Improve research marketing
Resources		
Optimize use of human resources	Ensure staff satisfaction	Facilitate compatibility of family and career
Increase professionalization of management	Extend quality management	Prepare institution for system accreditation

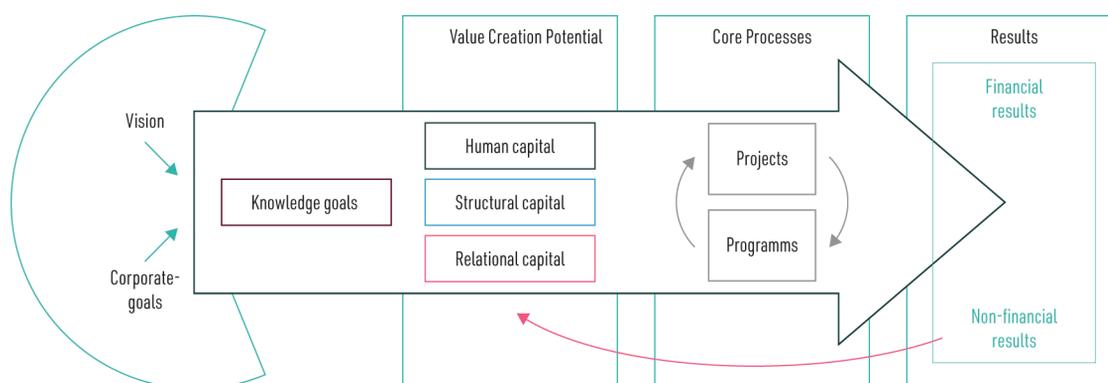
Source: Authors based on Lödning and Mosiek 2011, 5.

Source: Authors based on FH Münster n.d., Hochschulrektorenkonferenz n.d.

Example 15 Intellectual capital statements in Austria

One approach to transforming intangible assets into internal reporting and management procedures are intellectual capital statements (ICS), which have become widely used in Austria. The basic idea behind an ICS is to represent the value of institutions' intangible assets such as knowledge and competences, and thereby to complement financial reporting procedures. One model of ICS has been developed by the Austrian Research Center. In this model, intellectual capital is captured via quantitative and qualitative measures and a narrative part within the ICS. Taking the institution's overarching vision as a starting point, knowledge objectives and related measures (covering intellectual capital, results, and impact) are derived (see Figure 11). The ICS developed this way can then be used to provide external stakeholders with knowledge on the institution and to support internal management processes. In Austria, ICS have been made part of the yearly reporting duties of public higher education institutions to the Ministry for Education, Science and Culture.

Figure 11 The intellectual capital statement model of the Austrian Research Center



Source: Pircher and Pausits 2011, 13.

Source: Authors based on Pircher and Pausits 2011.

c) Good Governance 1: Cooperation and Participation

Cooperative and Participatory Approach & Transparency

A particularly marked change in internal governance arrangements that can be observed in many countries is a shift of powers away from bodies of academic self-governance toward leadership and management positions. As part of the development of institutions toward so-called “organizational actors” (Krücken 2011, 1), the position of leaders on different institutional levels such as rectors and deans has been strengthened in many (European) institutions at the expense of the powers of collegial academic decision-making bodies like the senate (Krücken 2011).

Recent shifts in rights and responsibilities among different bodies and actors lead to a fundamental challenge related to the design of internal governance arrangements: finding the right balance between the responsibility of collegial bodies and personal responsibility. It is indisputable that both elements need to be present in a good internal governance structure. The strategic development of institutions and an institution's efficiency and performance benefit from leaders who have the decision-making competences required to promote

the development of a clear vision and support its implementation (cf. Hofmann 2005). Moreover, important decisions for the strategic development of institutions that might be beyond an egalitarian consensus of all actors involved require personal responsibility. In addition to the general rationale behind involving academics in institutional governance as a precondition for academic freedom (see “3.2 b) Autonomy and Accountability”), and because they are the key experts in institutions, their involvement also promotes a shared vision across institutions, the appropriateness of institutional strategies, and ownership of development processes by institutional members (cf. OECD 2008).

In addition to the balance of the responsibility of collegial bodies and personal responsibility within the formal structures, much depends on the actual leadership behavior of institutional leaders. As has been observed for Germany (Püttmann 2013), even though the formal leadership roles of rectors have been strengthened, participatory leadership approaches including the involvement of internal stakeholders are still prevalent. Similarly, the increase in institutional autonomy in Germany has also promoted creativity related to the development of new, innovative participation instruments, that is, approaches other than the involvement of internal stakeholders via councils. Important in this respect are intense internal communication mechanisms, and the transparency of decision-making procedures, and of the rights and responsibilities of the governance bodies and actors.

Stakeholder Involvement

Partly as a result of an intensified outward orientation of institutions, and partly induced by direct political influence, new ways of involving external stakeholders in the internal governance of higher education institutions have evolved in many countries. The attention given to the relationship between higher education institutions and their environment has increased significantly, including a proliferation of external stakeholders that are perceived to have a legitimate interest in the institutions’ activities. Driven by the idea that a stronger involvement of representatives from society and the economy would increase the responsiveness of institutions, bring in new perspectives and expertise from different backgrounds, enhance accountability, and increase efficiency, governments in various countries have opted for allowing or even prescribing the involvement of external stakeholders in the internal governance of higher education institutions (cf. Antonowicz and Jongbloed 2015; OECD 2008). There also was an expectation that inputs from external stakeholders could help overcome internal blockades inside universities to set strategic priorities. The higher education institutions themselves have also sought new ways of integrating external stakeholders to promote the quality of their activities.

The establishment of governing boards comprising representatives from society and the economy has emerged as one of the most important forms of external stakeholder involvement. In 20 of the 28 European higher education systems investigated by the European University Association (EUA) in 2010 (Estermann and others 2011), institutions were required to include external stakeholders in the internal governance of their institution at the central level, and in three other systems institutions were able to choose to do so (see Figure 12). Leaving aside the differences among European higher education systems, these bodies — and therewith the external stakeholders they comprise — tend to be

primarily involved in the determination of strategic directions for the development of institutions; the supervision of the institutional leadership, in some cases even appointing the highest official such as the rector; and budgetary issues (cf. de Boer and File 2009; Estermann and others 2011). That distinguishes these boards from the institutional leadership responsible for management-related tasks (see also “3.2 d) Good Governance 2: Differentiation of Functions and Distribution of Powers”) and implies that the external stakeholders’ direct influence on academic matters tends to be limited and that there is no micromanagement of institutional processes (cf. OECD 2008).

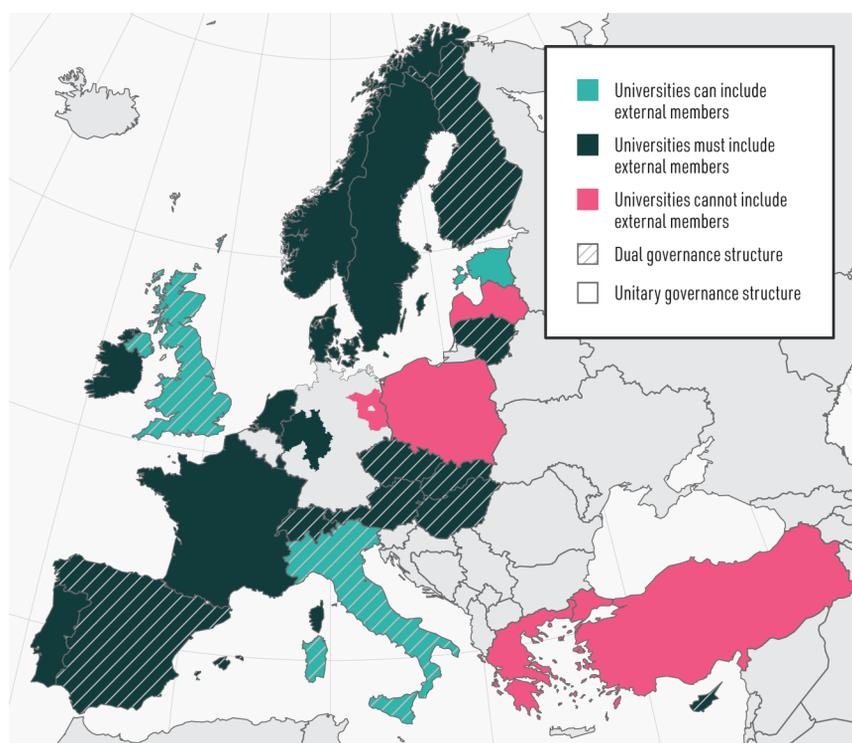


Figure 12 Structure of governing bodies and inclusion of external members in Europe

Source: Estermann and others 2011, 27.

In the course of the increasing involvement of external stakeholders in governance boards, different challenges have become apparent that can limit their positive impact on the development of higher education institutions. A basic precondition for the abovementioned benefits from the involvement of external stakeholders to occur is that they actually take up their responsibilities. As experience has shown, this is not always the case, just as institutions can face difficulties in finding individuals that are sufficiently motivated and willing to invest the resources required (OECD 2008). Another key requirement is that external members of governing bodies act in the best interest of institutions and not as the representatives of any constituency or organization they might belong to. In addition to considering these challenges when dealing with external members in governing boards, institutions also have options to directly promote the benefits that can be derived from this — at least as long as the related decisions can be made by institutions. To increase the range of new perspectives that external stakeholders bring to institutions, members of the respective academic diaspora who add experiences from other contexts and can promote internationalization efforts could, for instance, be included (cf. OECD 2008). To deal with potential conflicts of interest, institutions can establish codes of conduct. Addressing the

right practical issues related to involving external members in internal governance is key for realizing benefits and avoiding pitfalls, as experience in Germany reveals (see Example 16).

Example 16 Experience with university councils in Germany

Experience with university councils staffed with external members in Germany reveals the importance of distinguishing between the formal legal structures and the practical handling of these bodies. Related to the functioning of university councils, there are legal structures determining (formally) their role, for example, related to strategic decisions or the appointment of the rector. Issues of practical management related to university councils have a major impact on their functioning as well. Based on experience in Germany, several of these issues can be identified:

- Determining requirements for council members (for example, their knowledge of the system, expertise, and motivation) and for the composition of the council (for example, combining different backgrounds or including alumni)
- Choosing the chairperson carefully (for example, related to his or her time available or relationship with the institution's leadership)
- Preparing council members for their work (for example, providing information on legislation and rules, and on the steering approach of the institution)
- Creating adequate reporting systems to inform council members, but also to inform the university members about the work of the council
- Involving the council early enough in important matters
- Providing the council with the infrastructure required for its functioning
- Setting clear rules for how council members interact with members of the university and how to deal with conflicts of interest.

These (selected) aspects merit being taken into account by institutions that want to improve the management of university councils and, thereby, increase the benefits derived from them.

Source: Authors based on Meyer-Guckel and others (2010).

Involving external stakeholders in internal governance in ways other than governing boards can be found in different higher education institutions as well. In addition to an involvement in governance on the central level, external stakeholders can also contribute to lower-level activities. One example is the development and improvement of programs via involvement in continuous advisory structures for programs (see Example 17), where, also promoted by regulations concerning quality assurance, civil society, and private sector representatives have been involved more frequently in recent years.

Example 17 The involvement of external stakeholders in program development and improvement at the Mittelhessen University of Applied Sciences

The possible scope of external stakeholder involvement in the development and implementation of higher education programs is exemplified by work-integrated programs in Germany, like the ones offered by the Mittelhessen University of Applied Sciences (UAS). To align its programs more closely with the demands of employers in the region, Mittelhessen UAS developed work-integrated programs, which are characterized by a combination of phases of study at the higher education institution and phases of work at the companies participating in the program. Mittelhessen UAS and the employers work together on different levels for the development, implementation, and improvement of these programs.

The basic structure of all programs was developed jointly, including the regional chambers. To implement the programs, a special center at the institution was established, that receives advice from a board staffed with representatives of Mittelhessen UAS and the companies participating in the work-integrated programs. The involvement of both parties in this board ensures a connection between the theoretical and practical parts of the programs as well as up-to-date study content in line with the employers' requirements. This connection is reinforced by boards on lower levels responsible for certain program fields, which deal with, among other things, the continuous development of programs, quality assurance processes, and knowledge transfer activities. There is an additional connection between employers and programs in that practitioners from the companies are directly involved in teaching activities.

Source: Authors based on the website of StudiumPlus; <http://www.studiumplus.de/wps/splus/home/studiumplus/>.

Not only has the way in which external stakeholders are integrated into the internal governance of higher education institutions changed, but so has the involvement of internal stakeholders. The changing ways of internal stakeholder involvement have to be seen against the backdrop of the broader change of the growing importance of managerial self-governance and personal responsibility, and a declining (formal) influence of academic self-governance in many countries and institutions (cf. OECD 2008). This does not imply that their influence vanished altogether. What can be observed, however, is a focus of their decision-making powers on selected matters, for example, academic matters (as opposed to more administrative matters) in the case of academics, or student services in the case of students (cf. OECD 2008).

Decision-making powers on selected matters are only one example of a reinvigorated focus on the importance of students as internal stakeholders of higher education institutions. In addition to the influence students have gained as (paying) customers of higher education institutions in several countries (in some cases they are directly involved in decisions on how fees are spent), also other ways of student involvement in higher education governance are considered. As part of the Bologna Process, the Prague Communiqué (2001) states that the ministers of Bologna Process signatory countries “affirmed that students should participate in and influence the organization and content of education at universities and other higher education institutions,” and the Berlin Communiqué (2003) states that “[s]tudents are full partners in higher education governance.” Furthermore, there is a twofold involvement of students in quality assurance processes both as clients of higher education institutions in internal quality assurance processes (for example, via student surveys) and as experts on their own affairs in external quality assurance processes, as determined as a standard by the ESG (ENQA 2015), and internal quality assurance processes.

d) Good Governance 2: Differentiation of Functions and Distribution of Powers

Differentiation of Functions – Relationship between Strategic and Management Tasks

The transfer of responsibilities from governments to increasingly autonomous institutions led to a growing number of tasks on the institutional level, which induced a separation of more or less clearly distinguished fields of activities within institutions. Steering functions formerly performed by ministries or similar system-level governing bodies, ranging from study-program-related to human resource decisions, have been more and more shifted to higher education institutions themselves. This has led to the emergence of different sets of tasks within the internal governance of institutions (cf. Eurydice 2008; Hofmann 2005), and in particular to a separation of strategic and management tasks.

Separating strategic and management tasks is beneficial for various reasons, but needs to be framed by a suitable balance of powers and adequate checks and balances. Assigning strategic and management tasks to different bodies and actors leads to greater effectiveness and efficiency. In the case of strategic decisions, for instance, bodies responsible for a wider range of matters including

management-related ones, such as senates or faculty councils, get too easily mired in dealing with issues of minor importance at the expense of important strategic decisions requiring intense discussion (cf. Hofmann 2005). With respect to management tasks, what is particularly important in most cases is the speed with which decisions can be made, so that institutions remain flexible and capable of reacting quickly to unforeseen challenges. A sound separation of strategic and management tasks could, for example, lead to a decision-making constellation where a collegial body determines basic principles for the allocation of resources, but where specific allocation decisions based on those principles are made by the rectorate or deans.

Changing task structures within higher education institutions has led to the development of a tripartite structure separating overall strategic steering responsibilities, day-to-day management, and decision making on academic matters in several European countries. A trend observed in Europe is the development of a governance arrangement on the central level of higher education institutions consisting of an executive body, for example, the rectorate; a collegial academic body, for example, a senate; and an advisory or supervisory board (comprising external stakeholders) that is the decision-making body responsible for strategic institutional development (cf. Eurydice 2008). This arrangement is an appropriate way of accounting for several of the challenges that have to be solved via the design of internal governance structures, including finding a balance between the responsibility of collegial bodies and personal responsibility, assigning different sets of tasks to different bodies and actors, and securing the effectiveness and efficiency of governance processes. The major challenge for institutions related to designing their governance structures in this way is to achieve efficiency and to secure adequate checks and balances among the three bodies, which depends on the detailed arrangement of their competences. One part of these checks and balances is that the rights and responsibilities of bodies and actors are well defined and clear to institutional members (cf. Hofmann 2005). In addition, adequate relations among the bodies can also be supported by instruments such as codes of good governance, like the one developed in the German federal state of North Rhine-Westphalia (see Example 18).

Example 18 Principles of good governance in North Rhine-Westphalia

Striving to formulate a basic framework for good governance practices within higher education institutions, the chairpersons of university councils in the German federal state of North Rhine-Westphalia (NRW) developed a set of principles. The basic idea behind the principles is to complement the legal provisions covering the relationship between the federal state and higher education institutions, and the relations between the institutions' internal governing bodies with principles of good governance of higher education institutions developed jointly by the institutions and the ministry. The principles developed this way in NRW cover five basic issues:

- a trustful cooperation among all actors, that is, ministry representatives, university councils, rectorate, and senate
- the responsibilities and working principles of university councils
- the responsibilities of the chairpersons of university councils as those vested with the ministry's function as employer of the rectorate
- potential conflicts of interest of members of the university councils and the rectorate
- transparency related to the work of university councils.

Source: Authors based on KVHU NRW 2015.

Distribution of Powers

The general developments in internal governance discussed above have led to a change of profiles of different positions and bodies, especially of that of the higher education institutions' executive leadership (rectorate). Whereas the governance of higher education institutions in Europe was long characterized by a separation of powers between ministries and academic collegial bodies, several of the powers of these two sides have been shifted to the rectors¹³ (cf. Eurydice 2008; see Example 19), to enhance the responsiveness and strategic development capacities of institutions, among other reasons. Responsibilities of rectors in many countries include strategic planning, budgeting, organizational issues, and the general management of institutions. In these functions, rectors are usually supported by a wider group of individuals within the rectorate, whose composition has also undergone several changes in the recent past. In addition to the vice-rectors, a function that has been integrated in this body in many cases is that of the head of administration. In addition, the areas of responsibility directly assigned to individuals in the rectorate have become more diverse (Hofmann 2005). In the United Kingdom (Middlehurst 2004), for instance, it is no longer only the “traditional” activities and support services such as teaching and learning, research, libraries, and estate that are covered by the different positions within the executive body, but also others like knowledge transfer, community relations, and human resources.

Example 19 Internal governance arrangements in Ireland

Various higher education reforms in Ireland have led to internal governance arrangements that conform to several of the general trends also observed in other countries. On the system level, overall responsibility for higher education lies with the Department of Education and Skills. The major sector governing body, however, is the Higher Education Authority, which possesses far-reaching advisory functions, acts as the funding authority for higher education institutions, and oversees the institutions' strategies and quality assurance procedures. On the institutional level, the main governance actors are:

- the senior decision-making body (with a majority of external stakeholders), which approves proposals by the executive team on the direction of institutional development, strategy, funding allocations, internal mergers, and chairs and professorships; many of these competences have been shifted from the committee of academic staff to this body
- the executive team (led by the rector), among others responsible especially for proposals related to the institution's future development
- the deans, responsible for many academic matters (for example, degree programs and research priorities)
- the committee of academic staff, approving the decisions by the deans.

Source: Authors based on de Boer and others (2010).

Changing responsibilities of the institutional leadership have been accompanied by new modes of selecting rectors.¹⁴ There are four basic ways rectors are selected (Estermann and others 2011):

- The rector is *elected* by a (large) electoral body that comprises representatives of the different groups of internal stakeholders

¹³ In the following, the term “rector” and related terms like “rectorate” are used to refer to the executive head and his or her team, even though different terms such as “president” or “vice-chancellor” are used in some countries.

¹⁴ Issues related to academic selection and promotion will be covered in greater detail in the second phase of the project. Therefore, only a brief overview on the selection of rectors is presented in this report.

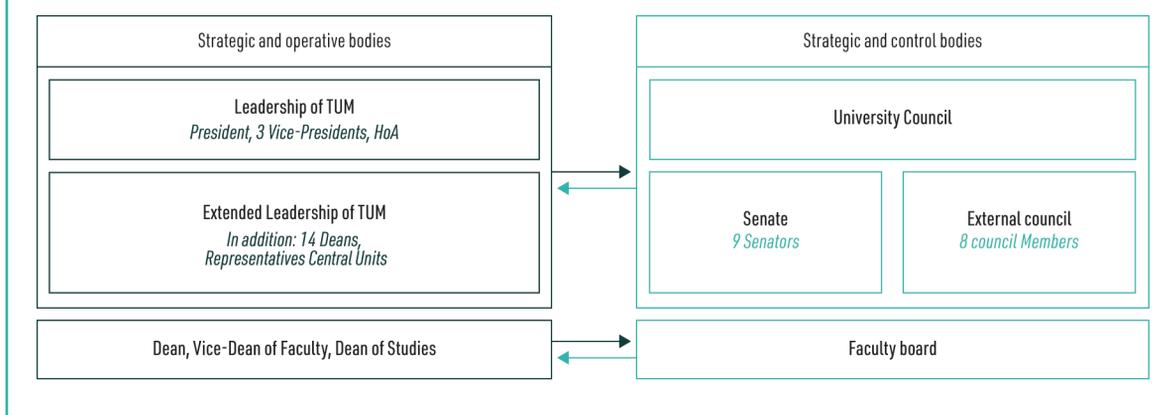
- The rector is *elected* by a collegial governing body (for example, the senate)
- The rector is *appointed* by an advisory or supervisory board (for example, a governance board comprising external stakeholders)
- The rector is *appointed* jointly by the collegial governing body and the advisory or supervisory board.

In some countries, a (formal) validation of the outcome of the selection process is required, for example, by the ministry responsible for higher education. In recent years, different European countries, among others Denmark, Finland, the Netherlands, Scotland, and some German states, have moved from electing rectors to having them appointed by governance boards. Both procedures, election and appointment, have certain advantages. Democratic elections give institutional members a say in who heads their institution, and can increase the acceptance of rectors and the policies they initiate. However, they often are afraid of taking tough decisions, because they later will have to return to their previous (professorial) positions. Having the rector appointed by governance boards, however, can promote candidates who go beyond an egalitarian consensus reflecting the institutional members' partial interests. Such a candidate can be particularly important in times of major changes, which require decisive action and leadership. One possibility to combine the strengths of those two approaches is to involve the governance board and a collegial body, such as the senate, in the selection process, for example, by granting the senate the right to approve candidates selected by the governance board. In some countries/institutions, the responsible body (either the senate or the council) appoints a search committee that can also use "head-hunters" to identify external candidates (Kolster and others 2016).

Designing internal governance structures and processes in a way that they are efficient and do not overburden the institutions' members is one of the most important and challenging tasks for institutions. The design of governance arrangements should also lead to coherent institutional practices, among others related to a correspondence of different types of power and responsibility (cf. Hofmann 2005), and well-functioning relations among all bodies and actors involved. There are two major issues in this respect. First, the number of governance bodies and actors should be limited, especially of those that have only an advisory function (cf. Hofmann 2005). In the case of the Technical University (TU) Munich, Germany, for example, most senate-related internal councils and boards have been abolished for exactly that reason (see Example 20). Second, the size of governance bodies should allow for efficiency, especially related to the time needed for reaching decisions (cf. Hofmann 2005). The overarching target for institutions should be streamlined governance structures and processes that lead to decisions of a sufficient quality in an efficient manner.

Example 20 The internal governance arrangements of the Technical University Munich, Germany

Within the internal governance structures of the Technical University (TU) Munich, there is a clear and efficient separation among different types of responsibilities and tasks. Under the internal governance arrangements of the TU Munich, Germany (see Figure 13), supervision and control tasks are performed by a university council, which itself comprises two bodies: the senate (consisting of nine members from within the institution) and the external council (consisting of eight external members). A special feature of the structure is that when it was introduced, most senate-related councils were abolished. With respect to the strategic and operative tasks, the highest decision-making body consists of the president, three vice-presidents, and the head of administration. For some matters, this body is extended by also involving the deans and the representatives of the central units. This design ensures a clear separation of decision-making and supervisory tasks in the internal governance arrangements of the TU Munich. Moreover, structures are lean for a clear leadership, without neglecting the relevance of a broader involvement of the institution's units, which can be realized via the extended leadership body involving, among others, the deans.

Figure 13 Internal governance structures of the Technical University Munich

There have been changes in governance structures on lower institutional levels that are similar to the changes on the central level. There is a tendency of lower-level governance structures to resemble those on higher institutional levels (cf. Eurydice 2008). This is also true for the general changes in governance structures. The position of dean has in many institutions evolved into an executive position, with a more managerial portfolio of activities comparable to that of rectors (Eurydice 2008). Deans have also become more involved in steering and management activities on the central level (Sursock 2011; see also Example 20).

A general discussion emerging from the more recent changes in governance structures concerns the adequate balance between powers on the central and lower institutional levels, that is, the adequate degree of devolution. Issues comparable to those already discussed with respect to the balance between the responsibility of collegial bodies and personal responsibility apply here as well, although in a slightly different form (cf. Hofmann 2005). There is, on the one hand, the need for a strategic framework for institutional development and for adequate competences on the central level to promote the implementation of related objectives. On the other hand, many decisions related to specific activities benefit from being made by those actors closest to the issues. In addition, as part of the overarching shift of governance arrangements centered on autonomy, many of the arguments in favor of institutional autonomy apply to units as well, such as the importance of units that can proactively take up incentives provided by internal governance and funding arrangements and design their activities accordingly in the most efficient way (see Example 21).

Example 21 Devolution at the Free University of Berlin, Germany

At the Free University (FU) of Berlin, there has been a consistent allocation of competences to different institutional levels.

In the course of the introduction of a performance-oriented funding system in 1992, a new approach toward internal governance was introduced as well. The basic principle of this approach is that the responsibilities for budgets, decision making, and the implementation of decisions should be assigned to the units, which are also responsible for the outcomes of activities. This principle is supposed to establish a link between the interests of units and the institution as a whole, and grant sufficient autonomy to units. In addition, the steady increase of the performance-based allocation component (currently 30 percent of the faculties' budgets) has been accompanied by a gradual increase in the devolution of competences. The gradual increase was supposed to ensure sufficient experience with the related competences before proceeding to the next level of devolution.

Source: Authors based on FU Berlin n.d.

Recruitment and Staff Development

Changes in governance arrangements have also reached the level of individual managers, where new activity profiles together with new skill demands have emerged (cf. Krücken 2011). Many internal governance and management positions have previously been filled with academics who transferred to these positions from their academic duties for limited periods of time only or fulfilled their duties part time. In line with the shift toward more managerial governance approaches, a trend toward more full-time management positions that require various new skills has emerged. These skills include, among others, technical knowledge and competences needed for using newly introduced strategic steering instruments, and general leadership and management skills. Many academics who switched to those more managerial positions in the past did not have adequate managerial skills. This has led to the establishment of training programs in many countries that explicitly target this clientele and the skills they need (see Example 22) — and which institutions can revert to for improving the functioning of their internal governance arrangements.

Example 22 Training programs for higher education leaders and managers

As a result of changing skill requirements in the sector, various training programs for higher education leaders and managers have been established in different countries. These programs cover different types of staff – administrative staff, unit-level academic leaders, and different positions within the central-level leadership – and are offered by a variety of institutions. Selected examples for these programs from different countries are:

- tertiary education management graduate courses at the LH Martin Institute, Australia, which address individuals on the middle to senior management level^a
- master's degree courses in education management and higher education and science management at the Donau-University Krems, Austria^b
- a study program in administration and management of higher education of the University of Tampere, Finland,^c targeting, among others, higher education administrators
- a training course for vice-rectors and vice-presidents developed jointly by the German Rectors' Conference and the Centre for Higher Education, Germany,^d which focuses on leadership skill development of newly appointed higher education leaders
- a Master of Business Administration in higher education and science management for middle management offered by the Osnabrück University of Applied Sciences, Germany^e
- a Master of Business Administration in academic management aimed at individuals who want to pursue an academic career and improve their related management skills at the University of Basel^f
- a variety of programs for different types of higher education leaders and managers offered by the Leadership Foundation for Higher Education, United Kingdom.^g

Note:

- a. <http://www.lhmartininstitute.edu.au/postgraduate-award-programs/183-tertiary-education-management-graduate-courses>.
- b. <http://www.donau-uni.ac.at/de/departement/wbbm/bereich/weiterbildungsmanagement/index.php>.
- c. <http://www.uta.fi/jkk/heg/en/studies/non-degree-studies/KOHA.html>
- d. http://www.che.de/cms/?getObject=250&getLang=de&strAction=programm&PK_Veranstaltungen=415
- e. <https://www.hs-osnabrueck.de/de/studium/studienangebot/master/hochschul-und-wissenschaftsmanagement-mba/>.
- f. <https://advancedstudies.unibas.ch/studienangebot/kurs/mba-in-academic-management-19698>.
- g. <https://www.lfhe.ac.uk/en/programmes-events/index.cfm>.

There has also been a change in the skills demanded of administrative staff.

This change has to be seen against the backdrop of a general shift from a bureaucratic approach toward administrative tasks, with staff members as regulatory administrators, toward a profile of service-oriented managers. Service-oriented managers are managers capable of creating and using incentive systems for steering purposes, who oversee the entire steering environment, and who enable academic and administrative staff to provide quality services. The overall change has also led to the development of an entirely new profession, that of higher education managers in areas of quality assurance, institutional research, internationalization, and so forth (cf. Krücken 2011), in contrast with the classic administrator. Again, training programs for this particular clientele have been established in many countries (see Example 22).

In addition to the different types of training programs mentioned above, approaches of comprehensive staff development and human resource development strategies have become an important topic of discussion in many higher education institutions. To cope with the recent and potential future changes, developing comprehensive, flexible approaches toward the development of different staff categories and their skills, competences, and training, and embedding these approaches into internal governance structures, has emerged as an important task for higher education institutions.

3.3 Requirements for “Good” Internal Governance Arrangements

As discussed in detail above, there can be no one-size-fits-all solution for designing internal governance arrangements. Higher education systems have different histories, traditions and values, regulatory frameworks, and overall approaches toward governance. Similarly, institutions exhibit particular historical traits, and traditions and values, and differ in, among other things, size, composition, and profile. Both types of particularities influence which way of designing internal governance structures and processes would be best, so there cannot be the one and only best approach. This leads to the challenge for institutions to find their own ways in designing internal governance arrangements in line with the characteristics of their institution and the framework conditions they face.

That is why in the following, rather than providing a complete proposal for the “best internal governance arrangements,” an outlook will be provided on general normative requirements for “good” internal governance arrange-

ments that offers a broad framework for the assessment of such arrangements. These requirements are based on the discussion above and take into account:

- international, particularly European, experiences, good practices, and standards for designing internal governance structures and processes derived from findings from the recent research literature
- the World Bank team members’ professional expertise in the field.

Using these sources, the team has identified four (A–D) major blocks of requirements (see Table 7), which will be described in greater detail below.

Table 7 General requirements for “good” internal governance arrangements

A. Strategic development and governance	A.1. Having in place clear and precise institutional strategies aligned with institutional strengths/weaknesses and their environment
	A.2. Having in place action plans that structure and support the strategy implementation process
	A.3. Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process
	A.4. Developing measures for the implementation of strategies
	A.5. Monitoring the strategy implementation process and adapting instruments/objectives if necessary
	A.6. Securing and monitoring fitness for purpose of governance structures
	A.7. Accompanying institutional developments with change management
B. Autonomy and accountability	B.1. Securing academic freedom
	B.2. Maintaining academic integrity
	B.3. Anchoring accountability measures and quality assurance in governance structures
	B.4. Establishing adequate monitoring procedures and management information systems
C. Good governance 1: Cooperation and participation	C.1. Balancing responsibility of collegial bodies and personal responsibility and maintaining a cooperative approach
	C.2. Involving external stakeholders in institutional governance and securing their proper conduct
	C.3. Developing appropriate ways of involving internal stakeholders on different institutional levels
D. Good governance 2: Differentiation of functions and distribution of powers	D.1. Separating strategic and management tasks framed by checks and balances
	D.2. Equipping central leadership with sufficient and adequate competences
	D.3. Securing efficiency and transparency of governance structures
	D.4. Establishing an adequate level of devolution
	D.5. Ensuring staff development and developing human resource strategies

A. Strategic development and governance

Determining directions for the future development of higher education institutions is among the key functions of internal governance. This entails the development of an institutional mission and sound strategic objectives, as well as strategic planning at lower institutional levels. Serving as the main point of reference for institutions' strategic planning activities, institutional strategies and action plans have to be clear and precise so that they can effectively guide the activities of institutional units and members.

- **Requirement A.1.: Having in place clear and precise institutional strategies aligned with institutional strengths/weaknesses and their environment**
- **Requirement A.2.: Having in place action plans that structure and support the strategy implementation process**

To formulate strategies that are fit to underpin strategic steering activities, the way in which they are developed is key. Adapting strategies to the circumstances and characteristics of institutions requires an in-depth knowledge of their activities and environment. The fit between strategies and institutions can also be promoted by the involvement of a wider range of institutional members — as well as of representatives from the institutional environment (external stakeholders) — in the strategy development process.

- **Requirement A.3.: Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process**

Following the determination of strategic directions, their implementation must be supported via day-to-day management, which requires the provision of suitable instruments. Complementing the processes of strategy development and implementation, a close monitoring of the implementation process and ensuing actions are required for successful strategic development.

In addition to determining and implementing strategies, governance must strive to regularly monitor the degree of goal attainment and performance. Governance structures should also offer means for effective managerial interventions to adjust detected discrepancies between the strategies and targets set and actual performance. More generally, objectives need to be reassessed regularly to account for changing circumstances.

- **Requirement A.4.: Developing measures for the implementation of strategies**
- **Requirement A.5.: Monitoring the strategy implementation process and adapting instruments/objectives if necessary**

Structures and processes of governance are not an end in themselves. They serve the strategic development of a certain institutional profile within the framework conditions given by the higher education system, including national policy goals, and institutional characteristics and visions. This makes their fitness for purpose the overarching objective for their design. Each higher education institution has its own history, traditions, and values. Each higher education system exhibits particular features as well. Given their influence on the functioning and outcomes of governance, all of these particularities can be relevant for the determination of governance structures and processes. In the face of continuous changes in the environment of institutions and shifts in strategic objectives, governance arrangements should remain adaptive and flexible, and should be able to generate innovative solutions. These adaptations — as well as strategy development, implementation, and adjustment — require institutional

leadership to guide, involve, and motivate (most of) the organization with a view toward moving into new directions.

- **Requirement A.6.: Securing and monitoring fitness for purpose of governance structures**
- **Requirement A.7.: Accompanying institutional developments with change management**

B. Autonomy and accountability

The freedom of teaching and research lies at the heart of higher education. Securing it within reasonable limits is among the functions that adequate internal governance arrangements need to fulfill. Academic freedom is a crucial precondition for higher education institutions and systems to function properly. Securing academic freedom is the responsibility of all higher education stakeholders, including higher education institutions. This does not imply, however, that academics, managers, or leaders can do whatever they themselves deem right.

- **Requirement B.1.: Securing academic freedom**

In the same way that institutions are responsible for securing academic freedom, they also need to ensure that that freedom is not misused by academics. Preventing and dealing with academic misconduct is an important component of institutions' attempts to enhance accountability toward their environment and a means to prevent harm to the society and science in general.

- **Requirement B.2.: Maintaining academic integrity**

Especially within a framework of enhanced autonomy, institutions need to be accountable to supervising entities. Hence, it should be ensured via internal governance that institutions satisfy the supervising entities' request for accountability, especially via suitable quality assurance mechanisms.

- **Requirement B.3.: Anchoring accountability measures and quality assurance in governance structures**

Strategic steering activities and new accountability requirements lead to a growing demand for data and information on internal processes. In parallel to an increasing orientation toward evidence-based decision making and the outcomes of activities, institutions need better knowledge of their inner processes, also to prove to their environment the scope and quality of their activities. This requires a sufficient quantity and quality of data derived from specific information and reporting instruments, as well as systematic approaches of information and knowledge management.

- **Requirement B.3.: Establishing adequate monitoring procedures and management information systems**

C. Good governance 1: Cooperation and participation

The strategic development of institutions requires both the responsibility of collegial bodies and personal responsibility. The strategic development of institutions and an institution's efficiency and performance benefit from leaders who are capable of promoting the development of a clear vision and supporting its implementation. Important decisions for the strategic development of institutions

that might be beyond an egalitarian consensus of all actors involved require personal responsibility. In addition to the general rationale behind involving academics in institutional governance as a precondition for academic freedom, and as they are the key experts in higher education institutions, their involvement also promotes a shared vision across institutions, the appropriateness of institutional strategies, and ownership of development processes by institutional members. More generally, bringing together diverse, sometimes conflicting interests requires cooperative and participative approaches that serve as a basis for effective negotiation processes on all institutional levels.

- **Requirement C.1.: Balancing responsibility of collegial bodies and personal responsibility maintaining a cooperative approach**

In the face of the various purposes of higher education, there is a wide range of stakeholders with a legitimate interest in the activities of higher education institutions. These comprise external stakeholders such as representatives of society and the economy and employers, as well as internal stakeholders such as academics, administrators, and students. An appropriate involvement of the diversity of stakeholders in internal governance increases an institution's ability to account for all stakeholders' interests and its responsiveness to external demands. Even though they are supposed to represent the interests of their constituencies, all actors involved in governance should first and foremost act in the best interest of the institution.

- **Requirement C.2.: Involving external stakeholders in institutional governance and securing their proper conduct**
- **Requirement C.3.: Developing appropriate ways of involving internal stakeholders on different institutional levels**

D. Good governance 2: Differentiation of functions and distribution of powers

The determination of strategic directions and their implementations on a day-to-day basis are separate tasks. This has to be reflected in the governance structures so that both tasks can be carried out effectively. In addition to assigning these tasks to different bodies and actors, the composition of the bodies and the selection of individual actors should be aligned with the respective task. To simultaneously ensure the fairness, justice, and transparency of processes of governance, adequate checks and balances to protect these values should be in place.

- **Requirement D.1.: Separating strategic and management tasks framed by checks and balances**

The implementation of strategies that give direction to an entire institution requires a central management that has sufficient powers to actually promote such a development.

- **Requirement D.2.: Equipping central leadership with sufficient and adequate competences**

In addition to being effective, governance arrangements should not overburden the administrative and academic staff of institutions. Their engagement in internal governance and related duties such as reporting procedures should not consume too much time and or too many resources. **And the design of internal governance structures and processes must be clear to all stakeholders**

involved. The rights and responsibilities of different bodies and actors should be well defined and clear. A culture of transparency also implies that decision-making processes at all stages follow an adequate level of openness.

➤ **Requirement D.3.: Securing efficiency and transparency of governance structures**

Notwithstanding the need for an overarching strategic framework and a leadership equipped with sufficient competences, decisions on implementation benefit from being made by those actors best positioned to develop adequate solutions. Given that these actors are in many cases the ones closest to the issues at hand, decision-making powers should be devolved to lower institutional levels as long as this does not impede the overall strategic development of institutions.

➤ **Requirement D.4.: Establishing an adequate level of devolution**

Internal governance arrangements need to offer support for exercising academic and administrative leadership at all levels. This includes the targeted development and promotion of leadership and management skills, also via broader approaches of systematic human resource development and professional training.

➤ **Requirement D.5.: Ensuring staff development and developing human resource strategies**

4 General Summary

Internal funding and governance are key components of the strategic steering capacities of higher education institutions. In relation to changes of funding models and governance approaches on the system level, various developments within institutions can be observed for both fields in the more recent past. In many countries, among them most European ones, a general shift toward autonomy-centered, output-oriented steering approaches by governments has confronted higher education institutions with the challenge of adapting their internal funding models and governance arrangements accordingly. Despite differences among countries and institutions related to their particular histories and characteristics, more general lines of development can be identified, as can a range of good practices of how institutions can react to emerging challenges.

Public HEIs are expected to meet policy goals in a cost-effective way throughout European higher education systems. Because internal allocation models are designed to incentivize both revenue growth and cost control, set targets, and fund strategic priorities, they play a key role in HEI attempts to meet this expectation. Well-functioning internal funding models can align with external revenue streams and reflect national goals, thereby increasing the sufficient incentive compatibility between institutional directions and policy goals. For that reason, system-level funding, particularly performance-based funding, has been regarded as an important force in shaping the internal allocation models of HEIs.

At the same time, internal funding models commonly take into account institutional strategies and profiles, including those appearing at the level of units (faculties, schools, institutes, departments). International trends show that financial autonomy of institutions can be strengthened through an increased level of resource diversification. Generation of additional income through multiple new or existing funding sources contributes to balancing the income structure of the institution and reduces the resource dependency of institutions on any single source of financing, including state funding.

In many countries, unit-level autonomy is considered a particularly important prerequisite for sustainable strategic development of the whole institution. The main rationale behind higher autonomy of units is that it is believed to support responsibility, transparency, and entrepreneurial thinking. Autonomous units are considered to be more responsive to strategic initiatives and in generating, deploying, and allocating their own income streams in a way that supports their cost-effective operation. The current international trend is to favor bigger unit sizes, with a high level of operative and financial autonomy. Sufficient size of the units allow them to develop their own specific objectives under the broader framework of an institutional strategy.

Many European institutions use block grants and formula funding. Block grants and formula funding support a decentralized budgeting approach by allowing greater freedom for units in their financial decisions. At the same time, funding formulas are expected to lead to increased transparency and legitimization of allocation decisions. In particular, by offering incentives that link institutional goals and resource allocation, formula funding supports stronger performance orientation.

At the same time, increased unit-level autonomy often needs a counter-balance, which can be achieved through the creation and effective use of strategic central funds (reserves). Allocations of these funds are often based on discretionary decision-making processes on the part of the institution's central leadership.

In several countries, performance-based funding is allocated internally primarily to units, while staff salary schemes including a wider performance component are used in parallel. Keeping a right balance between allocations to units and individuals is important. When funding is channeled to the unit level to support research and teaching, monetary incentives can simultaneously facilitate development in those areas, thereby also benefiting individuals.

Institutions rarely have a pure budgeting model relying on a single allocation principle. Rather, institutions rely on hybrid models which combine elements from several allocation principles. Most institutions use a budgeting mix that includes input- and output-based funding formulas plus some discretionary funding that can be used to achieve particular priorities or address financial problems. Nevertheless, most institutions seem to seek a balanced structure in the light of functions of the three-pillar model, that is, between “basic funding” offering stability (Pillar 1), performance-based funding fostering productivity (Pillar 2), and profile/innovation-oriented funding promoting change (Pillar 3). Internal target agreements are often used to bring further balance between funding streams allocated under the three pillars and goal orientation toward the strategic objectives of the institution and units.

Internal governance arrangements can be considered the backbone of every higher education institution's capacity for internal coordination and strategic development. Major developments in this field have been triggered by changing approaches toward the governance of higher education systems, namely a shift toward more indirect forms of steering higher education systems. These approaches center on the autonomy of higher education institutions, framed by incentive mechanisms installed to gear institutions toward implementing policy objectives, and by enhanced accountability and quality assurance mechanisms. Adding to this are growing challenges for institutions to thrive in increasingly volatile, competitive environments. As a result, institutions experience increasing pressure to develop capacities for acting strategically as integrated actors — a direction toward which many institutions have developed.

Institutions have increased their engagement in determining directions for their future development. Institutional strategies and action plans have become the main instruments for this purpose, requiring a certain degree of clarity and preciseness in order to fulfill their function properly. Promoting the overall quality of strategies and their impact, strategy development processes, including a thorough analysis of institutional strengths and weaknesses and their relation

with the institutional environment, as well as the involvement of internal stakeholders, have emerged as particularly important. In addition, increasing attention has been given to the importance of the processes of strategy implementation and monitoring the implementation progress. Institutions have also become engaged in increasing the fitness for purpose of their internal governance arrangements, especially related to strategic development capacities.

Institutional activities can also be observed with respect to academic freedom and integrity, as well as accountability. Institutions have established measures for preventing and dealing with academic misconduct, as an important component of their attempts to enhance accountability toward their environment. Under the heading of accountability, especially quality assurance processes have gained in importance. Quality assurance within institutions, in particular if seen as part of a broader “quality culture,” has become connected to internal governance in various ways. In addition, information and data needs resulting from strategic steering activities and new accountability requirements have received more focus, for example, via new reporting and information instruments.

Questions concerning internal cooperation and participation in relation to strategic development capacities have emerged under the heading of good internal governance. Recent shifts in rights and responsibilities among different bodies and actors in institutions lead to a fundamental challenge related to the design of internal governance arrangements: finding the right balance between the responsibility of collegial bodies and personal responsibility. As part of the same overarching change of internal governance approaches, new ways of involving external stakeholders in the internal governance of higher education institutions have evolved in many countries. Moreover, not only has the way in which external stakeholders are integrated into internal governance changed, but also the involvement of internal stakeholders.

Good internal governance also concerns the differentiation of functions and the distribution of powers within institutions. The transfer of responsibilities from governments to increasingly autonomous institutions leads to a growing number of tasks on the institutional level, which induced a separation of more or less clearly distinguished fields of activities within institutions, namely strategic and management tasks. Separating these tasks is beneficial for various reasons, but needs to be framed by a suitable balance of powers and adequate checks and balances. Another discussion emerging from the more recent changes in governance structures concerns the adequate balance between powers on the central and lower institutional levels, that is, the adequate degree of devolution. Given the pronounced developments of internal governance arrangements, designing internal governance structures and processes in a way that they are efficient and do not overburden the institutions’ members has become an important and challenging task for institutions. Changes in governance arrangements have also reached the level of the individual, where new activity profiles together with new skill demands emerged. This is true for both leadership and management staff and has induced the establishment of different types of staff development initiatives, even though only rarely of comprehensive staff development and human resource development strategies.

Based on the analysis of the aforementioned developments and good institutional practices in reacting to them, two sets of requirements have been developed, one for good internal funding models and one for good internal

governance arrangements. These will be taken up by a second report under the current higher education project to assess the status quo of internal funding and governance in Latvian higher education institutions. Together with the outcomes of the status quo assessment, the outcomes of the report at hand will serve as the basis for recommendations for the further development of internal funding and governance by Latvian higher education institutions to be presented in spring 2017.

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Report 2

INTERNAL FUNDING AND GOVERNANCE IN LATVIAN HIGHER EDUCATION INSTITUTIONS: STATUS QUO REPORT

13 February 2017

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Abbreviations

AAL	Art Academy of Latvia
CHE	Centre for Higher Education
CHEPS	Center for Higher Education Policy
DU	Daugavpils University
ENQA	European Association for Quality Assurance in Higher Education
EU	European Union
EUA	European University Association
HEI	higher education institution
KPI	key performance indicator
LASE	Latvian Academy of Sport Education
LIHE	Law on Institutions of Higher Education
MoES	Ministry of Education and Science
R&D	research and development
R&I	research and innovation
RSU	Riga Stradiņš University
RTU	Riga Technical University
STEM	science, technology, engineering and mathematics
UAS	University of Applied Science
UL	University of Latvia
VUAS	Vidzeme University of Applied Sciences

Executive Summary

Latvia is currently in the process of undergoing a significant reform by transforming its higher education funding system to be more compatible with European best practices and with the recommendations offered by the World Bank (2014), especially in the light of a “three-pillar funding model.” In particular, the recent introduction of second pillar funding (performance-based funding) and plans to reform first pillar funding (basic funding) now challenge higher education institutions (HEIs) to assess their internal funding models especially vis-à-vis how well these models are able to respond to the changing dynamics of the system-level allocations and reflect national goals in the area of higher education. Therefore, in the course of this process, developing solid and clear principles guiding the assessment of the strengths and weaknesses of these internal funding models with respect to the capacity to respond to external developments and opportunities becomes highly important. This pertains in particular to the development of high quality research-based higher education, strengthening the links between higher education and the labor market, the consolidation of the research sector and increasing innovation performance, the development of a knowledge base and innovation in the areas of Latvia’s Smart Specialization Strategy, increasing the international visibility and competitiveness of research, and the renewal and mobility of human capital in higher education, research and innovation.

Following a first World Bank higher education advisory service in 2013/14 that addressed the Latvian higher education funding model on the system level, a second higher education project with World Bank support addressing the internal funding models, governance arrangements and human resources policies of Latvian HEIs was started in 2016. To complement the changes on the system level, the second higher education project turns to the developments within institutions — particularly with regard to the question of how the new performance-based funding and incentive orientation is reflected on the institutional level — and potentials for further development in the fields of internal funding and governance. Based on two sets of requirements, one for good internal funding models and one for good internal governance arrangements, an assessment of the status quo was conducted — which is presented in this report.

Subsequent to the reform of the system-level funding model, Latvian higher education institutions have started to adapt their internal funding models or at least intend to introduce changes in the near future. The internal allocation of the institutions’ income from the performance-based funding pillar is at the center of these reforms; adaptations to the new external model were implemented internally within a short time.

The internal funding models of higher education institutions in Latvia are generally capable of accounting for both the external incentives and institu-

tional objectives — thereby also establishing a connection between system-level policy objectives and institutional activities. Incentives provided by the system-level funding model and those provided by the funding models within institutions are in most cases in tune with each other. The same holds true for the performance orientation, which is realized within most institutions via financial incentives provided to units and/or individuals. The internal funding models also appear capable of forwarding financial stability for teaching activities provided by the state funding for study places to the unit level. However, changes to the allocation mechanisms for study places on the system level could impair the actual degree of unit-level financial stability in case the number of state-funded study places in certain fields is substantially reduced. In the field of research, in contrast, there appears to be no funding stream available to *all* units that is stable in the long run. This is not only due to fluctuations in state allocations but also a greater orientation toward other factors (like the strategic pooling of limited funds) by institution-internal funding models, resulting in a targeted allocation of funds, for example, for research clusters or priority areas. Different mechanisms for implementing institutional objectives into internal funding models have been introduced. Nevertheless, there remains some room for improvement in the form of a stronger and less fragmented alignment of funding models and institutional objectives, for example, by adding a focus on well-selected strategic priority areas to the allocation of research funding. In addition, strategic steering through internal funding models has the strongest focus on the field of research (at the expense of other fields of activity) and, therefore, could be improved in connecting the different higher education missions.

Some institutions use a significant part of their performance-based income to provide salary bonuses to individuals, a practice that could result in some challenges. Providing academics with financial incentives in terms of personal income for a variety of different activities can lead to overly fragmented incentive systems and undesired side effects. In these cases, mitigating measures or a shift toward other types of incentives (for example, incentives targeting institutional units, and not individuals) are worth considering by institutions. Similar critical points apply to the differentiation of research and teaching positions in Latvia, which also entails a fragmentation of payments for different activities.

Institutions enjoy a comparatively high degree of financial autonomy, but face constraints related to the availability of funds. Institutions generally use the financial flexibility they have within the limits of their autonomy. Institutions that are more successful in diversifying revenues, for which at least some institutions have established promoting measures, appear to have more resources they can spend according to their own strategies. Practices of reserve building and using reserves strategically vary among institutions, accordingly. **Institutional subunits have a rather low degree of financial autonomy, especially related to the institutional budgeting approach.** This is at least partly at odds with the current developments toward a new form of system-level steering, which requires units with a greater potential for strategic development.

Internal funding models are overall transparent, and the models are underpinned with data and information of mostly sufficient quality, as suggested by the provided data. Various units in higher education institutions in Latvia have an overall understanding of the internal funding models. However, further enhancement of the transparency and in-depth knowledge about the functioning of funding models at the decentralized and individual level could increase the

models' impact. The same holds true for the data used for internal funding allocations, where the development of comprehensive management information systems could solve some of the issues related to data availability and quality, and promote the impact of steering activities.

Whereas basic and performance-based funding are integrated into internal funding models, a component that supports innovative projects (in advance) is mostly lacking. Despite selected attempts of institutions to provide innovation funding, there is no fully developed ex-ante funding component that could contribute to the targeted strategic development of institutions. Even though European Structural Funds are used to provide funding for investments in strategic projects *to institutions* (the third pillar), these funds do not lead to the development of a stable innovation-oriented, ex-ante funding component *within institutions*, and are primarily aimed at stimulating research activities and targeted investments in infrastructure. A component of internal funding systems that systematically and on a broader scale provides financial support for projects before their realization, that are supposed to bring forward innovations and a clearer profile of institutions, has not yet been implemented.

In the field of internal governance, changes of the overall steering approach have led to new developments and challenges for internal governance structures and processes. However, all institutions engage in strategic planning and have developed strategy documents as well as selected instruments for their implementation. Still, there is a strong focus of strategies on research in some institutions, and the more general challenge of strategies being rather generic in many cases. Questions concerning adapting strategy development processes to overcome these issues arise at this point, which might enhance the profile orientation of institutions and the impact of their strategic steering activities. In this direction, institutions have started to act to ensure the fitness for purpose of their governance structures and processes, but could and will have to pursue these approaches further. Among the key tasks related to these approaches is a focus on the institutional structures and processes behind accountability mechanisms and quality assurance processes, which have gained in importance due to current developments toward a steering approach centered on autonomy.

Internal governance processes are characterized by a deep-rooted democratic culture and highly interactive decision-making processes. Internal governance arrangements also exhibit a lack of separation of strategic and management tasks. Additional key characteristics comprise an abundance of internal governance bodies and actors. In this context, issues of efficiency and strategy-relevant decision-making have become important. In some institutions, competences of the institutional leadership — at the central and decentralized level — appear to be limited. Contrasting this situation with the increasing need for a strategic development of institutions suggests that there is an imbalance between the responsibility of collegial bodies and the personal responsibility of higher education leaders and managers.

External stakeholders are involved in the governance of Latvian higher education institutions in different ways, but for the most part without formal decision-making rights and responsibilities. To increase the benefits from external stakeholder involvement, a more formal and systematic way of integrating them into governance processes could be worth considering.

Taken together, the characteristics of internal governance arrangements raise the issue of streamlining governance structures and processes, which some institutions have started to get engaged in. However, any attempt in this direction should keep the balance with the democratic culture of institutions and pay particular attention to necessary checks and balances. Adaptions of internal governance structures and processes would therefore require detailed stock-taking and an in-depth assessment of competence allocation. Finally, leadership and management skills appear to lag behind the requirements stemming from recent developments in the field of internal governance, without adequate training schemes being in place.

Looking beyond the status quo in Latvia, different issues worth tackling in the future emerge. When considering the relevance of internal funding and governance for the strategic development of institutions, five overarching challenges can be identified:

- 1) Guaranteeing a sound basis for strategic steering activities in the form of relevant strategies and precise action plans
- 2) Promoting clear and balanced internal funding models that can further comprehensive institutional development
- 3) Bringing governance structures and processes in line with the requirements of autonomy-centered and performance-oriented steering approaches
- 4) Restructuring institutional subunits to complement the new steering approaches
- 5) Taking more active steps to develop the required human resources.

By building on the current dynamics induced by recent reforms, Latvian higher education institutions and the higher education sector as a whole are well advised to take up these challenges to further improve their strategic development in the direction of quality and performance orientation in higher education in Latvia.

1 Introduction

Following a first World Bank higher education advisory service in 2013/14 that addressed the Latvian higher education funding model on the system level, a second higher education project with World Bank support¹⁵ addressing the internal funding models, governance arrangements and human resource policies of Latvian higher education institutions started in 2016.¹⁶

The 2013/14 higher education project led to the reform of the Latvian state funding model for higher education in the form of the introduction of a new, three-pillar model including a performance-based pillar, bringing the funding model closer to European best practices. To complement the changes on the system level and to address the effective management of scarce resources to attain institutional and policy goals, the second higher education project turns to developments within institutions — particularly with regard to the question of how the new performance-based funding and incentive orientation is reflected on the institutional level — and potentials for further development in the fields of internal funding and governance. Based on two sets of requirements, one for good internal funding models and one for good internal governance arrangements, an assessment of the status quo was conducted — which is presented in this report.¹⁷

In methodological terms, the first phase of the second higher education project, which focuses on internal funding and governance, relies on the study of available documents and detailed information on individual institutions, information coming from in-depth interviews primarily conducted during site visits to institutions, and workshops and verification meetings. The work on this report was methodologically preceded by research of the World Bank Latvia

¹⁵ The term “project” is subsequently used for this World Bank higher education advisory service.

¹⁶ Historically, the second higher education project is therefore anchored in financing reform, and the financing work under the second project is linked to earlier work. Financing is thus discussed first in the report at hand, while governance — which was introduced as an additional theme as compared to the first project — follows in the later section of the document.

¹⁷ The Legal Agreement between MoES and the World Bank stipulates that Phase 1 of the new engagement focuses on “university-internal governance and performance-based financing in Latvian HEIs” envisaging three outputs: one on international trends and practices, one on the status quo in Latvian universities (this report), and related recommendations. The discussion presented in this report is based on information provided by MoES and individual HEIs, including in the context of in-depth interviews during site visits. These interviews were structured by criteria developed in close consultation with MoES and related questionnaires. The report primarily focuses on performance-based funding (that is, Pillar 2 funding), since incentives for institutional performance are primarily set through this pillar, while Pillar 1 contains base funding provided by MoES, and Pillar 3 funding is considered to cover European Structural Funds for higher education at the system level. A comprehensive discussion of these two funding sources and their implications on the institutional level would have been beyond the scope of this report.

higher education financing team¹⁸ on international experience with internal funding and governance. From this earlier product of the second project, criteria for HEI internal funding and HEI governance arrangements were conceived. These criteria were subsequently applied to an assessment of the current situation in Latvia. However, while information on and findings of the project were discussed and disseminated more broadly, including during a workshop on 23 November 2016,¹⁹ seven Latvian HEIs — the University of Latvia, Riga Technical University, Riga Stradiņš University, Daugavpils University, Vidzeme University of Applied Science (UAS), the Art Academy of Latvia, and the Latvian Academy of Sport Education — joined the project as case study institutions, which allowed for more in-depth assessments and discussions on the issues covered by this report. The different size, profile, nature, and strategies of the case study institutions involved allowed the team to obtain a sound overview on developments in the sector. Those seven institutions together also receive the major share of overall state funding,²⁰ which is why the in-depth case studies underlying this report cover a significant part of the Latvian higher education funding system.

The first phase of the second project, focusing on internal funding and governance, will see three major outputs. The report at hand is made available to the public at the same time as the aforementioned report on international experiences with internal funding and governance. Building on both outputs, the team will prepare recommendations for the further development of internal funding and governance by spring 2017.²¹ This first phase will be succeeded by a second phase in 2017/18 that will address questions of academic selection, promotion, and remuneration. These topics are thus only discussed to a limited extent in this report.

¹⁸ Members of the World Bank higher education financing team are Dr. Nina Arnhold, Senior Education Specialist and Task Team Leader, World Bank; Adjunct Professor Jussi Kivistö, University of Tampere, Finland; Vitus Puttmann, Consultant, World Bank; Professor Hans Vossensteyn, Director of the Centre for Higher Education Policy (CHEPS), the Netherlands; and Professor Frank Ziegele, Director of the Center for Higher Education (CHE), Germany. The team would like to thank the Latvian Ministry of Education and Science (MoES) and the seven case study institutions as well as all other sector representatives involved for the strong collaboration that has made the preparation of this report possible.

¹⁹ The workshop agenda can be found in Annex 1.

²⁰ According to data provided by the MoES, the combined share of the seven case study institutions in 2015 was 71.8 percent for the state funding for study places, 90.6 percent for the research base funding, and 75.1 percent for the performance-based funding.

²¹ The first phase also saw the development of another analytical output, a note on Latvian doctoral education and promotion, which was prepared by Dr. Andrée Sursock, EUA Board Member and World Bank Consultant.

2 Internal Funding

2.1 Internal Funding in Context and the Requirements for Internal Funding Models

In general, internal funding models are mediating devices between external revenue streams of an institution and internal resource allocations. By creating incentives, internal funding models are one of the most important steering instruments for guiding organizational and individual behavior of faculties, departments, and individual staff, and are therefore an integral part of the overall governance system of an institution. The design, broader architecture, and specific elements chosen for the internal funding model reflect the institutional priorities, or lack of them, often quite accurately. Therefore, funding models play a crucial role in the institutional strategic planning and management by reinforcing and supporting (or by disorienting and obstructing) the realization of the strategic goals of an institution. Generally, to be effective, funding models should be transparent and simple, with a limited number of indicators that reflect the key priorities — or overarching domains — of an institution.

External revenue streams, and especially the state funding model, set the most important preconditions for the development of internal funding models for most of the public higher education institutions. To secure the maximum benefits from the state funding model, institutions need to adjust their internal allocation logic to be incentive-compatible with the allocation logic of the state funding model. Incentive compatibility does not mean that institutions should copy the state allocation model internally. However, decoupling the internal financial incentives from the external ones is likely to increase the risk of reductions in external revenues, if organizational activities are promoted that are not in line with the goals set in system-level policies and, therefore, with the activities that are rewarded by the state funding model. For example, if the research council funding is an important and significant resource for universities, one might consider the internal funding model to include an incentive for attracting research council funding, even though this might not be a part of the national funding formula for teaching and research.

Latvia is currently in the process of undergoing a significant reform in transitioning its higher education funding system to be more compatible with European best practices and with the recommendations offered by the World Bank (2014), especially in the light of a “three-pillar funding model.” In particular, the recent introduction of second pillar funding (performance-based funding) and plans to reform the first pillar funding (basic funding) now challenge HEIs to assess their internal funding models especially vis-à-vis how well these

models are able to respond to the changing dynamics of the system-level allocations. Therefore, in the course of this process, developing solid and clear principles guiding the evaluation of the strengths and weaknesses of these internal funding models with respect to the capacity to respond to external developments and opportunities becomes highly important.

Based on the identification of international experiences and good practices, World Bank team members’ professional expertise in the field, and the criteria developed for the assessment of the Latvian system-level funding model, a set of normative requirements has been identified to assess internal funding models. These requirements are summarized in Table 1, and are outlined in detail in the report “International Trends and Good Practices in Higher Education Internal Funding and Governance,” (World Bank 2016a) made available to the public concurrently with this report. These requirements offer a broad and multidimensional framework for the assessment and identification of current strengths and weaknesses associated with the internal funding models of Latvian HEIs. They also feed into the recommendations on the future development of internal performance-based funding in Latvian higher education institutions, which will be offered in a separate report to be published in the first quarter of 2017.

Table 1 General requirements for “good” internal funding models

A. Strategic orientation	A.1. Aligning internal funding model with external revenue streams and reflecting national goals
	A.2. Promoting institutional strategies and profiles
	A.3. Promoting unit-level objectives
B. Incentive orientation	B.1. Creating performance rewards and sanctions
	B.2. Providing clear and nonfragmented incentives
	B.3. Avoiding undesired side effects
C. Sustainability and balance	C.1. Combining top-down and bottom-up approaches
	C.2. Providing a sufficient level of stability
	C.3. Guaranteeing continuity in development
	C.4. Balancing the overall model architecture
	C.5. Promoting diversification of unit-level funding sources
	C.6. Balancing the key institutional missions
D. Transparency and fairness	D.1. Ensuring transparency
	D.2. Supporting the perception of fairness
E. Level of autonomy and flexibility	E.1. Guaranteeing financial autonomy and academic freedom
	E.2. Implementing an adequate level of regulation
F. Link to governance and management; practical feasibility	F.1. Increasing reliability and availability of data
	F.2. Ensuring administrative efficiency
	F.3. Ensuring coherence with other governance approaches and university culture
	F.4. Ensuring the ability of the leadership to act

2.2 Status Quo in Latvia

The reform of the system-level funding model clearly has an impact on Latvian higher education institutions. External changes have already induced internal changes in universities, and it is to be expected that this development will continue in the future. Several of the institutions have started to adapt their internal funding models; others are planning to implement changes in the near future. The internal allocation of the newly introduced performance-oriented funding appears to be at the center of the institutions' reform efforts — and it will be at the center of the following assessment as well. Nevertheless, the shift toward performance orientation underlying the system-level reforms has also impacted reform efforts beyond allocations under the new income stream.

Notwithstanding the importance of the internal allocation of performance-oriented income, all of the institutions' income streams and their internal allocation should be considered to some extent for a sound assessment. This, first, comprises the overall structure of the state funding model:

- basic funding for teaching and research (the first pillar)
- performance-oriented funding (the second pillar)
- innovation-oriented funding (the third pillar).

The first pillar consists of two components. Under the teaching-related component, institutions receive funds based on the number of study places allocated to them following institutional negotiations with the Ministry of Education and Science (MoES) and, where applicable, their respective line ministry, for example, the Ministry of Culture in the case of the Art Academy of Latvia.²² In 2016, EUR 85.6 million²³ was disbursed to institutions in this way. The second component of the first pillar is base funding for research. This is distributed to higher education institutions based on a formula that takes into account input-related criteria (for example, maintenance costs for infrastructure and staff costs) and performance-related criteria (for example, research projects acquired and publication output). Funding under this component amounted to EUR 14.3 million in 2016.

Under the second pillar, EUR 6.5 million was distributed in 2016 on the basis of performance on five criteria, that is, a fixed sum for each of the following criteria was designated among institutions:

- Number of “young scientists” engaged in research (that is, all principal investigators, investigators, and research assistants who have been elected as researchers and are either graduate students or have graduated not longer than five years ago) (in full-time equivalents)
- Amount of funding attracted from international sources for research and development (R&D) and other projects (for example, from Horizon 2020)

²² Another possibility for institutions to obtain state-funded study places consists in agreements with ministries other than the MoES or the respective line ministry, which might fund the education of specific types of professionals.

²³ Data on funding allocations under the different pillars of the state funding model have been provided by the MoES.

- Amount of funding attracted via R&D contracts with public, commercial, and other entities (except for local governments)
- Amount of funding attracted from local governments and local-government-owned companies (via regional research projects and subsidies)
- Amount of funding attracted via creative and artistic projects.

The third funding pillar currently consists exclusively of European Structural Funds and the related co-funding by the Latvian government, which finance major investments and strategic projects.²⁴ Following a regulation issued by the Council of Ministers on the funds' specific purpose, institutions can apply for funding under different programs, during 2014–20, among others to improve their programs in the fields of science, technology, engineering and mathematics (STEM) and to develop research and innovation (R&I) capacities.²⁵ Besides public funding for teaching and research, institutions generate substantial income via tuition fees and state as well as third-party funding from research and other types of projects. Only a few institutions do not charge tuition fees.

The amount of funding available from the different income sources and their share among the overall budgets varies markedly among institutions. With a view to the following discussions, it is important to note the different possibilities for institutions to acquire certain types of funding, which leads to different compositions of their budgets. Some institutions rely mainly on state funding, whereas others attract considerable amounts of funding from tuition fees or projects co-funded by third parties (see Figure 1). According to calculations based on data provided by the MoES for those institutions that served as cases for this report, the share of tuition fees among the institutions' overall budgets, for instance, varies between 2.0 and 36.4 percent. The importance of the state funding models' different components also varies among institutions (see Figure 2). Among the case study institutions, income from second-pillar state funding amounts to less than 2 percent of the total income from the state in some institutions, but to more than 6 percent in others. The differences related to the research base funding are even more pronounced, with shares among the overall state income ranging from 1.9 to 22.3 percent among the institutions included in Figure 2. There also seems to be a relationship between the first- and second-pillar funding: institutions that hold a larger share of first-pillar research funding have also been able to attract a higher share of second-pillar funding. Research-related criteria are used in both allocation streams. The varying shares of income from the second pillar suggest that there is no across-the-board allocation, but that the objective of establishing an actual relationship between allocations and different degrees of performance in research has been achieved.

²⁴ Due to its particular characteristics, the third funding pillar will be touched on only briefly in the following subsections, but will be discussed more comprehensively under the heading of an overall balanced funding model (see "2.2 Balance and Context").

²⁵ The way in which funding under this third pillar is allocated to higher education institutions in Latvia does not allow for specifying the amount of funding that will be disbursed to institutions. First, higher education institutions compete with research institutes that are not attached to higher education institutions for some of the funding available. Second, not all funding foreseen under the different programs will necessarily be disbursed to institutions. However, the overall amount of funding for which higher education institutions can compete during 2014–20 amounts to EUR 225 million. According to the MoES, most of the 2014–20 programs are still in a development stage. Only few have already been started in 2015. Therefore, institutions will have received the first funding only in 2016.

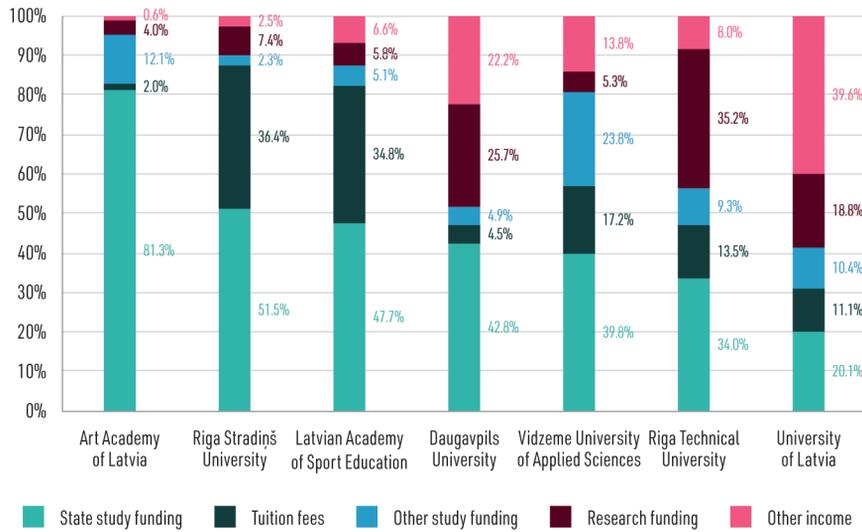


Figure 1 Income structure of selected Latvian higher education institutions, 2015

Source: Ministry of Education and Science.

Note: Riga Stradiņš University includes funds allocated to Red Cross Medical College of Riga Stradiņš University; University of Latvia includes P. Stradiņš Medical College and Riga Medical College of the University of Latvia. "State study funding" consists predominantly of basic study funding; "Tuition fees" includes tuition and student fees; "Other study funding" includes income related to the study process from a variety of EU structural funds instruments, stipends and scholarships from non-state donors, and infrastructure income from projects related to the study process; "Research funding" includes basic and performance-based state funding, EU structural funds income related to research, and income from state research programs, obtained research grants, and so forth; "Other income" includes third-party funding (including from municipalities) and EU structural funds for infrastructure projects not directly related to research.

The income categories are based on MoES data and have been slightly regrouped for the purpose of this report. There are general challenges related to the funding data of Latvian higher education institutions. Institutions use different ways of categorizing data so that the comparability among different accounts is limited. There has been no systematic adaption of data reporting practices following the reform of the system-level funding model, but such an adaption is currently being considered by the MoES. As mentioned in footnote 9, according to the MoES, most of the 2014–20 structural funds programs are still in a development stage. Only a few have been already started, in 2015. Therefore, institutions will have received the first funding only in 2016. The data in this figure will therefore refer mostly to the income from the 2007–13 structural funds programs.

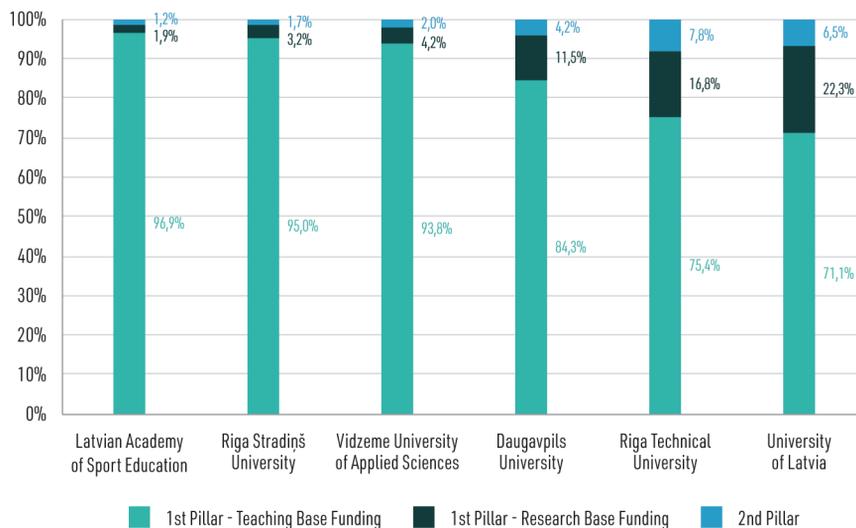


Figure 2 Composition of state income for selected Latvian higher education institutions, 2015

Source: Ministry of Education and Science.

Note: Riga Stradiņš University includes funds allocated to Red Cross Medical College of Riga Stradiņš University; University of Latvia includes P. Stradiņš Medical College and Riga Medical College of the University of Latvia.

a) Strategic Orientation and Incentives

Institutional Revenues and Internal Allocation

Higher education institutions in Latvia have developed internal funding models generally capable of translating the incentives set by external revenue streams into corresponding internal incentives — thereby also establishing a connection between system-level policy objectives and institutional activities. Comparing the underlying logic of institutional income streams with their internal distribution reveals that external and internal financial incentives are essentially in line with each other. This can, for instance, be observed with respect to the institutions' income from the performance-oriented pillar of the state funding model, which most institutions allocate internally based on the same orientation toward performance and with the same focus on research activities that also characterize the allocation from the state to institutions (see also below). The correspondence of the external and internal allocation logic holds true irrespective of the composition of the institutions' budgets and their basic approach toward internal funding allocations. The reform of the state allocation toward performance orientation in research coincided with a readiness of the universities to pick up such incentives, even if the financial impact related to the overall budget is limited. Few universities had already anticipated such performance-oriented funding and had implemented performance-based internal funding mechanisms before the change of the framework set by the state created a momentum for internal changes.

The alignment of external and internal financial incentives is important for institutions, because it has a strong impact on their capacities to generate funds and secure a sustainable financial basis. Such a financial basis is also a precondition for providing institutional subunits with sufficient financial stability. If the internal incentive structure is incompatible with the one of the income streams, risks of unsustainable levels of revenue generation — and particularly spending — may emerge. Especially in the case of performance-based allocations, in some universities the corresponding incentives on the two levels stimulate the units' and individuals' activities and performance in a direction that increases revenues from the state funding model. In others, this does not yet appear to be the case. This is likely to put the first group of universities at a competitive advantage. Revenue generation capacities and the design of internal funding models, especially related to the allocation of base funding, are furthermore important factors behind the financial stability of institutional subunits, which allows them to fulfill their core academic tasks properly.

Looking at the different funding streams separately, it appears that the study place component more or less automatically aligns with national priorities as these funds are allocated to institutions in connection with a clear purpose. The discussions between institutions and the MoES — and, where applicable, their respective line ministry — on the allocation of study places determine the size of this income stream, and the resulting agreements state that the funds have to be used in line with the objectives negotiated, that is, the academic preparation of a certain number of professionals in different fields. Regulations pertaining to these funds reinforce their alignment with system-level objectives (see below for details on the institutions' flexibility in using study place funding). Even though there are certain possibilities for internal realloca-

tions,²⁶ cross-subsidizing between programs or diverting funds to other purposes on a broader scale appears hardly possible as the institutions mainly distribute the funds in correspondence with the agreements on study places, leading to a close alignment of external and internal allocation systems.

A key issue related to the state funding for study places concerns the financial stability of institutional subunits. The state funding for study places and research base funding are both part of the first pillar of the state funding model. One of the functions of this pillar is to provide institutions with a *sufficient* degree of financial stability that enables them to perform their academic activities in an appropriate manner. In the case of institutions whose subunits have their own budgets,²⁷ the proper fulfillment of the core academic tasks by institutions furthermore depends on the financial stability of units, which internal funding models have to establish. However, unit-level financial stability does not imply that the institutions' academic structures have to remain unchanged; adaptations of these structures can be advisable for various reasons, including greater internal efficiency and stronger integration of teaching with research. In general, the degree of unit-level financial stability is strongly influenced by the interplay of two factors: (1) the degree of stability of base funding allocations from the state to institutions, and (2) the mechanisms used for the internal allocation of base funding within institutions.

The total state expenditures for study places and the related income of institutions remained more or less stable in recent years, but there were major changes to the allocation mechanisms on the state level. State funding for study places²⁸ (for a discussion of financial stability related to research activities see below) remained more or less stable from 2011 to 2016. During this period, the lowest overall amount allocated to institutions was EUR 80.7 million (in 2013) and the highest amount was EUR 87.0 million (in 2015). The highest year-on-year decrease was 3.9 percent (in 2016), wherefore overall funding levels cannot be considered a threat to institutional or unit-level financial stability. The income development of the seven case study institutions during 2011–16 confirms this. During this period, there are only three instances among all seven institutions where a year-on-year decrease exceeded 2.5 percent.

In contrast to the stability of overall funding levels, the specific modalities of study place allocations have undergone changes in recent years. The most important change from the perspective of institutional and unit-level financial stability concerns the distribution of study places among fields. Following the priorities within the MoES with regard to expected labor market demands, the number of study places in the field of social sciences gradually decreased, whereas

²⁶ Distinguishing the internal funding streams related to the institutions' income from different types of students is difficult. Nevertheless, questions concerning the internal reallocation of funding for doctoral students are discussed in the note "Latvian doctoral studies and promotion system" made available to the public concurrently with this report.

²⁷ From the perspective of an assessment of internal funding models, unit-level financial stability only emerges as a relevant issue in those cases where units are able to command a significant share of the resources spent on their activities. Given that salaries account for the major share of costs in most cases, the following discussion of internal allocations in the context of unit-level financial stability addresses only those institutions where salaries are paid from unit-level budgets.

²⁸ Overall state funding for study places comprises funding from the MoES as well as from other line ministries, namely, the Ministry of Health (for Riga Stradiņš University), the Ministry of Agriculture (for the Latvian Academy of Agriculture), and the Ministry of Culture (for the Latvian Academy of Culture, the Art Academy of Latvia, and the Jāzeps Vītols Latvian Academy of Music).

the number of study places in the STEM fields increased. These changes are implemented gradually, providing higher education institutions with possibilities to react to the changes. The more or less stable overall funding levels combined with shifts between fields to which study places were allocated suggest that institutions have the possibility to forward financial stability to units via study place funding in some fields, while adjustments are required in others.

The relationship between financial stability on the system and the institutional level on the one hand, and financial stability on the unit level on the other hand also depends on the internal funding models and the specific mechanisms used for the internal allocation of base funding. The key issue in this respect is whether institutions allocate study place funding internally based on factors that are more or less stable over time, for example, student numbers or — at least in some fields — the number of study places. For example, basing internal funding more on numbers of graduates may lead to a stronger redistribution of funds if completion rates differ among disciplines and programs. Considering only those institutions that have unit budgets (see footnote 13 for details), all institutions (that is, three of the seven case study institutions) foresee a connection between the internal allocation of study place funding and stabilizing principles, such as the number of state-funded study places allocated to units or the workload connected to implementing programs to which state-funded study places have been allocated. Also in the case of institutions that cover most expenditures directly from the central level, a link between funding decisions and either the distribution of study places among units or other stabilizing principles such as student numbers can be observed in some institutions (this is the case for at least two of the seven case study institutions), whereas in other institutions this link is — based on the information available — not explicitly observable.

More possibilities for a deliberate alignment of incentives exist in the case of the research-related component of the first funding pillar. Institutions enjoy latitude in deciding on the way in which these funds are allocated since internal allocations are not connected to a purpose as specific as in the case of state funding for study places. There is only a general provision in a cabinet regulation that these funds have to be used for research-related purposes such as the salaries of scientific staff members, preparing commercialization activities, co-funding projects, and implementing institutional strategic objectives. Some institutions use their freedom to reward research performance via this funding stream, also along the lines of the system-level objectives for research, with a potentially positive effect on the amount of research base funding and on the income from the second funding pillar (see Figure 2).

The research base funding provided by the state appears not to translate into a stable basic allocation supporting units' research activities in all cases. Three reasons why not *all* units receive stable basic funding supporting research activities can be identified: (1) the fluctuations in allocation *levels* from the state to higher education institutions, (2) changes to the allocation *mechanisms* on the state level, and (3) the internal allocation mechanisms of institutions. Compared to the state funding for study places, research base funding²⁹ allocations from the state to institutions exhibit greater fluctuations. Despite an overall increase

²⁹ In contrast to the state funding for study places, all research base funding is allocated by the MoES.

in the amount allocated to all higher education institutions, from EUR 7.8 million in 2011 to EUR 14.3 million in 2016, there was a significant decrease of 10.9 per cent in 2013. Moreover, all but one of the seven case study institutions have witnessed a year-on-year decrease in research base funding exceeding 10 per cent at least once during 2011–16. Four of the seven institutions even experienced a year-on-year decrease exceeding 50 percent (even though these were the institutions where research base funding accounts for a comparatively small share of the overall income from the state). The mechanisms behind the allocations of research base funding changed fundamentally in recent years. First, following a new cabinet regulation in 2013, greater weight was attached to research quality within the formula used. Second, the outcomes of an external assessment of research institutions in Latvia — which include institutes within higher education institutions that can receive research base funding — were used for research base funding allocations. On the one hand, highly-rated institutes received additional funding in 2015. Units with low ratings that undertook neither attempts to merge with other institutes nor efforts for structural reform, on the other hand, do not receive research base funding anymore from 2016 to 2019 (that is, until the next round of the research assessment), most likely leading to an amplification of earlier trends.

Finally, the mechanisms used for allocating research base funding within institutions have the potential to further reduce the stability provided via research base funding. In this, the institutions' internal funding models can be oriented toward factors other than stability, such as a strategic pooling of limited funds that results in a targeted allocation of funds, for example, for research clusters or priority areas. Leaving aside those institutions that have no unit budgets (see above) or that receive only very low levels of research base funding, all remaining institutions (that is, three of the seven case study institutions) allocate a significant part of research base funding based on non-stabilizing factors (for example, performance indicators), a competitive basis, or discretionary decisions (even though these could as well be linked to stabilizing factors). Only if performance levels remain stable among different academic units, funding will be stable as well. But as soon as performance levels fluctuate or start seriously diverging from each other, budgetary capacity and (in)stability will also evolve in desired or less desired directions.

The scope for a targeted alignment of incentives is related particularly to the second pillar of the state funding model. However, in at least some institutions there are notable differences between the objectives pursued by the state- and the institution-level funding model. On the system level, allocations are based on the institutions' performance in the field of research, namely performance related to the development of human resources, international competitiveness, and links with external stakeholders. All institutions assume the general direction of these objectives and support research and research-related activities via their internal allocation mechanisms. However, whereas some institutions focus allocations on research exclusively, some address a far broader range of objectives, including a range of indicators related to research, teaching and learning, and valorization, for example, drop-out rates, number of publications, and international patent applications.

Turning from the objectives pursued by allocations to the mechanisms used for allocations: Institutions also take up the performance orientation of the second pillar of the state funding model, even though differences among

the specific allocation mechanisms exist. Adaptions of the mechanisms used on the institutional level can be necessary depending on internal steering cultures or specific situations. Even minor adaptions can serve this purpose. Within one Latvian higher education institution a formula-based allocation model is complemented by target agreements to better align allocations with the implementation of the institutional strategy (see Example 1). Such an improved alignment can also be established by using entirely different allocation mechanisms such as internal competitions for project funding, which is a second approach to be found in Latvia. In this way, funding allocations can be focused on strategic priority areas of institutions and support their future development. A third allocation approach used by some Latvian institutions is forwarding the funds directly to the units and individuals that generated the income. Some institutions split up the performance-based income and allocate the parts with different mixtures of allocation methods. By doing so, institutions are able to pursue more than one objective at the same time, for example, promoting overall strategy implementation and putting particular emphasis on supporting doctoral students, or providing incentives to units as well as to individuals (see also below).

Example 1 Adapting system-level allocation mechanisms to institutional circumstances

The internal funding model of Riga Technical University (RTU) was changed in 2015 to exhibit a direct and clear link between internal funding allocations and the institutional strategy. A system of performance agreements at RTU preceded the governmental implementation of the second pillar funding. At RTU, a range of key performance indicators (KPI) are derived from the three core objectives of the institutional strategy: a high-quality study process, excellence in research, and sustainable innovation and commercialization. Each year, faculties discuss with the rectorate the objectives to be achieved within the following year for a number of indicators in each of these three activity areas:

- Teaching and learning (for example, student and graduate numbers, drop-out rates, average age of academics, and number of subjects taught in English)
- Research (for example, the number of scientific research staff, external research projects, publications, and citations)
- Innovation and commercialization (for example, the number of patent applications, agreements with companies, and spin-off companies created).

Following the introduction of the performance-based funding pillar of the state funding model, internal funding allocations that are also based on a formula have been introduced at RTU. However, the formula-based allocations are directly connected to the abovementioned KPIs. Slightly more than 50 percent of RTU's income under the performance-based funding pillar is allocated to faculties in this way.

Turning to the institutions' revenue streams that do not come from the state, particularly strong links between external and internal incentives can be observed. Since institutions allocate income from tuition fees and third-party-funded projects to the units that generated it, units benefit directly from engaging in these activities. It is a common practice, however, that a share of these funds is retained by the central level for various purposes, such as infrastructure funds or central improvement initiatives.

Additional practices of aligning external and internal financial incentives can be observed by looking at internal funding models as a whole. The performance-based income, for example, is used by institutions to support research activities, which has the potential to increase income from the research component of the first funding pillar since it is allocated to institutions partly based on their performance in this area. Another example is deductions made from tuition fee income and third party-funds that are used to provide co-funding for additional income-generating projects.

The general tendency toward a balanced alignment of incentives between the system-level and institution-level funding models nevertheless leaves room for systematically reflecting and improving this alignment, including planned deviations from the system-level model. In general, an adequate alignment comprises more than transferring the state model to the institutional level. In this sense, higher education institutions in Latvia have already developed various instruments that reflect both external and internal priorities, for example, the indicator-based performance agreements in Riga Technical University (see Example 1), and allocate (some) resources on that to purposefully achieve alignment and in some areas planned deviation. As will be discussed in greater detail below, institutions benefit from explicitly and systematically reflecting their strengths and weaknesses vis-à-vis the funding allocations by the state and other income sources, and taking up the outcomes of this assessment in the internal management. One example in this respect is how different institutions exploit their potential to acquire funds from municipalities, which are also rewarded by the performance-based allocations of the state funding model. Whereas some institutions have already taken decisive actions, others have not yet taken on this challenge, because they may lack the means or ideas how to do this.

Incentives and Leadership Capacity in Implementation of the Strategy

In addition to an alignment of external and internal incentives and the uptake of system-level objectives, good internal funding models also must integrate the profile and objectives particular to an institution. Different mechanisms for this integration have been established by the higher education institutions in Latvia. All institutions possess at least some kind of strategy that can serve as the basis for connecting funding models and institutional profiles and objectives. Some have also developed action plans to guide the process of strategy implementation (for an in-depth discussion of institutional strategies see “3.2 a) Strategic Development and Governance”). Some institutions use their strategies for discretionary allocation decisions by evaluating budget requests from units based on their fit with institutional objectives. Others have developed a more formal link by making their strategies the basis for formula-based allocation mechanisms from which indicators are derived or by focusing competitive funding for projects exclusively on priority research areas determined in the strategy. These approaches are not only applied to the internal allocation of performance-based income, but also of research base funding. Some institutions have also installed funds dedicated to their development in line with strategic objectives built mainly from the central levels’ deductions from tuition fee and third-party income, even though these funds appear to be of limited size in most cases. Finally, some institutions pay general salary bonuses tied to the individuals’ contribution to institutional strategic objectives.

There are, however, factors that confine the contribution of internal funding models to the implementation of institutional strategies and profiles. Since these do not apply equally to all institutions, the extent to which funding allocations can be used as a strategic instrument differs from institution to institution. As has already been mentioned, there are funding streams that hardly allow for a targeted internal allocation, among them the income related to state-funded study places. The agreements resulting from the yearly negotiations between higher education institutions and the MoES — and, in the case of those institutions where the MoES is not the supervising ministry, their respective line

ministry — as well as labor market representatives, that cover, among others, the number of state-funded study places state the purpose of this type of funding, including the expected outcomes (that is, a certain number of study places and graduates in different fields). The general obligation that institutions have to use the study place funding for the purpose it was allocated for can also be found in a cabinet regulation. **Even though there are no further, detailed provisions, for example, a fixed amount to be spent per student enrolled on a state-funded study place, significant deviations of internal allocations from the negotiation outcomes appear to be hardly possible.** In practice, most institutions establish a direct link between the study places allocated to them and the internal distribution of study place income. As a matter of fact, this apparent lack of flexibility related to the use of study place funding is one of the factors behind the more general issue that the amount of money that can be used to promote strategic development is rather low in some institutions.

The impact of funding models can also be impaired by a lack of conciseness of institutional strategies. If an institutional strategy, for example, contains too many objectives without signaling which activities are given priority, then it is difficult to provide clear financial incentives to units and individuals in line with the institutional strategy. Another aspect that needs to be considered in this respect is the institutional leadership’s capacity for influencing the design of internal funding models so that these contribute to institutional objectives. This will be discussed in greater detail below (see “3.2 d) Good Governance 2: Differentiation of Functions and Distribution of Powers”).

While further-reaching impacts of the introduction of the new funding model will become fully visible only in the future, already now initial effects of the performance-based funding model can be observed. Of particular importance in this respect is that the — often scarce — income from the second pillar of the state funding model and other resources open to strategic allocation are spent in a targeted way (see Example 2). This concerns, for example, institutional profiles and missions such as a focus on applied research or regional engagement. These as well as other characteristics of institutions could be taken up more strongly by internal funding models, for example, via target agreements linked to funding for specific projects or via the adaption of indicators used within funding formulas.

Example 2 Allocating scarce funds strategically

When deciding on parts of the internal allocation of income from the performance-based pillar of the state funding model, the University of Latvia (UL) opted for a particularly focused allocation mechanism. Parts of the performance-based income of UL are used to provide financial support for research activities via tender-like processes. Only activities that contribute to the priority research areas are eligible for funding. That way, UL not only established a direct link between internal funding allocations and its institutional strategy, but also secured a focused impact by avoiding spreading funds across the entire institution. In this, the internal funding model of UL provides another good example of a sensible adaption of external allocation mechanisms to institutional conditions.

Another key factor behind the impact of internal funding models in Latvia is the operationalization of internal allocations of performance-based income and the ensuing degree of strategy and performance orientation.³⁰ For this purpose, two major allocation mechanisms can be distinguished, which are both practiced in Latvia: allocations based on “discretionary” decisions, for example, when projects are selected for financial support, and criteria-based allocations, for example, within funding formulas. In the case of the former, the degree of strategy and performance orientation is mainly the outcome of the design of related decision-making processes and criteria. The main challenge here is to ensure that decisions exhibit a direct connection to institutional objectives and that the process and link to strategic objectives is clear to all applicants. In the case of formula-based allocations, a first basic issue to consider is the share of indicators that actually measure performance, and not inputs, and their weight among all indicators. Closely connected to this aspect is the overall number of (performance) indicators. On the one hand, too few indicators can lead to the perception of unfairness if units consider the internal funding models to be skewed toward the outcomes of other units, which limits the strength of incentives deriving from the funding model. Too many indicators, on the other hand, can render the internal funding models ineffective as well, if no clear and sufficiently strong incentives derive from them. With many indicators “everybody will gain something.” Especially considering challenges related to a high number of indicators appears to be relevant for some Latvian higher education institutions. Common to both aforementioned scenarios is the question whether institutional cultures and subject-specific issues are sufficiently respected by the measurement of performance, a requirement for balanced allocation mechanisms that provide incentives for all units and individuals. Here, one mitigating measure that higher education institutions in Latvia could consider is a certain degree of diversity and flexibility of measurements, that is, indicators and their weighting. Again, questions of fairness can easily arise at this point.

To systematically establish and preserve institutional capacities for strategic steering via internal funding, the alignment of profiles and strategies with allocation mechanisms must be assessed continuously. For this, internal procedures for the reflection on the alignment and for the adjustment of funding models need to be introduced, which also take into account the need for continuity of funding models discussed below (see “2.2 d) Balance and Context”).

Integration of Higher Education Missions in Internal Funding Models and Avoiding Unintended Side Effects

All missions of higher education — teaching and learning, research, and the so-called “third mission”³¹ — are accounted for in the internal allocation models of Latvian higher education institutions. From the perspective of incentives and strategic steering, however, there is a bias toward research and research-related activities as intended by the state funding model. Part of

³⁰ The issues discussed in the following also apply to the performance-based allocation of other types of funding, for example, research base funding.

³¹ Examples for activities falling under the third mission are: research cooperation and study programs designed together with the business sector, continuing professional development in a life-long learning context, widening participation of non-traditional students, contribution to developing or partner countries, spin-off companies, and different forms of direct interaction with society.

the reason behind the comparatively greater openness of the field of research to strategic steering attempts is the influence of the state funding model, which foresees a focus of the performance-oriented second funding pillar on the research mission. Even though some institutions choose to broaden the scope of activities rewarded under this income stream, the aforementioned bias remains. This bias is reinforced by the freedom related to the internal allocation of research base funding compared to the less flexible study place income, and by the (at least partial) performance orientation of this income stream. All in all, there is a greater orientation toward (rewarded) performance in the case of research, which is rational for institutions given the increased potential for revenue generation, and leads to greater potential for strategic steering in this field. Moreover, it appears that institutions were open to the incentives stimulating research activities because cutbacks after the financial crisis affected the field of research particularly severely. Comparable possibilities for strategic steering exist in neither the case of the teaching and learning-mission nor for the third mission — even though these activities might have a generally high priority for units if they are responsible for a significant share of the units' revenues.

Despite the bias of strategic steering capacities toward research, there are sporadic measures aimed at the other two missions as well. In the field of teaching and learning, some universities establish development funds for study programs, even though on a small scale. The development of study programs is also promoted by rewarding academics directly for their time spent on this activity. Many institutions (at least five of the seven case study institutions) also use first pillar funding not only to cover the costs directly accruing to the implementation of study programs but also to promote teaching quality via support for staff development and mobility or via funding quality-relevant support services. At least one institution has implemented a system for rewarding the teaching performance of units via first pillar funding, and at least two institutions reward individuals directly for their teaching performance via first pillar funding. These approaches are in addition to the possibilities for implementing teaching activities in formula-based allocations discussed above, as at least one institution in Latvia does in order to make teaching more efficient across faculties (pooling courses) and more directed toward quality. Approaches toward promoting the third mission used by institutions target research and development cooperation with external partners that are at least partly funded by the external partners. Support measures for this type of activity include seed funding and co-funding provided by institutions to enable the establishment and development of cooperation.

Every higher education institution is in one way or another engaged in all three higher education missions and should, therefore, promote each of them internally in line with its respective profile and mission. Moreover, given the interconnections between the three missions, securing their adequate integration should also be an objective of internal funding models.

Some characteristics of the allocation mechanisms in Latvian higher education institutions suggest that there is room for better integration of the different higher education missions. This could increase the institutions' flexibility in focusing on the different missions and lead to a more holistic notion of performance. One barrier to the integration of the missions is the existence of different external funding streams for teaching and learning and research (based on separate laws), which are distributed within institutions in different ways without connections to each other on a broader scale in most cases. This separation,

at least in some cases, also pertains to the negotiations surrounding funding allocations for different missions. However, selected approaches of integrating funding for teaching and learning and research under the first pillar of the state funding model can be found. This generally applies to the mutual benefits deriving from staff members who are involved in both types of activity, being funded by the respective funding streams. Additional forms of integration relate to graduate education (and can be found in at least two of the four case study institutions receiving relevant amounts of research base funding), where students can be involved in research, thereby directly benefitting from the infrastructure and research projects supported via research base funding, or be hired as technicians or assistants, also funded via research base funding.

Additional barriers to the integration of the missions derive from the paramount (financial) importance of one type of activity for some institutions, and especially units. Strong reliance on tuition fee income can lead to a focus on related activities at the expense of a more balanced activity profile. Similar skewed orientations of units and individuals can derive from the already mentioned stronger incentives for an engagement in research provided by many funding models. The issue here is that the lack of integration restricts the institutions' possibilities for focusing flexibly on the missions in different areas, and might limit certain benefits from an integration, such as teaching that includes state-of-the-art knowledge derived from research. Moreover, rewarding academics separately for teaching and research activities leads to a fragmentation of incentives. An integration of the missions could therefore promote the development of a more holistic notion of performance, even though its particular focus can differ among individual cases.

Related to the discussion of the integration of the different missions into internal funding models is another challenge, namely the unintended side effects of allocation mechanisms. Every internal funding model bears the risk that the activities of units and individuals are affected in ways not foreseen by the design of the model, leading to problematic behavior from the perspective of institutions as a whole. One such challenge in Latvia stems from the way in which study-program-related funds are distributed within some institutions. The allocation to lower-level units directly responsible for carrying out parts of programs, as opposed to allocations to units responsible for entire programs, might have a negative effect on the cooperation between them, even though more collaboration would be in the interest of the institution as a whole. Potentially impacting the field of teaching and learning in a negative way, as well, the overall focus on research of incentive models plus the less flexible and input-oriented study place approach can lead to a neglect of innovation through new, attractive study programs. Problematic side effects can also be observed in the field of research. For instance, depending on the way in which research performance is measured, there might be a bias toward researchers who are already successful, even though it would also be in the interest of institutions to provide less established or upcoming researchers with performance incentives. In at least one institution this is realized by providing doctoral students with funding possibilities on a competitive basis. Whatever the specific side effects, their mere possibility calls for a close monitoring of the effects of internal funding models to detect them as early as possible, to share good practices, and to take appropriate actions afterward.

Unit-Level vs. Individual-Level Incentives in Allocating Performance-Based (Pillar 2) Funding

One particularly relevant aspect of internal funding models in Latvia concerns the allocation of the income from the second pillar of the state funding model as (a) grants to units or project-specific funding, or (b) salary bonuses to individuals. Both types of approaches can be found in Latvia.³² Some institutions allocate the performance-based income exclusively to units, in the form of grants and funds tied to certain activities or project-specific funding. Others use it entirely to provide salary bonuses related to the performance of individuals. A mix of the two approaches can be found as well.

Both approaches can be used to provide performance incentives for university members, but the financial incentives directed at individuals via their salaries could result in some challenges in an academic context. Even though the low wage levels of some academic staff make attempts in the direction of salary bonuses understandable in Latvia, some of the critical sides of this approach merit consideration. As noted in the research literature (see, for instance, Frey and Jegen 2001), academics tend to exhibit a strong intrinsic motivation, that is, they choose to become academics because of a genuine interest in teaching, research, and the freedom of thought, as opposed to extrinsic, financial motives. Providing intrinsically motivated academics with financial incentives in terms of personal income for a variety of different activities can lead to the so-called “crowding out” effect, when intrinsic motivations are supplanted by extrinsic ones. A first mitigating measure in this respect is not rewarding single activities, but overall performance, for example, by classifying individuals into performance groups and rewarding them accordingly. Financial incentives could also be geared toward supporting academics with what they intrinsically value doing, for example, providing more financial opportunities for conducting research as a reward for research performance. Financial incentives could also be used in the form of short-term, one-off rewards, either financially or “in kind” (see Example 3).

A second major challenge related to incentives in terms of personal income is that once a certain level of bonuses has been reached, individuals get used to these levels and reductions have negative consequences in terms of staff motivation. This implies that establishing and especially increasing the level of bonuses constrains the financial freedom of institutions in the future. In addition, sanctioning a potential drop in performance becomes difficult due to the strong adverse motivational consequences. Finally, many activities in higher education institutions, among them those that are supposed to be incentivized in Latvia, such as research or knowledge transfer activities, are conducted by groups, wherefore providing funds not to individuals can be advantageous. Higher education institutions in Latvia will have to find a balance between the two basic approaches, especially considering the challenges that personal-income-related incentives bear in the long run (for an approach that mitigates this challenge, see Example 3). One aspect worth considering in this respect is that some of the abovementioned critical points also apply to the differentiation of

³² The following discussion also applies to other income sources used to provide financial performance incentives to individuals.

research and teaching positions in Latvia. This differentiation entails a fragmentation of payments for different activities, which — as discussed above — can pose problems in an academic context.

Example 3 Options for nonfinancial incentives for academics

At the Latvian Academy of Sport Education (LASE), the allocation of pillar-two funding is limited. Therefore, consideration is being given to allocating the funds to individuals based on performance, using a credit system for various types of achievements in teaching and research. Different possibilities are being considered.

A first approach would provide salary bonuses for individuals based on their teaching and research performance. A second approach would also reward performance but not in the form of salary bonuses. Rather, direct support would be given to individuals' academic activities, such as conference visits. The latter approach is an example of how incentives can be provided to individuals directly in a less problematic way.

b) Financial Autonomy and Sustainability

Institutional Financial Steering Capacity

The overall level of financial autonomy of higher education institutions in Latvia is comparatively high, with restrictions primarily being related to the availability of funds, and to limited possibilities for using study-place income flexibly. Institutions nevertheless use the flexibility they have within the limits of their financial possibilities, which vary greatly among institutions also due to their success in diversifying their revenues. Generally, the diversification of income sources is key for the sustainable financial development of institutions. Securing funds not only from the government, but also from students via tuition fees and from public and private entities via third-party-funded projects, enables compensating shifts in one funding source by shifts in others, increasing overall stability and spreading financial risk. In addition, cooperation with external entities can also promote institutional activities in other ways (see Example 4), for example, by securing financial support for students. As discussed, some institutions depend heavily on state funding, whereas others manage to attract relevant shares of their budgets via tuition fees and third-party income.

Example 4 Financial support for institutional activities via cooperation with external entities

Via a broader collaboration with a foundation, the work of the Art Academy of Latvia (AAL) is supported financially in different ways. In 2012, a memorandum of collaboration was signed by AAL and the Boris and Ināra Teterev Foundation, which now supports the activities and objectives of AAL by:

- providing students with grants
- supporting study trips of students
- supporting creative trips of the AAL teaching staff
- enabling AAL to honor achievements in its key fields of activity, namely visual arts, design, and art history, in the form of the Art Academy of Latvia Prize.

In addition, AAL's strategy development process was supported under a different project by the same foundation.

Most institutions have established measures to promote revenue generation by units. Notwithstanding barriers constraining the actual possibilities for revenue generation, the units' activities in this area are also a result of the incentives connected to them. This, first, concerns the possibility for units to directly benefit from the income they generated, which appears to exist in most institutions in Latvia. The incentives deriving from this are particularly strong in institutions and units with a low funding base. Second, internal funding models can provide additional incentives to engage in revenue generation. Some Latvian higher education institutions have implemented such incentives in their allocation models by financially rewarding income generation, which is in line with the state funding model. Some institutions have also established funds that provide seed funding for projects that have the potential to develop into bigger projects that lead to more income generation. In addition, nonfinancial support mechanisms can also be found, among them administrative support for attracting third-party funding and the systematic investigation of collaboration opportunities.

Closely connected to the different levels of revenue diversification, practices of reserve building vary among institutions as well. Acquiring funds from sources other than the state is particularly important for the establishment of reserves. Not only can these funds contribute to financial stability and sustainability in case of unforeseen decreases of income, they also enhance the institutions' capacity to promote their strategic development, among others by investments in capital-intensive projects that cannot be financed out of the annual budget. Even though possibilities for establishing reserves exist in Latvia, the financial situation of higher education institutions in general and the varying scope of revenue generation strongly limit the actual extent of reserve building.

Still, institutions that manage to build reserves use them strategically for different purposes. In addition to the mechanisms supporting research covered above, reserves built by institutions and their units are also used to finance some more resource-intensive activities such as accreditation procedures and larger investments in equipment and infrastructure. Overall, the financial potential to build reserves is very limited.

Another way in which institutions use their autonomy and the funding they generate is to co-finance state-funded study places or to create institution-funded study places. Institutions do not face any restrictions in this respect, but not all of them engage in those activities — which is at least partly related to the funds available to institutions. Some institutions (two of the seven case study institutions) provide co-financing to the state-funded study places. At least two of the institutions that create institution-funded study places (which four of the seven case study institutions do) focus these places exclusively on fields where graduates are in high national or regional demand, such as natural sciences. However, there are major shifts in the number of institution-funded study places created each year in at least some institutions.

Given the relevance of both revenue generation and reserve building, a comprehensive approach to these activities that goes beyond the selected approaches for promoting revenue generation mentioned above is worth considering. Such an approach could consist of structured plans for financial risk management and the diversification of the institutional income based on the assessment of an institution's strengths and opportunities for attracting funds. In the specific Latvian context, additional revenue generation could take place

via intensified attempts to use the existing funding sources, for example, by developing programs in high demand by fee-paying students. However, institutions could also turn to revenue sources that are not currently at the center of the attention of all institutions. Examples of this are philanthropic activities, summer schools, and activities pertaining to international students.

Unit-Level Financial Autonomy

The financial sustainability of units and their capacity for strategic development are at least partly an outcome of their size, their structural similarity (requiring a consistent definition of what a unit is), and their degree of financial autonomy. Currently, a move toward bigger units can be observed in some Latvian higher education institutions. In general, a wide range of unit sizes can be found in Latvia. Even within some institutions, the size of units ranges from a few to several hundred staff members. Of late, some institutions have started to consider rearranging their internal structures toward bigger entities. This could lead to benefits in terms of the financial stability of the bigger entities, and in terms of a more strategy-oriented use of resources. The issue of adapting internal structures is also relevant beyond the question of an appropriate autonomy of units. Especially when seen from the perspective of performance-oriented internal allocation mechanisms, restructuring units along the lines of a consistent definition of what a unit is, becomes relevant in order to enable consistent application of the mechanisms to all units. It appears that such a consistent definition is not used in all institutions. In addition to size differences, units formally on the same institutional level, that is, all treated as budget units, can comprise quite different entities ranging from departments and institutes to laboratories and specialized centers.

The degree of the financial autonomy of units varies among institutions, especially related to the institutional budgeting approach and the distribution of decision-making competences on spending. Whereas some institutions have only one central budget, others foresee separate budgets for every unit. The centralized budgeting approach, under which almost all funds are pooled at the central level and distributed from there mainly on a discretionary basis, severely restricts the financial autonomy of units, especially if combined with the distribution of funds along line items. These restrictions can be even greater if other aspects of autonomy such as the possibility of carrying over funds from one financial year to another are limited as well. In contrast, units having their own budgets and a far greater degree of financial autonomy can also be found in Latvia. There are, however, reasons for the centralized budgeting approach. Making critical decisions that became necessary during the financial crisis and the ensuing budget cuts for the higher education sector was facilitated by making decisions on the central level. In the case of small institutions, in addition, the administrative burden is reduced by having only one budget and, especially when funds are scarce, necessary adjustments can be made on the central level more easily and quickly.

In the face of current developments in Latvia, there are reasons to consider an increase of unit-level financial autonomy. Increasing unit-level financial autonomy would, for example, mean introducing block grants or lump-sum budgets for all units — an approach that has become common practice in Europe. One rationale behind this is the potential for increasing efficiency, if units directly

benefit from carrying out their activities in a less resource-intensive manner and have direct incentives to engage in cost-saving measures. In addition, units would also have greater incentives to spend their funds strategically. They also could react flexibly to changing needs and situations. A second reason for considering greater unit-level financial autonomy relates to the changes of the funding systems on the system and the institutional level. For performance-oriented allocation mechanisms to function properly, it is necessary that units can actually benefit financially via additional funds for their own budgets. And, given the fact that public budgets started to increase again, it seems rational to realize a parallel development in increased funds and greater decentralized autonomy. A first step in this direction could, for example, be the establishment of funding pools for deans, which would increase unit-level financial autonomy but not go as far as the introduction of lump-sum budgets for units. In such a situation, it is necessary to keep in mind that things that can be better and more efficiently organized collectively, that is, at higher institutional levels. The group size of more autonomous units is also important. Groups need to be large enough to mutually pool resources and spread risks, but not so large that individuals lose connectivity, responsibility, and loyalty to the group.

In addition to financial autonomy, there are two other key requirements for the strategic development of units: an adequate distribution of competences among the central level and the unit level, and that the financial autonomy of units is complemented with other powers. Units need a sufficient degree of autonomy to develop their own profile, albeit without hampering the coherent strategic development of institutions as a whole. To be able to promote their strategies, units require latitude in deciding, within certain limits, on their internal funding models. In that respect, it is relevant that decision makers have sufficient powers, so that freedoms can actually be used for strategic as opposed to across-the-board allocations. Units also must be involved in decision-making processes dealing with the institution-level funding model, so that their particularities and strategies are accounted for. The overall balance of central and decentralized competences, however, must be seen in the light of an institutions' size, history, culture, and mission. Nevertheless, compared to other European countries, units in Latvia have a relatively low amount of power and competences (see also “3.2 d) Good Governance 2: Differentiation of Functions and Distribution of Powers”), which would merit a reassessment in light of current developments.

c) Transparency and Feasibility

Aspects Related to Transparency and Fairness in Internal Allocations

The members of higher education institutions in Latvia have an overall understanding of the internal funding models, not least because of the comprehensive discussions held during their preparation (involving the World Bank team) and introduction, and the many internal meetings in which financial matters are discussed. The inclusive nature of the governance processes in Latvian higher education institutions (see also “3.2 c) Good Governance 1: Cooperation and Participation”) has a positive impact on the understanding of internal funding models by the institutions' members and on their transparency, at least at the level of unit heads. In addition, obtaining information by approaching

those responsible for the design of internal funding models seems to be possible in most institutions. At least some institutions have also taken action to inform internal stakeholders, for example, by providing units with guidelines on the functioning of allocation mechanisms. At other institutions, accompanying instruments like performance contracts increase the transparency of the funding logic.

Still, there is room for a more thorough understanding by institutional members. This would enhance the internal funding models' transparency and impact. The understanding institutional members have of the funding models of their institutions is a key factor behind the models' impact. Units and individuals need to know how they can increase their income, leading to greater engagement in those activities the funding models seek to incentivize. All internal stakeholders should, therefore, be familiar with what exactly they can do to benefit from the internal funding models. There should also be an understanding of the actual allocations, for example, of potential differences in allocations to units. In the case of discretionary allocation decisions, for example, it should be clear to all stakeholders how the decisions were made, that is, by whom and on what basis. The same degree of transparency should pertain to the allocations to nonacademic units, for example, when a share of some of the units' income sources is deducted for this purpose, and the practice of "taxing" by the central level more generally. Here, clarifying the relationship between the allocations to nonacademic units and the benefits produced by them is important. Some institutions (at least three of the seven case study institutions) apply deductions to their units' income to cover the costs of the central administration, of the support services, or related to premises, or to build reserves at the central level for future investments. In institutions where deductions are made (and for which detailed information is available), their share oscillates around 25 percent in study place funding and/or at least 5 to 35 percent in research base funding. All in all, not all units and individuals within Latvian higher education institutions apparently have an in-depth understanding of internal funding models, and especially an understanding of deductions by the central level and allocations to nonacademic units.

To promote an in-depth understanding of funding models and their transparency, systematic approaches are key. Informing internal stakeholders on the details of internal funding models and their outcomes is hardly possible via "one-off" information events like the discussion processes mentioned above. Systematic, regular information campaigns and processes, however, have not yet been established by the Latvian higher education institutions. There are nevertheless first attempts in that direction, for example by involving the marketing department in internal communication procedures or by increasing the visibility of performance differences among units by providing them with information on their performance on which allocations were based. Additional options would be to clarify the function of information multipliers and to make information on funding models a stated function of higher education management. One potential instrument in this context would be a yearly budget communication meeting between the central administration and the decentralized leadership. Systematic approaches are particularly relevant for the uptake of the newly introduced allocation mechanisms for the income from the second pillar of the state funding model, including the criteria used on the system (and of course also institutional) level.

The transparency of funding models is one factor behind the perception of their fairness, as is the strategic rationale behind the design of the models. If, for instance, discretionary spending decisions are made in line with strategic

priorities, for example, in the field of research, this connection to the strategy should be clearly communicated. The connection between strategic objectives and internal allocations should also be made explicit when deploying formula-based approaches. Making clear the reasons behind allocations becomes even more relevant when cross-subsidizing among units is practiced or when funds that were — at least from the perspective of units — generated by one unit, for example, via the second pillar of the state funding model, also benefit others. Especially regarding formula-based allocations, differences between fields and units must be implemented impartially to ensure fairness of internal funding models. Some Latvian higher education institutions do indeed consider field differences within their allocations models, for example, related to cost differences among fields and differences related to the applicability of bibliometric indicators. With respect to the internal allocation of study place funding, some institutions (at least two of the seven case study institutions) take up the study field coefficients used by the MoES. Others have their own ways of accounting for cost differences, for example, by developing their own coefficients or by reviewing all budget requests in detail (in total, at least five of the seven case study institutions take into account cost differences between fields in internal allocations). In at least some cases, however, it can be questioned whether the particular circumstances of fields and units receive sufficient attention.

Aspects related to Administrative Efficiency and Availability/Reliability of Performance Data

Irrespective of their specific design, internal funding models come with costs in terms of the time and resources needed for budgeting processes and for the administration of allocations. Moreover, if performance-based allocation mechanisms are used, additional investments to meet the accompanying information and data needs might have to be made. Basic investments in terms of time originate from the development and administration of funding models, including time for the related decision-making procedures. In addition, financial investments might become necessary, particularly if comprehensive adaptations of data and information delivery systems are needed, but also for maintenance costs. Internal funding models require accurate and trustworthy (performance) data if they are to be effective and fair, and some of these data might have to be collected for the first time. Moreover, new reporting practices can be required. A particularly challenging issue is cost data, which are, among others, needed for a field-oriented differentiation of funding allocations. Given all these costs, securing the efficiency of decision-making and administrative processes becomes important. However, efficiency always must be weighed against other priorities such as the level of precision of data.

Connected to the particular governance culture in Latvian higher education institutions, decision-making processes related to internal funding models and budget allocations are often time-consuming. Due to the inclusive, communication-intensive processes of internal decision making (see also “3.2 c) Good Governance 1: Cooperation and Participation”), decisions related to funding models and allocations require considerable time from the members in many institutions. Moreover, discussions between the institutional leadership and units during the budgeting processes are very fine-grained in some institutions, which adds to the workload resulting from the overall high number of budget units in some cases.

Comprehensive management information systems that deliver data of a sufficient quality do not exist in all Latvian higher education institutions, leading to major challenges for strategic steering approaches. In some institutions, various types and sources of data, including paper-based forms, that cannot be linked to each other easily, are used within internal budgeting processes. This can lead to problems with data quality and increases the resources needed to compile information for the decision-making processes. When considering the establishment of comprehensive management information systems (see Example 5), institutions would be well advised to look for data sets that are already available, for example, from their participation in U-Multirank (see Example 6). These data are not yet used for own institutional purposes. Reverting to the data set from U-Multirank, in which many institutions in Latvia participate and which is promoted by the government, could also lead to benefits related to nationally aligned data. Investments in data quality in this system could serve multiple purposes. Finally, efforts to further develop internal data and information management will become relevant in the context of the centralized higher education information system that is currently under development in Latvia.

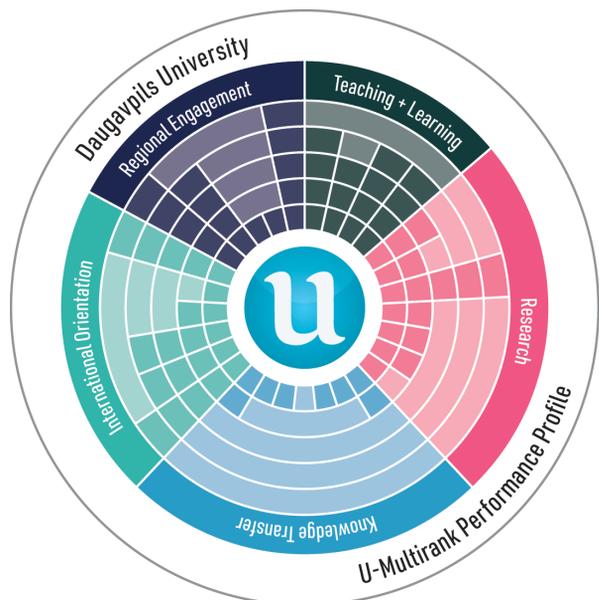
Example 5 Comprehensive management information systems

A particularly well-developed management information system can be found at Riga Stradiņš University (RSU). Based on software developed for the banking sector, the DIV information system was designed at RSU. A key feature of the system is that it provides precise data that are updated frequently. Moreover, the system not only provides standard information such as student and staff numbers, but also covers a wider range of internal management processes.

Example 6 Unused potential of readily available data sets

Data already collected by institutions but not used for strategic steering purposes can provide a good starting point for improving management information systems, as the participation of Daugavpils University (DU) in U-Multirank reveals. DU is one of the Latvian higher education institutions that participates in the multi-dimensional ranking U-Multirank. As shown in Figure 3, participants in U-Multirank like DU already have at their command various indicators on institutional activities - each of the "beams" of the sunburst chart represents one indicator (to which several more are added in the U-Multirank database). These data cover a broad range of activities, comprising the areas of teaching and learning, research, knowledge transfer, international orientation, and regional engagement, and are based on an elaborate methodology that represents a European standard of performance data for the higher education sector. In addition to institution-wide data, data at the disciplinary level are available for many disciplines.

Figure 3 U-Multirank profile of Daugavpils University (www.umultirank.org)



d) Balance and Context

Finding an Appropriate Balance among the Three Pillars

Whereas basic funding and, as of late, performance-oriented funding, are well-integrated into the internal funding models of most higher education institutions in Latvia, attempts to also provide targeted funding for innovations and profile-oriented developments are currently weak. In this, the situation on the institutional level mirrors the structure of funding received from the Latvian state. Base funding for teaching and research (the first pillar) still accounts for the major share of the institutions' income from the state and of their internal funding streams related to state funding. Due to the latest reforms on the system level, the performance-oriented component (the second pillar) has gained in importance also on the institutional level. Even though European Structural Funds are used to provide funding for investments in strategic projects to institutions (the third pillar), these funds do not lead to the development of a stable innovation-oriented ex-ante funding component within institutions, and are primarily aimed at stimulating research activities and targeted investments in infrastructure. A component of funding systems that systematically and on a broader scale provides financial support for projects before their realization, that are supposed to bring forward innovations and a clearer profile of institutions, has not been implemented, yet. This holds true for all higher education missions — teaching and learning, research, and the third mission. To attain well-designed internal funding models capable of systematically promoting the strategic development of institutions, the two approaches of funding future performance ex ante and rewarding past performance ex post would both have to be integrated into the systems in a balanced way.

Other imbalances in the financial situation and within the funding models can also be found in Latvia. One pertains to the overall funding situation and its effects on the management of funds. In the case of income from the second pillar of the state funding model, for example, some of it is used to compensate for low salary levels. While this was not the intention of this funding allocation on the system level, it is nevertheless understandable from the perspective of affected institutions. Another aspect has already been discussed in greater detail above — the focus on research of the allocations of performance-based funding within some institutions. One reason for this is the system-level objective behind this funding stream, but the focus is also understandable from an institutional perspective given the cutbacks to funding in the aftermath of the financial crisis and its strong impact on research activities, which can now be remedied via this new income source. The focus on research of performance-based allocations within institutions — as opposed to an input orientation of funding for teaching and learning — is reinforced by the performance orientation of research base funding on the system level and within some institutions, and additional funding possibilities for research activities in the form of competitive project funding.

To establish a balanced funding model comprising three funding pillars within Latvian higher education institutions, changes would be needed. A few approaches already pursued by selected institutions could serve as a starting point for such an undertaking. Considering some of the fundamental imbalances discussed above first, one of the objectives of such a model would have to be to cover all higher education missions — teaching, research, and

the “third mission”³³ — under each of the pillars, which is currently not the case in Latvia. This could also reduce the number of internal funding streams, leading to lesser complexity of funding models with a positive impact on their uptake within institutions. A second major shift would concern the innovation- and profile-oriented funding component. In some institutions, measures like development funds, even though small, have already been established. Starting with such an approach, the way toward a comprehensive and balanced model could also include the use of mechanisms that are not used to date in Latvia on a broader scale, among them target agreements. Moreover, a better-balanced model would also include shifting some parts of allocations from input-orientation toward output-orientation, for example, in the field of teaching and learning, where graduates or exams could be used as the basis for funding allocations, and not student numbers. For this particular aspect, but also for others like the reorientation of the performance-based allocations beyond research, progress cannot be achieved by institutions alone, but would require state actors to take a fresh look at the current model.

Continuity Aspects related to Funding Models

Internal funding models require a certain degree of continuity to develop an impact. Too frequent changes of the basic architecture and the specific mechanisms are likely to make institutions less attentive to current requirements, reducing their orientation toward those activities that are the target of financial incentives. Nevertheless, the adaption of internal funding models can become necessary, but changes should in general be made cautiously. In addition to the already mentioned stability over time, all changes should be based on a careful evaluation of the internal funding models’ impact.

In light of these requirements, and especially given the potential for change discussed above, related practices within institutions require attention. At least some institutions adapt their internal funding models regularly, albeit only pertaining to details in some cases, or have plans for future adaptations. It would be relevant in those cases to ascertain that even minor changes do not hamper the impact of the funding models and that they are based on a sound assessment of the previous impact of the models. Other institutions currently have no plans for a targeted development of their internal allocation mechanisms. In those cases — and especially if a general direction for changes is foreseen — medium- and long-term plans could be made concerning the adaptations and communicated internally. Implementing new models step by step, similarly to the state level, could be a good approach, but it must be transparent to the whole institution and there should be no surprises.

These requirements related to institutional practices equally apply to the system level. First, institutions should be assured that basic characteristics of the current funding model will persist so that they can better plan for the future. Second, future developments of the system-level funding model — among them the potential implementation of teaching and learning into the performance-oriented funding pillar — would merit being planned and communicated to the higher education community. This will help to plan and design internal models adequately, taking into account the alignment issue.

³³ See footnote 17.

2.3 Conclusions on Internal Funding

The reform of the system-level funding model has been taken up quickly by Latvian higher education institutions, however, the internal changes mostly pertain to the introduction of performance-based funding allocations. The resulting internal funding models fulfill many requirements for good internal funding models, but several challenges and room for improvement remain. Many good practices can be found in different higher education institutions in Latvia, even though the institutions are at different stages of development with respect to their internal funding models. There is neither a perfect model nor a one-size-fits-all solution. Institutions exhibit different strengths and weaknesses; all of them have developed good approaches in some areas but need to solve issues in others. This creates many possibilities for institutions to learn from each other in benchmarking processes and to exchange good practices for their mutual benefit.

Notwithstanding the many differences between the internal funding models of Latvian higher education institutions, focusing on key characteristics allows for an assessment of the status quo. This status quo is depicted in Table 2 based on the requirements for good internal funding models derived from international experiences and good practices, the World Bank team members’ professional expertise in the field, and criteria developed for the assessment of the Latvian system-level funding model. These requirements are outlined in detail in the report “International Trends and Good Practices in Higher Education Internal Funding and Governance,” made available to the public concurrently with this report.

Table 2 Status quo of internal funding models in Latvian higher education institutions

A. Strategic orientation	
A.1. Aligning internal funding model with external revenue streams and reflecting national goals	<ul style="list-style-type: none"> • Performance orientation and focus on research of the second pillar of the state funding model are taken up internally • Basic alignment of external and internal incentives is given for all income streams • Alignment of incentives connects system-level policy objectives and institutional activities
A.2. Promoting institutional strategies and profiles	<ul style="list-style-type: none"> • Funding models are connected to institutional strategies in different ways (including deliberate deviations from the system-level allocation mechanisms) • Scope for use of new models in support of institutional priorities remaining • Limited use of innovation funds to stimulate profiling
A.3. Promoting unit-level objectives	<ul style="list-style-type: none"> • Unit-level specification and differentiation are not clearly promoted by the internal funding models due to the current structural particularities

B. Incentive orientation

B.1. Creating performance rewards and sanctions	<ul style="list-style-type: none"> • Incentives are provided to units and/or individuals in most institutions • Performance orientation of state funding model's second pillar is taken up in most institutions; some institutions also provide performance incentives via other funding streams (e.g., research base funding) • Only a few performance incentives for teaching and learning and third mission exist • Challenges related to the impact of incentives exist (e.g., the lack of funding available for targeted allocations; major reliance on one income source for some institutions and units)
B.2. Providing clear and nonfragmented incentives	<ul style="list-style-type: none"> • Potential fragmentation of incentives in some institutions (due to high number of objectives/ indicators; fragmentation of rewards for different types of activities)
B.3. Avoiding undesired side effects	<ul style="list-style-type: none"> • Limited incentives to collaborate across programs and units in some cases • Potential neglect of innovation through new study programs due to overall focus on research of incentive models and inflexible study-place approach • Potential lack of targeted funding incentives for less established or upcoming researchers • Incentives provided to individuals directly bear particularly high potential for unintended side effects (crowding out of intrinsic motivation)

C. Sustainability and balance

C.1. Combining top-down and bottom-up approaches	<ul style="list-style-type: none"> • Financial autonomy and competences of units are limited
C.2. Providing a sufficient level of stability	<ul style="list-style-type: none"> • Marked differences in degree of income diversification of institutions and units (hence insufficient degree of risk spreading in at least some cases) • Funding models can forward the potential for stability provided by state funding for study places to units
C.3. Guaranteeing continuity in development	<ul style="list-style-type: none"> • Regular adaptations of models in at least some institutions • Communication surrounding change processes not always well developed
C.4. Balancing the overall model architecture	<ul style="list-style-type: none"> • First and second pillars established • Third pillar not developed yet within many institutions (e.g., lack of targeted support for innovative projects)
C.5. Promoting diversification of unit-level funding sources	<ul style="list-style-type: none"> • Funding models contain incentives for revenue generation activities • Revenue generation is directly supported in some institutions
C.6. Balancing the key institutional missions	<ul style="list-style-type: none"> • All missions are accounted for in internal funding models • Bias toward research in the incentives and strategic steering – reflecting the system-level funding model • Potential for better integration of missions

D. Transparency and fairness

- | | |
|--|---|
| D.1. Ensuring transparency | <ul style="list-style-type: none"> • Basic understanding by institutions' members and transparency exist • Lack of in-depth knowledge about functioning of funding models in some parts of institutions |
| D.2. Supporting the perception of fairness | <ul style="list-style-type: none"> • Perception of fairness promoted by extensive discussion processes surrounding internal funding models • Extent to which field differences are taken into account remains questionable in some institutions |
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E. Level of autonomy and flexibility

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|---|--|
| E.1. Guaranteeing financial autonomy and academic freedom | <ul style="list-style-type: none"> • Financial autonomy of institutions is comparatively high • Restrictions result from lack of available funds |
| E.2. Implementing an adequate level of regulation | <ul style="list-style-type: none"> • The corresponding level of regulation is adequate |
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F. Link to governance and management; practical feasibility

- | | |
|---|--|
| F.1. Increasing reliability and availability of data | <ul style="list-style-type: none"> • Information and data required for current allocation mechanisms available for the most part • Challenges related to different sources and types of data in some cases |
| F.2. Ensuring administrative efficiency | <ul style="list-style-type: none"> • Administrative efficiency hampered by extensive decision-making processes and restrictions in budgeting processes |
| F.3. Ensuring coherence with other governance approaches and university culture | <ul style="list-style-type: none"> • Internal funding models mirror governance approaches and take into account cultural particularities of institutions |
| F.4. Ensuring the ability of the leadership to act | <ul style="list-style-type: none"> • Scope of decision-making rights of institutional leadership and managerial capacity in the institutions questionable (due to far-reaching competences of collegial bodies) |
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3 Internal Governance

3.1 Internal Governance in Context and the Requirements for Internal Governance Arrangements

Internal governance arrangements are the backbone of every higher education institution's capacity for internal coordination and strategic development. Comprising “internal management structures, decision-making arrangements and leadership roles and the relationship between these internal functions and the role of governing bodies” (Middlehurst 2004, 259), internal governance as a concept focuses on the distribution of functions and powers and on structures and processes behind the legitimated determination of institutional strategies and policies (cf. Eurydice 2008). This distinguishes internal governance from management, which refers to the processes of implementing institutional objectives on a day-to-day basis within the strategy and policy framework determined via internal governance (cf. Eurydice 2008).

Changing approaches toward the governance of higher education systems have increased the importance of the governance structures and processes within institutions. Many governments, among them most of the European ones, have started to replace their direct influence on higher education institutions with more indirect forms of steering higher education systems from a distance. These new approaches center on the autonomy of higher education institutions — which, even though not an end in itself, is supposed to lead to improved outcomes such as higher-quality programs or more and better research results — which is framed by incentive mechanisms installed to gear institutions toward implementing policy objectives determined by the government and by enhanced accountability and quality assurance mechanisms. This requires higher education institutions that are capable of acting strategically (cf. Antonowicz and Jongbloed 2015; de Boer and File 2009). To live up to this requirement and thrive in increasingly volatile, competitive environments, institutions need to develop sufficient strategic steering capacities, which are first and foremost an outcome of the design of their internal governance arrangements.

Recent developments in Latvia and the comparatively high degree of institutional autonomy make assessing the internal governance arrangements of Latvian higher education institutions a worthwhile undertaking at this moment in time. The introduction of a performance-oriented pillar into the state funding model marks a shift toward a stronger focus on outputs in steering higher education institutions. Seen together with the possibilities deriving from the auto-

onomy of institutions, strategic steering capacities, and therefore also questions concerning the design of internal governance arrangements, have gained in importance in Latvia.

The following assessment of internal governance structures and processes in Latvian higher education institutions is based on a set of requirements for “good” internal governance arrangements developed in the context of a report on international trends and good practices in the field made available to the public concurrently with this report. There are no one-size-fits-all solutions for structures and processes of internal governance due to their dependency on the particularities of institutions and their surrounding higher education systems. Nevertheless, similar developments in the field of higher education governance, and challenges common to many higher education institutions, allow for identifying broader international trends and good practices with a wider applicability. These international trends and good practices have been investigated by the World Bank team based on the research literature and the professional expertise of the team’s members in the field, resulting in a set of requirements for “good” internal governance arrangements, which are summarized in Table 3 and discussed in greater detail in the report “International Trends and Good Practices in Higher Education Internal Funding and Governance,” made available to the public concurrently with this report. This set of requirements serves as the basis for the following assessment of the strengths and weaknesses of internal governance in Latvian higher education institutions, and for the recommendations offered in a separate report to be published in the first quarter of 2017.

Table 3 General requirements for “good” internal governance arrangements

A. Strategic development and governance	A.1. Having in place clear and precise institutional strategies aligned with institutional strengths/weaknesses and their environment
	A.2. Having in place action plans that structure and support the strategy implementation process
	A.3. Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process
	A.4. Developing measures for the implementation of strategies
	A.5. Monitoring the strategy implementation process and adapting instruments/objectives if necessary
	A.6. Securing and monitoring fitness for purpose of governance structures
	A.7. Accompanying institutional developments with change management
B. Autonomy and accountability	B.1. Securing academic freedom
	B.2. Maintaining academic integrity
	B.3. Anchoring accountability measures and quality assurance in governance structures
	B.4. Establishing adequate monitoring procedures and management information systems

C. Good governance 1: Cooperation and participation	C.1. Balancing responsibility of collegial bodies and personal responsibility and maintaining a cooperative approach
	C.2. Involving external stakeholders in institutional governance and securing their proper conduct
	C.3. Developing appropriate ways of involving internal stakeholders on different institutional levels
D. Good governance 2: Differentiation of functions and distribution of powers	D.1. Separating strategic and management tasks framed by checks and balances
	D.2. Equipping central leadership with sufficient and adequate competences
	D.3. Securing efficiency and transparency of governance structures
	D.4. Establishing an adequate level of devolution
	D.5. Ensuring staff development and developing human resource strategies

3.2 Status Quo in Latvia

a) Strategic Development and Governance

Strategy Development and Implementation

All higher education institutions in Latvia engage in strategic planning and have developed strategy documents. Due to a government requirement that obliges institutions to develop research strategies — which some institutions explicitly welcomed since it promoted internal deliberation processes — strategic planning activities give particular attention to research. At least some institutions have developed fully-fledged institutional strategies — also directly adapted to their institutional profile (see Example 7) — and related action plans that serve as the basis for the strategy implementation process. Determining the direction for the future development of institutions is one of the key functions of governance processes. Not least from the perspective of diversified higher education systems able to fulfill all higher education missions effectively and meet societal demands, it is important that institutions develop a profile and clear objectives for their future development. Documents such as institutional strategic plans are key in this respect, because they serve as the background for strategic planning on all institutional levels, and for the strategic steering of institutions. Higher education institutions in Latvia tend to use their strategies for exactly those purposes, among others, as a point of reference for their internal funding models. In addition, some institutional strategies also establish a direct link between institutional development and strategic objectives for the Latvian higher education sector as a whole.

Example 7 Taking up institutional profiles in institutional strategies

Vidzeme University of Applied Sciences (VUAS) is among the institutions that have directly taken up their institutional profile characteristics in their strategy. VUAS is a young institution that has a clear regional mission. This specific mission is also mirrored in the strategic priorities of the institution, which include knowledge transfer as well as providing “ideas leadership” within the region in which it is located. Part of the vision for the institution is the creation of an ecosystem consisting of the university itself, its cooperation partners, and its graduates, which becomes “one of the major promoters of shaping the future in Vidzeme” and influences “actively the processes in Latvia and [beyond] its borders” (VUAS 2016).

The discussion processes that led to the institutional strategies involved a wide range of stakeholders. In most cases, internal stakeholders including academic staff and students as well as external stakeholders, were involved in strategy development processes. The role of external stakeholders, however, appears not to comprise in-depth engagement in some cases, triggering the question whether a more intense involvement could be foreseen in the future — as is the case in many other countries. Another element that the strategy development processes of at least some institutions shared is the combination of bottom-up elements like extensive consulting processes, with the determination of the broad direction of the strategy and the development process itself by a smaller group on the central institutional level.

Concerning the institutional strategies themselves, there are different challenging issues worth noting. Overcoming these issues in the course of future strategy development processes might enhance the profile orientation of institutions and the impact of their strategic steering activities. There is a tendency of the institutional strategies to be rather generic and in some cases very comprehensive (amounting to between 200 and 300 pages), potentially limiting their use for guiding institutions toward a clear profile, and for the internal allocation models. A particularly critical aspect in this respect appears to be the alignment of the strategies with institutional circumstances and related institutional characteristics. However, strategies that are concise and specific and contain a clear profile can be found in Latvia as well. The extent to which the strategic objectives are operationalized also varies, which is another key factor influencing the strategies’ potential to effectively guide institutional development. Within some strategies, there are clear objectives for the different institutional priorities or even key performance indicators for annual targets broken down to the faculty level. Others, however, are less precise when it comes to breaking down the intended development into measurable outcomes. What remains questionable, in general, is the extent to which institutions establish a genuine link among different missions within their strategies, especially since there are examples for institutions where strategy-related discussions are separated for the different missions.

For the implementation of strategies, institutions need to have adequate measures and instruments in place. A first measure is the well-designed internal communication of strategies. On the precondition that strategies contain clear objectives, communicating these internally to all stakeholders is important for securing an impact by making the objectives serve as guidelines for the activities of units and individuals. Even though information flows in this direction exist in Latvian higher education institutions, more systematic communication strategies could be established. The implementation of strategies requires direct support for related activities, among others via internal funding allocations (see Example 1). As discussed above (see “2.2 a) Strategic Orientation and Incen-

tives”), there is ample room for more closely aligning internal funding models and strategies, especially via targeted financial support for initiatives and projects that directly contribute to strategic objectives.

Another important instrument for increasing the overall impact of institutional strategies is the monitoring of their implementation — and the ensuing adaption of instruments where necessary. A sound strategy implementation process requires a periodic assessment of whether goals are attained and how different units perform in this respect. This requires a sufficient quantity and quality of data provided by management information systems (see also “2.2 c) Transparency and Feasibility”). As a follow-up to the outcomes of these assessments, discussions about the suitability of instruments are necessary, and potentially also discussions about the objectives themselves. Internal governance structures must provide for this. Within Latvian higher education institutions, there are different approaches toward monitoring the progress of the strategy implementation process, ranging from yearly discussions between the central and the unit level on the issue, to a stringent system based on key performance indicators. Some institutions, however, do not monitor progress at all. To improve their capacities for strategy implementation, institutions could assess their internal monitoring procedures, including the availability of relevant information and data, as well as the suitability of their follow-up measures.

Anchoring and Connecting Higher Education Missions

Institutional strategies and internal governance structures as a whole should account for the different higher education missions and their connection. There appear to be some deficiencies in Latvia in this respect. There, for example, is a strong differentiation between teaching and research units in at least some institutions. A particular issue in this context is the fragmentation of teaching and research in the staff policy, which partly goes back to the existence of two national laws related to higher education.³⁴ There is a difference between teaching-focused “academic positions” and research positions to which academics are elected for six-year terms. One implication of this differentiation is a fragmentation of teaching and research within the personnel. This might lead to the perception that teaching and learning are lower-level tasks within institutions compared to research, negatively impacting the connection between the two fields of activity, especially if the two activities are also rewarded differently. One solution to this problem would be an academic staff structure that has only one type of status comprising both teaching and research duties, even though the importance of the two activities can vary with the specific tasks, positions, or persons. When it comes to the connection of the different higher education missions, another key factor is institutional strategies. As mentioned, some institutions exhibit a certain detachment of the different missions within their strategies. This can impact governance processes that are related to the strategies, for example, when strategy discussions between the institutional leadership and units take place separately for different missions.

³⁴ Because this issue is relevant within the context of internal governance and funding, a brief overview will be presented in the following. Due to its complex implications and the fact that staff-related topics will be covered by the second phase of the current higher education project, a detailed analysis will take place there.

In the face of the tendency toward fragmentation, a holistic approach is needed toward all three higher education missions — albeit under the framework of a clear institutional profile derived from the interaction of the different missions, potentially also including a specialization on certain topics. Such an approach would allow for new connections between the missions and related synergies to emerge. It would also enable a more effective and efficient differentiation among units in line with their different strengths.

Fitness for Purpose: Alignment and Adaption of Governance Structures

Governance structures are influenced by — and should account for — a wide range of factors, including political priorities, particularities of the surrounding higher education system, the institutions’ particular history, traditions, and values, and the profile and intended mission of an institution. The overarching goal in this respect should be to ensure the fitness for purpose of governance structures and processes, something that Latvian higher education institutions have started to get actively engaged in, but could pursue further. Given that governance structures and processes are no ends in themselves, but are supposed to support the development of institutions, adapting them to the objectives in question is key. This implies a continuous monitoring of their fitness for purpose, especially related to changing circumstances, including changes of the system-level policy priorities, and shifts in the institutions’ objectives.

One trend with the potential to increase the fitness for purpose that can currently be observed in some Latvian higher education institutions is the shift toward larger institutional subunits, affecting the basic academic and governance structures of institutions. The structure of academic units is very complex in some Latvian higher education institutions, comprising various faculties, institutes, units, departments, centers, and laboratories (see, for example, Annex 2). However, there are some changes that can be interpreted as a shift toward larger, more homogenous units (see Example 8), including the merger of units, the abolishment of groups of professors as a structural unit, and installing vice-rectors with the responsibility for field-oriented groups of faculties leading to an implicit new layer above the faculties. Similar developments can also be observed in other countries, where they are perceived to be good measures to stimulate internal cooperation by overcoming traditional (field) barriers and to create a critical mass within units, particularly for research activities. Additional benefits include the possibility of combining units with complementary strengths, and increasing administrative efficiency (for example, by limiting the number of members at certain decision-making tables). Bigger units also bring enhanced possibilities for the self-steering of units (for related challenges in Latvia see “2.2.b) Unit-Level Financial Autonomy”), which resonates with recent changes to the general steering approach in Latvian institutions. For this benefit to materialize, however, the devolution of powers would be required as well. The adequate size of units depends on the circumstances and characteristics of an institution; however, the smallest units should be large enough to be a bit diverse and robust to spread some risks, while being small enough to maintain a level of “collective responsibility and loyalty.” The developments in Latvian higher education institutions stop short of establishing matrix structures, which have become more common in other countries. Still, approaches in this direction exist, for example, the establishment of research platforms in line with the institutional strategic focus.

Example 8 Adjusting internal structures

Daugavpils University (DU) is currently undergoing a broad restructuring process that has the potential to increase the fitness for purpose of its internal structures. The restructuring process consists of the establishment of fewer, larger units, and has already been completed for the research institutes, but is still ongoing for faculties. This change process is in line with developments in various European countries, where institutions seek to establish units that have a critical mass and a greater potential for strategic development.

Attempts to improve the fitness for purpose of governance structures via adapting decision-making structures and processes can be found as well.

The starting point for this in many institutions is governance structures that are characterized by great complexity (see, for example, Annex 2), among others related to the number of bodies and actors involved in decision-making processes. One attempt to adapt governance structures has been to reduce the size of the senate in at least one institution; other institutions reflect similar changes, for example, related to the constitutional assembly. Other approaches followed by Latvian institutions include strengthening the position of deans (most prominently by increasing financial powers following the introduction of the second pillar of the state funding model), shifting the allocations of study-program-related funding to higher institutional levels, and simplifying the internal legislative framework.

Other possibilities for adapting governance structures should be considered by institutions. Some research institutes, for instance, are formally part of universities, but exhibit separate decision-making processes and strategies without links to the strategy of the university they are part of. Here, institutions could benefit from a more structured integration.

Irrespective of the nature and direction of efforts to change internal structures, accompanying them with an appropriate change management is very important. Otherwise, benefits connected to these changes might not materialize or reforms might fail altogether. Important in this respect are the intense internal communication of change processes and the deliberate search for shared interests across affected units. Moreover, if mergers are included, these benefits from being based on a sound analysis of possibilities and potentials for combining strengths of different units.

b) Autonomy and Accountability**Protection of Academic Freedom and Assurance of Academic Integrity**

Academic freedom is the basic precondition for a functioning higher education system. That is why securing it is an important function of governance structures and processes. In connection to academic freedom, internal governance must also ensure academic integrity, not least as one element of the accountability of higher education institutions toward the state and society. In Latvia, the principle of academic freedom is anchored in the Law on Institutions of Higher Education (LIHE), which also states that an institution's administration has "a duty to guarantee and respect the rights of students and academic staff" (LIHE 6(5)) in line with the other provisions on academic freedom. The law (LIHE 26(2)) also covers duties of higher education institution staff members that concern their conduct vis-à-vis the proper functioning of institutions, the rights of

other persons, and the fulfillment of their duties. Specific instruments through which institutions address academic integrity include ethics committees and codes of ethics (see Example 9). Institutions are also engaged in the prevention and detection of plagiarism via an electronic system, which institutions must join to be eligible for state-funded study places.

Example 9 Protecting academic freedom and assuring academic integrity

One of the instruments used in Latvia to protect academic freedom and ensure academic integrity is a code of ethics, such as the Academic Ethics Codex of the University of Latvia (UL).^a UL's codex, which was approved by the university's senate, defines five basic principles: academic freedom, fairness and justice, responsibility, loyalty, and respect and collegiality. The codex specifies the implications of the principles for the activities of academics, other staff members, and students. The way in which different internal stakeholders are supposed to contribute to the implementation of the codex is also covered.

Note:

a. http://www.lu.lv/fileadmin/user_upload/lu_portal/eng/general-information/documents/regulations/The_Academic_Ethics_Codex_of_UL.pdf.

Establishment of Accountability and Quality Assurance Mechanisms

When the system-level and institution-level steering approaches revolve around the autonomy of institutions and institutional subunits — a direction toward which Latvia is heading — accountability is of paramount importance.

This includes the accountability of institutions to external entities, especially the state as the major provider of funds, and to internal stakeholders, and the accountability of all decision makers within institutions to other internal stakeholders. Key instruments for establishing accountability are the institutions' reporting duties to supervising entities, transparency mechanisms related to internal decision-making processes, and quality assurance. From the perspective of internal governance, it is not the specific quality assurance mechanisms that are of interest, but the way in which quality assurance is anchored in the institutional structures and their connection to external quality assurance mechanisms.

Developments in the fields of system-level and institution-level quality assurance have gained momentum in Latvia in recent years. On the system level, an accreditation agency is in the process of becoming operational, even though it is still in a pilot phase — and there is an ongoing process surrounding the doctoral studies and promotion system that also addresses issues of quality assurance (see Example 10). Institutions have also started to further develop their internal quality assurance processes, which they are required by law (LIHE 5) to implement. At least in some cases, institutions relate their efforts directly to the provisions developed on the European level by actors such as the European Association for Quality Assurance in Higher Education (ENQA). The Latvian government has supported the participation of higher education institutions in the transparency tool U-Multirank, through which institutions can be compared — and benchmark themselves — against peers worldwide in a differentiated (that is, based on a range of indicators) way. A range of bodies and actors on different levels can be found within institutions that deal with quality assurance. Several institutions have a body on the central level responsible for quality assurance, but also bodies and actors dedicated to this function on lower institutional levels. According to a 2013 MoES survey, two basic internal governance-related preconditions for functioning internal quality assurance systems were given in more than 90 percent of the 30 institutions surveyed: consistent and

structured decision-making processes in the field of internal quality assurance, and continuous improvement processes. Sufficient resources for the maintenance of the systems, however, were available in only slightly more than half the institutions. An increase in regular meetings of internal stakeholders, and integrating quality assurance in more institutional processes, were among the issues identified for the improvement of internal quality assurance systems.

Example 10 Connections between system-level and institution-level quality assurance

One area where the interdependencies of quality assurance mechanisms on the system and the institutional level can be observed clearly in Latvia is doctoral education. A recent World Bank note on “Latvian doctoral studies and promotion system” (World Bank 2016b) observes that the current doctoral studies and promotion system in Latvia was developed before quality assurance mechanisms for the doctoral level existed. Since then, a national qualifications framework with defined standards, considerations concerning new forms of doctoral education, and an intensified engagement of universities in internal quality assurance processes has emerged. Possibilities for the accreditation of doctoral education are currently under development by the newly established Latvian quality assurance agency. These developments open up possibilities for improving the Latvian promotion system, as covered in detail by the abovementioned note, namely:

- replacing the distinction between doctoral training and the conferral of the doctorate by a new process that monitors and controls the creation of doctoral programs
- establishing schools for doctoral education that take on important (internal) quality assurance responsibilities
- evaluating the internal quality assurance systems of institutions via the accreditation agency.

These three steps toward a new promotion system provide a good example of how changes on the system level can impact the quality assurance processes of institutions. Broadening the scope of considerations beyond the field of doctoral education, possibilities for institutions to continue developing their internal quality assurance processes so that they fit with the new quality assurance arrangements developing on the system level emerge as a worthwhile undertaking.

Establishment of Monitoring Procedures and Management Information Systems

Despite attempts by institutions to improve their internal monitoring procedures and the quality of information and data used for this purpose, there is still scope to further develop the related structures and processes. As has already been discussed with respect to the internal funding models (see “2.2 c) Transparency and Feasibility”), challenges remain related to the information and data available to institutions. These include common definitions of indicators and valid data collection methods. The same holds true for the broader context of process monitoring and documentation, wherefore the establishment of management information systems (in connection to the centralized higher education information system) would be important as well. However, additional requirements would have to be met in this context. In addition to the information and data relevant for funding allocations, a systematic approach toward process monitoring and documentation also requires information on the background of the performance of units and individuals, among others, on their specific strengths and weaknesses, which can then be taken up within strategic steering discussions.

c) Good Governance 1: Cooperation and Participation

Cooperative and Participatory Approach – Transparency

Among the most striking features of internal governance in Latvian higher education institutions are the deep-rooted democratic culture and the highly interactive and inclusive decision-making processes on all institutional levels. When seen from the perspective of a balance between strategic management and academic participation common in many European countries, there seems to be a comparatively strong focus on academic participation in most institutions, even though some exhibit a more equal balance. This is among others manifested in the strong influence of the academic self-governance part of the governance structures on decision-making processes. One of the results of this governance culture is the high degree of transparency of decision-making processes, which is promoted by intensive informal communications accompanying decision-making processes, and the open internal distribution of the outcomes of discussions. The strong role of democratic principles in Latvian universities seems to be an important aspect of identification of internal stakeholders with the university; people apparently are proud of this culture. Other results appear more critical, however, among them a lack of efficiency of governance processes, the time-consuming character of decision-making processes and the ensuing challenge of making quick decisions if necessary, and a certain reluctance to make decisions that are not entirely uncontested.

Further complicating institutional governance processes is the abundance of internal bodies and actors, which adds to the lack of efficiency and negatively impacts the transparency of the overall structures. This complexity, which will be discussed in greater detail below, makes it difficult in several cases for internal stakeholders to get a clear picture of the details of internal governance structures and processes, including the rights and responsibilities of the different bodies and actors. It is generally questionable whether these rights and responsibilities are sufficiently well defined and evident.

Contrasting the current approach to governance in Latvian higher education institutions with the increasing need for a strategic development of institutions raises the question of whether a more nuanced balance between the responsibility of collegial bodies and the personal responsibility of higher education leaders and managers could be established. On the one hand, academic collegial elements and a cooperative and participative approach lead to the benefit of a broader consensus that can be relevant for bringing together the different interests within an institution. Such an approach also increases the acceptance and legitimization of decisions and, therefore, promotes their implementation. On the other hand, strategic development of institutions with clear priorities also requires decisions that might be beyond an egalitarian consensus of all actors involved. For these types of decisions, the personal responsibility component — within the limits of a vision shared by all stakeholders and framed by checks and balances to avoid autocratic decisions — is required. Another relevant aspect is that academic collegial decision-making processes tend to be time-consuming, whereas governance via increased personal responsibility exhibits higher efficiency and greater flexibility. That is why, in many countries, shifts toward enhanced personal responsibility and greater abilities to make decisions of individuals like rectors and deans have been initiated. A good balance between the two

elements is required. This implies that academic and student participation should be accounted for in the management structures and processes, and that organs of collegial self-governance should also be open to managerial approaches.

Especially in the Latvian context, where the current governance culture is cherished by many, gradual shifts toward a more managerial, personal-responsibility-focused approach that does not destroy the democratic culture is particularly relevant. An approach currently being discussed in some institutions that fulfills this requirement is transferring management responsibilities for study programs from boards to individuals. In a similar way, strengthening the position of deans (see Example 11) and, thereby, also faculties, can lead to gains in management capacities, without neglecting democratic elements.

Example 11 Strengthening personal responsibility

Riga Technical University (RTU) seized the opportunities provided by the reform of the system-level funding model to gradually adjust the internal distribution of decision-making competences by strengthening the position of deans. Before the introduction of the second funding pillar of the state funding model, funding within RTU was allocated to units below the faculty level. In a move to counteract the resulting weak position of deans, more than half of the new performance-based second-pillar income is used to provide faculties with their own funds, with the dean serving as budget holder. This, first, opens new possibilities for strategic development on the faculty level. Second, deans, as the ones bearing responsibility for the development of faculties, now have greater opportunities to do so.

Stakeholder Involvement

External stakeholders are involved in the governance of Latvian higher education institutions in different ways, but without formal rights and responsibilities in most cases. On the central institutional level, most institutions include representatives from the society and the economy via a so-called convent of counsellors or an advisory council. At least one institution has two bodies comprising external stakeholders on the central level, and in at least one other institution, the body does not currently meet regularly. Additional opportunities for external stakeholder involvement exist on lower institutional levels, for example, within the so-called governance councils of study directions that deal with the development of study programs. In general, the influence of external stakeholders is mainly of a more informal, consultative nature. Not all bodies convene regularly, and some are not directly tied in with the governance structure.

Due to the expertise and innovative perspectives they can add to governance processes, external stakeholders have become better integrated into governance structures in many countries. External stakeholders generally serve as a powerful link between institutions and their environment, be it civil society, the economy, or politics. Given their expertise from various backgrounds, they can also provide valuable input for strategic and financial decision-making processes, and act as part of the checks and balances to establish the accountability of institutions. They can also directly promote specific undertakings of institutions, for example, by supporting projects or acting as business angels. The value that bodies staffed with external members can have is also a result of their composition. This pertains to a diversity of backgrounds, that is, from civil society, the economy, politics, science, and the regional environment, including alumni of the respective institution. In this, external bodies should mirror the profile of the institution. However, the most important criterion for involving any external stake-

holder is his or her expertise. External stakeholders should be perceived not as representatives of their constituencies, but as experts that act in the best interest of institutions.

Contrasting the current situation in Latvia with developments and practices in other countries, a more formal and systematic way of integrating external stakeholders into governance processes could be beneficial. This could increase the overall dynamic between external stakeholders and institutions. A stronger involvement could yield particular benefits when it comes to the development of strategies, processes on the program level, and the approval of budgets. In the case of strategy development, for instance, institutions could further develop their processes for gathering and systematically taking up input from external stakeholders, probably also granting them formal rights to veto strategies. A more intense engagement with external stakeholders could also enhance their function as ambassadors for institutions, as a connection to society, and as supporters of different activities within institutions. This would require enhancing institutional capacities for involving external stakeholders in internal governance, for example, by providing them with sufficient support in terms of information and decision-making capacity, and ensuring clear and efficient formal links between institutions and bodies staffed with external stakeholders.

Given the democratic and inclusive nature of governance processes, the involvement of internal stakeholders is well-developed in Latvian higher education institutions. This also holds true for students. Student representatives are generally well informed and strongly integrated into institutions' decision-making procedures, especially on matters of direct relevance for them. Informal channels of information appear to be open to students in at least some institutions as well. The possibilities for getting engaged in the governance of institutions seem to be actively exploited by students (see Example 12).

Example 12 Involving students in institutional development

The potential benefits that can be derived from involving students more intensely in the development of institutions can be observed at the University of Latvia (UL). As in other Latvian higher education institutions, students at UL are well integrated into internal governance processes. At UL, students also proactively promote important strategic topics in the field of teaching and learning. The student council has, for instance, initiated and promoted efforts to further elaborate existing institutional policies on e-learning, language competency, and using internships as integrated elements of the study program curriculum. Such efforts can be taken up by institutions to promote the quality of their activities.

d) Good Governance 2: Differentiation of Functions and Distribution of Powers

Differentiation of Functions – Relationship between Strategic and Management Tasks

The two broad types of tasks related to the development of higher education institutions — the determination of strategic directions and their implementation via management — are not always clearly separated within Latvian higher education institutions. For both types of tasks to be carried out effectively, a certain degree of separation is required through their assignment to different bodies and actors. Some institutions in Latvia exhibit a well-working separation of strategic and management tasks, whereas in other, especially smaller institutions, this is not the case. A separation more and more common within many higher education systems is the assignment of a supervisory role related to institutional strategies, including the right to approve strategies and budgets, to a governance body that comprises external members and of strategy development and management tasks to the institutional leadership (which works together with internal stakeholders in the strategy development process). Due to the more informal role of the bodies comprising external stakeholders, this is not realized in Latvia — but could be an option worth considering for the future. If such an option is considered, accounting for the abovementioned requirements for a sensible involvement of external stakeholders is of paramount importance so that the respective bodies are a proper part of institutions acting in their best interest, and not a new layer of governance counteracting the institutions' autonomy vis-à-vis the state and politics.

Distribution of Powers

If governance structures and processes are supposed to contribute effectively to the development of an institutional profile and the implementation of strategic objectives, the institutional leadership must have sufficient scope to make decisions and promote their implementation. In all Latvian higher education institutions, academic self-governance bodies such as the senate strongly influence the operative activities of the institutional leadership, which includes areas such as funding. To support the abovementioned abilities of the institutional leadership, the rights and responsibilities of bodies and actors on the central institutional level could be delineated more clearly from each other. Related to funding, for example, a body like the senate could be responsible for determining the broader framework and general principles, whereas the leadership could decide on specific decisions and allocations.

Another key factor affecting the impact of governance structures and processes is their efficiency, which is hampered in many institutions in Latvia. Since there is an abundance of formal and informal governing bodies, units, and actors, decision-making structures and processes tend to be overly complex and fragmented in many institutions. These structures also lead to various persons holding “double positions” and additional, informal negotiation processes. In addition, the governing bodies like the constitutional assembly or the senate are large

in some institutions or have even been increased in size — despite recent initiatives to reduce their size in other institutions. These factors combined reduce the efficiency, flexibility, and speed with which decisions can be made. Moreover, making strategic decisions that relate to well-defined priorities, and may thus not benefit all parts of an institution to the same extent, would become difficult under such an arrangement. Even in those cases where decisions by governing bodies are reached in a comparatively short time, there is reason to believe this is mainly a result of extensive informal deliberation in preparation for those formal decisions.

Considering potentials for streamlining governance structures and processes could contribute to the development of higher education institutions in Latvia. This could include an explicit discussion of the current number of governing bodies in institutions, starting with the functions that must be fulfilled. Here, the abovementioned factors influencing efficiency would merit consideration as well. The task structures of governance bodies and actors should also be included in these deliberations, accounting for the need to strengthen decision-making abilities and the responsibility of different actors as part of a more managerial, personal-responsibility-focused governance approach. Shifts in the latter direction could also increase ownership within institutions. Given the importance of the specific conditions of individual institutions for identifying potentials for streamlining governance arrangements, related efforts would have to be based on an in-depth analysis of individual cases.

Challenges related to the design of governance structures and processes affect the unit level as well. This must be seen against the backdrop of a generally low level of autonomy and competences of institutional subunits in Latvia, wherefore the overall level of devolution within Latvian higher education institutions appears to be low. This leads to a particularly challenging position for deans, who in some institutions are responsible for the development of their faculties but do not have sufficient possibilities to actually influence it. Even in those cases where deans enjoy some financial powers, the extent to which these are matched by other decision-making powers remains questionable. One reason for this could be the way in which they are installed. In at least one institution, deans are elected by the faculty council, whose members are chosen with the involvement of the deans themselves. To arrive at a sounder way of instating deans that solves this problem of mutual dependency, faculty council members could be elected by the faculty, whereas the dean is proposed by the rector and approved by the faculty council. This would entail a twofold legitimization, both top-down and bottom-up. Similar challenges can also be found on lower institutional levels. There is a tendency in some institutions to discuss certain issues on higher institutional levels, which lower-level bodies could tackle better. One example of this is detailed discussions on study programs in the senate, whereas the councils of study directions might be a more suitable forum. In addition, there might be a lack of responsibility for study programs by the directors under the current governance arrangements in some institutions.

Comparing the current situation of institutional subunits and their representatives within Latvian higher education institutions with the situation in other countries raises questions concerning devolution. Even though the strategic development of institutions requires a strategic framework whose implementation can be promoted by the institutional leadership, many decisions are best made by actors on lower institutional levels, who have a better knowledge of the relevant

situations. In the face of the current powers and autonomy of units, and the more recent shift in strategic steering approaches in Latvia, it is worth considering a potential shift of selected competences among institutional levels.

Recruitment and Staff Development

One key factor behind effective governance structures and processes on all institutional levels is the different individuals' leadership and management skills and competences. Especially in the case of a steering approach based on autonomy, individuals must command a wider variety of skills, ranging from leadership and management skills to more technical skills such as those required for new steering instruments like performance-based funding allocations. Few individuals have these skills when entering leadership positions in universities. The same holds true for the administration. Following a general shift from traditional administrative tasks to a proactive management approach — which itself has not been completed in all institutions in Latvia — leads to different skill needs. The general shift here is from an administrator being driven by formal rules and their execution toward a manager who is able to create and use incentive systems for steering purposes. This new-type manager also needs to oversee the entire steering environment within and outside of institutions, and enable academic and administrative staff to provide quality services.

This makes support mechanisms and training schemes all the more important, which could be developed more systematically by Latvian higher education institutions (possibly with support from the MoES). Comprehensive management training schemes for staff members, academics, and administrators do not exist in Latvian higher education institutions, despite some initiatives such as ad-hoc training facilities and mentoring and coaching programs. Since these would be required, given the need for individuals with the right skill sets discussed above, Latvian higher education institutions should consider establishing human resource development strategies that would address those needs. In doing so, institutions could revert to training opportunities provided by different institutions in various European countries tailored to the particularities of higher education institutions. The institutions' efforts to build capacities could also benefit from peer-learning activities within Latvia that cover relevant skills and good practices related to new management and steering approaches.

3.3 Conclusions on Internal Governance

Higher education institutions in Latvia exhibit internal governance arrangements that are closely connected to a deep-rooted democratic culture and a highly interactive and inclusive approach toward decision-making processes. Comparing the internal governance structures and processes against requirements for good internal governance arrangements reveals both conformities and discrepancies. As with the assessment of internal funding models above, several differences among institutions related to internal governance arrangements need to be considered. However, there are again common key characteristics that enable a more general assessment of the status quo. This status quo is depicted in Table 4 based on the requirements for good internal governance arrangements derived from international experiences and good

practices and the World Bank team members' professional expertise in the field. These requirements are outlined in detail in the report "International Trends and Good Practices in Higher Education Internal Funding and Governance," made available to the public concurrently with this report.

Table 4 Status quo of internal governance arrangements in Latvian higher education institutions

A. Strategic development and governance	
A.1. Having in place clear and precise institutional strategies aligned with institutional strengths/ weaknesses and their environment	<ul style="list-style-type: none"> • All institutions engage in strategic planning • Particular attention is given to research/research strategies; some institutions have fully-fledged institutional strategies • Relevance of strategies for strategic steering purposes varies (due to, for example, generic character and lack of preciseness)
A.2. Having in place action plans that structure and support the strategy implementation process	<ul style="list-style-type: none"> • Not all institutions have developed action plans
A.3. Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process	<ul style="list-style-type: none"> • Discussion processes leading to institutional strategies involve a wide range of stakeholders • Extent to which stakeholder input is taken up is questionable in some cases
A.4. Developing measures for the implementation of strategies	<ul style="list-style-type: none"> • Different instruments for strategy implementation are in place (e.g., connection to funding models) • Scope for improvement remains in many institutions (e.g., systematic communication strategies; new funding instruments)
A.5. Monitoring the strategy implementation process and adapting instruments/ objectives if necessary	<ul style="list-style-type: none"> • Great variety among institutions related to strategy implementation monitoring (from hardly any monitoring at all to yearly discussions based on key performance indicators)
A.6. Securing and monitoring fitness for purpose of governance structures	<ul style="list-style-type: none"> • Fragmented structure of (heterogeneous) units and overall high complexity of internal structures • Several instances of decoupled research institutes • Attempts to consolidate academic structures and streamline governance structures in some institutions • Some deficiencies related to the connection of different higher education missions
A.7. Accompanying institutional developments with change management	<ul style="list-style-type: none"> • Various new policy instruments addressing in particular pillar-two funding • To be developed further in the future; e.g., with respect to collaboration across units, integration of teaching and learning and research, and acquisition of funding for innovation
B. Autonomy and accountability	
B.1. Securing academic freedom	<ul style="list-style-type: none"> • Obligations of institutions as defined by LIHE (Section 6)
B.2. Maintaining academic integrity	<ul style="list-style-type: none"> • Specific instruments such as ethics committees and code of ethics exist in at least some institutions
B.3. Anchoring accountability measures and quality assurance in governance structures	<ul style="list-style-type: none"> • Several institutions have bodies on the central level responsible for quality assurance
B.4. Establishing adequate monitoring procedures and management information systems	<ul style="list-style-type: none"> • Selected challenges related to definitions of indicators and valid data collection methods • Comprehensive management information systems not established in most institutions

C. Good governance 1: Cooperation and participation

C.1. Balancing responsibility of collegial bodies and personal responsibility maintaining a cooperative approach	<ul style="list-style-type: none"> • Deep-rooted democratic culture and highly interactive and inclusive decision-making processes on all institutional levels • Balance tilted toward responsibility of collegial bodies as opposed to personal responsibility
C.2. Involving external stakeholders in institutional governance and securing their proper conduct	<ul style="list-style-type: none"> • External stakeholders are involved in different ways (on central level as well as lower institutional levels) • Involvement mostly in an advisory capacity (missing formal rights and responsibilities)
C.3. Developing appropriate ways of involving internal stakeholders on different institutional levels	<ul style="list-style-type: none"> • Well-developed involvement of internal stakeholders (especially due to democratic and inclusive governance processes) • Student representatives are generally well informed and strongly integrated into decision-making procedures

D. Good governance 2: Differentiation of functions and distribution of powers

D.1. Separating strategic and management tasks framed by checks and balances	<ul style="list-style-type: none"> • Strategic and management tasks not always clearly separated
D.2. Equipping central leadership with sufficient and adequate competences	<ul style="list-style-type: none"> • Lack of competences of central leadership due to strong position of bodies of collegial self-governance
D.3. Securing efficiency and transparency of governance structures	<ul style="list-style-type: none"> • Complex governance structures with a high number of bodies and actors and extensive informal negotiation processes lead to lack of efficiency and effectiveness of internal governance processes
D.4. Establishing an adequate level of devolution	<ul style="list-style-type: none"> • Weak position of units and unit leadership • Sporadic attempts to strengthen units
D.5. Ensuring staff development and developing human resource strategies	<ul style="list-style-type: none"> • Only very few human resource development initiatives for higher education management and administration

4 General Conclusions

Recent reform processes on the system level have triggered a remarkable dynamic within many Latvian higher education institutions. As has been shown in detail above, institutions have started to rapidly take up shifts toward a more performance-oriented and autonomy-centered steering approach for the higher education sector as a whole. Especially in the area of internal funding, new approaches and instruments have been developed and implemented. It appears likely that this dynamic will continue in the future.

Many characteristics of the institutions' internal funding models and governance arrangements conform to international trends and good practices. Nevertheless, potential for improvements remain. Considering the relevance of internal funding and governance for the strategic development of institutions, five overarching challenges worth tackling in the future emerge:

- 1) Guaranteeing a sound basis for strategic steering activities in the form of relevant strategies and precise action plans
- 2) Promoting clear and balanced internal funding models that can further comprehensive institutional development
- 3) Bringing governance structures and processes in line with the requirements of autonomy-centered and performance-oriented steering approaches
- 4) Restructuring institutional subunits to complement the new steering approaches
- 5) Taking more active steps to develop the required human resources.

Importantly, it is not only the institutions themselves that bear the responsibility for tackling these challenges, but the higher education sector as a whole, including the Latvian government. What follows are selected considerations on how the required changes could be brought forth by various actors.

To promote the relevance of strategies for strategic steering purposes, institutions could make this core function the overarching framework for strategy development processes. A key element of these processes is an extensive investigation of the characteristics of institutions and their environment as the foundation for subsequent discussion processes on institutional objectives. The discussion processes on institutional objectives should then be designed in a way that clear priorities emerge. In addition to internal stakeholders who play a crucial role in these processes, representatives of the institutional environment are an important resource. They can provide valuable input on an institution's relationship with its surroundings, but also act as an impartial arbitrator in priority-setting processes. Concluding the strategy development process, translating priorities into specific targets is key, also as the basis for action plans required for an effective and efficient implementation of strategies. These suggestions could be considered by Latvian higher education institutions during the next phases of strategy development.

Despite notable developments of internal funding models, greater clarity and balance could promote the models' impact on institutional development. First, the performance-based pillar of funding models would benefit from being opened up to both the teaching and learning mission and the third mission. This would greatly improve the balance of internal funding models, since performance incentives would no longer relate almost exclusively to the field of research. Second, current approaches to supporting innovative projects ex ante would have to be developed further toward a fully-fledged third pillar that promotes the strategic development of institutions. These changes, however, can hardly be implemented without related changes on the system level.

The new steering approaches developing within Latvian higher education institutions call for certain types of internal structures, which institutions could develop within the framework of their specific governance cultures. Currently, internal governance structures are characterized by a high number of bodies and actors and extensive negotiation processes. This all too easily leads to inefficiencies and a lack of effectiveness of governance processes, and it is at least partly at odds with the need for responsive, proactive decision-making arrangements. To deal with this challenge, internal governance arrangements could be reconsidered starting from the functions they have to fulfill, taking into account the abovementioned requirements. For this, an in-depth knowledge of the institutions would be required, so that potential reforms tie in with the particular institutional cultures and values.

Another requirement emerging from the need for enhanced strategic steering capacities of institutions relates to the position of institutional subunits, particularly faculties. Financial incentives, the autonomy of units, and separate unit budgets together form a package that must be in place if performance orientation is supposed to pervade entire institutions. This package benefits from being complemented by the nonfinancial powers of units and management skills. Considering the complex internal structures of many institutions in Latvia consisting of heterogeneous units, achieving the adequate position of units would require targeted internal restructuring processes, which would often include unit mergers.

One last, indispensable element of any attempt to increase the strategic development capacities of higher education institutions is the individuals responsible for internal governance and management. Autonomy-centered and performance-oriented steering approaches bring with them new demands in terms of skills and competences of higher education leaders and managers, which must be actively promoted by institutions. To achieve this, systematic human resource development initiatives are key. Complementing these, institutions could benefit from facilitated peer-learning processes integrated in the overarching capacity-building approaches.

By keeping up the current momentum, Latvian higher education institutions, with support from the entire higher education sector, could proceed toward a more strategic and performance-oriented steering approach. Tackling the five broader challenges outlined above, and the detailed possibilities for improvement covered in this report, would allow higher education institutions in Latvia to further improve their strategic development in the direction of quality and performance orientation in higher education in Latvia. One point of reference for the related efforts could be the detailed recommendations by the World Bank that will be published in early 2017.

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Annex 1

Workshop Agenda

MoES – World Bank

Workshop on HEI-internal Funding and Governance: International Experience and the Status Quo in Latvia

23 November 2016, 14.00 – 18.00

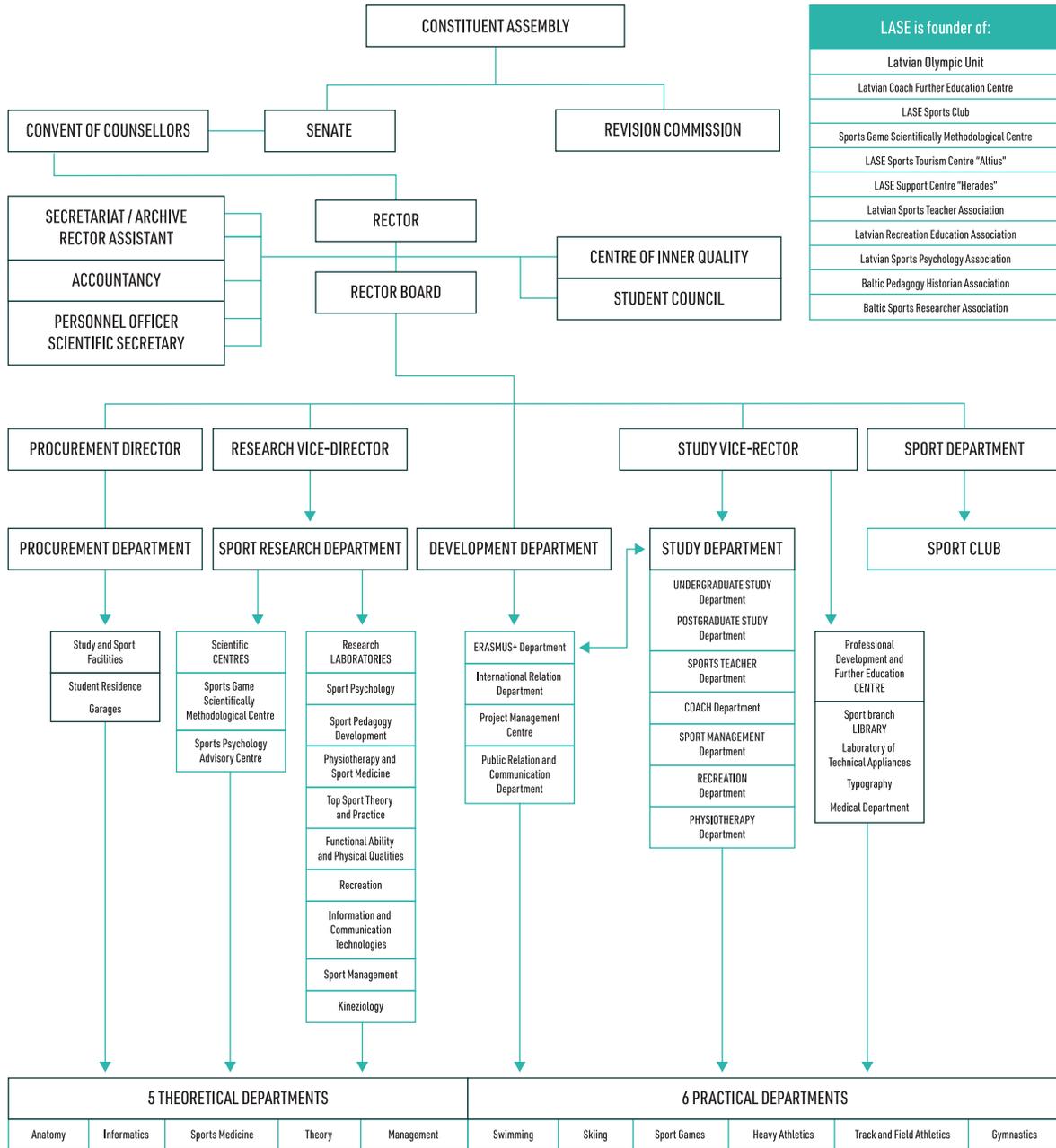
University of Latvia, Academic Center for Natural Sciences, Room 223

14.00 – 14.30	Registration
14.30 – 14.45	MoES and World Bank: Welcome and introduction
14.45 – 15.45	<p>Session 1: HEI-internal Funding and Governance: International Experience</p> <p><i>Focus: State of the affairs internationally; what is relevant for Latvia, what are key learnings</i></p> <p>World Bank Team: Presentation and selected country examples</p>
15.45 – 16.00	<i>Coffee/tea break</i>
16.00 – 17.45	<p>Session 2: HEI-internal Funding and Governance: Status Quo</p> <p><i>Focus: Overview on and validation of findings, towards recommendations</i></p> <p>World Bank Team: Presentation on status quo, followed by panel discussion</p> <p>General discussion</p>
17.45 – 18.00	MoES and World Bank: Summary and next steps

ESF project No. 8.3.6.1/16//001 "Participation in international educational studies"

Annex 2 Organization Charts

Latvian Academy of Sport Education



LASE is founder of:
Latvian Olympic Unit
Latvian Coach Further Education Centre
LASE Sports Club
Sports Game Scientifically Methodological Centre
LASE Sports Tourism Centre "Altius"
LASE Support Centre "Herades"
Latvian Sports Teacher Association
Latvian Recreation Education Association
Latvian Sports Psychology Association
Baltic Pedagogy Historian Association
Baltic Sports Researcher Association

Source: Latvian Academy of Sport Education, http://www.lspa.eu/eng/images/structure/LASE_structure_2015.pdf.

Report 3

INTERNAL FUNDING AND GOVERNANCE IN LATVIAN HIGHER EDUCATION INSTITUTIONS: RECOMMENDATIONS

April 2017

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Tables

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Abbreviations

ENQA	European Association for Quality Assurance in Higher Education
ESF	European Structural Funds
ESG	Standards and Guidelines for Quality Assurance in the European Higher Education Area
EU	European Union
HEI	higher education institution
LIHE	Law on Institutions of Higher Education
MIS	management information system
MoES	Ministry of Education and Science
SMART	specific, measurable, acceptable, realistic, and time-limited
SO	specific objective
SWOT	strengths, weaknesses, opportunities, and threats

Executive Summary

Addressing the further development of the internal funding models and internal governance arrangements of Latvian higher education institutions (HEIs) in the light of Latvia's current higher education funding reform process, this report presents recommendations for HEIs and the Latvian government.

Latvia is currently undergoing a significant reform in higher education by transforming its higher education funding system, which challenges Latvian HEIs to assess their internal funding models. Following a first World Bank higher education advisory service in 2013/14 that addressed the Latvian higher education funding model on the system level, a second higher education project with World Bank support³⁵ started in May 2016. The second project turns to, among others, developments within HEIs and potentials for further development in the fields of internal funding and governance. Based on two sets of requirements, one for good internal funding models and one for good internal governance arrangements, discussed in the report *International Trends and Good Practices in Higher Education Internal Funding and Governance* (World Bank 2016a) the status quo in Latvian HEIs has been assessed in detail in the report *Internal Funding and Governance in Latvian Higher Education Institutions: Status Quo Report* (World Bank 2017). Building on those two outputs, recommendations for the further development of internal funding and governance directed at the Latvian HEIs and the Latvian government have been developed, which are presented in this report.

In addition to a range of potential options for action whose relevance for individual institutions differs in line with institutional characteristics and the state of development of internal funding models and governance arrangements,³⁶ challenges that Latvian HEIs need to address in the short to medium term can be identified. In the field of internal funding, Latvian HEIs can already today start with selected adaptations of their internal funding models and with setting the course for potential reforms in the future. In that respect, HEIs would be well advised to start monitoring internal funding models and their impact (F20)³⁷; to engage in benchmarking processes and inter-institutional exchange on good practices in the field (F19); and to develop further necessary human resources in higher education management (F21). Building on those efforts, tasks to be tackled in the medium term include reinforcing the overall focus on performance (F5); finding the right balance between performance incentives directed at individuals and groups or units (F10); and reflecting on internal funding models from the perspective of a balanced three-pillar funding model (F11).

³⁵ The term "project" is subsequently used for this World Bank higher education advisory service.

³⁶ Annexes 1 and 2 provide an overview on all recommendations directed at HEIs.

³⁷ The terms in parentheses refer to the numbering of recommendations in the main part of this report.

With respect to internal governance, short-term options for HEIs such as advancing managerial skills exist, and additional key tasks will emerge in the medium term related to processes of strategic planning. Already in the near future, institutions could initiate improvements in the field of internal governance by promoting management and administration skills of selected staff members (G14), and by intensifying the communication on their institutional strategies (G2). Further possibilities will emerge in the medium term related to the development of new institutional strategies. When developing new strategies, HEIs need to pay particular attention to formulating them in a SMART way (G1), that is, specific, measurable, acceptable, realistic, and time-limited; need to consider options for ensuring an actual implementation of the strategy via adequate instruments (G3); and need to ensure that the implementation progress is monitored (G4).

Some of the possibilities for the Latvian government to promote internal funding and governance within HEIs can be implemented in the short term, whereas others are long-term tasks or need to be attuned to related efforts by institutions. During the next round of the annual funding negotiations between the Ministry of Education and Science (MoES) and HEIs, it could be considered how to increase the dynamic of first-pillar funding allocations within institutions and how to enable support for innovative new study programs (P1). The upcoming design of European Structural Funds (ESF)-funded programs furthermore provides the opportunity to ensure that they contribute to strategic priorities on the national and the institutional level, and that this connection is made clear (P3). It would also be relevant for the Latvian government to reflect on the future development of financial (and other) framework conditions for HEIs and to communicate their reliability actively (P7) as soon as possible. Complementing related efforts of HEIs, the government could offer support for the development of management and administration skills within institutions (P15) already in the short term. In the medium term, two tasks stand out: introducing coherent data requirements for institutions (P6), and promoting institutional strategies that are well-targeted and realistic (P8). Long-term tasks for the government concern more comprehensive undertakings such as the development of a national strategy, including adequate communication mechanisms (P9) and progress monitoring instruments (P10), and substantive changes to the system-level funding model such as extending the performance orientation of the second pillar of the state funding model to the field of teaching and learning (P2). Additional options for supporting HEIs with their reform efforts and for promoting the right framework conditions exist with specific programs funded via ESF, which need to be attuned to the strategic priorities emerging on the national and the institutional level, and the respective timelines.

Introduction

Following a first World Bank higher education advisory service in 2013/14 that addressed the Latvian higher education funding model on the system level, a second higher education project with World Bank support addressing the internal funding models, governance arrangements, and human resource policies of Latvian HEIs started in May 2016. The 2013/14 higher education project led to the reform of the Latvian state funding model for higher education in the form of the introduction of a new, three-pillar model including a performance-based pillar, bringing the funding model closer to European best practices. To complement the changes on the system level and to address the effective management of scarce resources to attain institutional and policy goals, the second higher education project turns to developments within institutions and potentials for further development in the fields of internal funding and governance. Based on two sets of requirements, one for good internal funding models and one for good internal governance arrangements, an assessment of the status quo in Latvian HEIs and of how the new system-level funding arrangements have stimulated institutional development and responsiveness was conducted. Both sets of requirements were developed by the World Bank Latvia higher education financing team³⁸ in close collaboration with the Latvian MoES and the higher education sector.³⁹

Concluding the first phase of the second project and focusing on internal funding and governance, this report presents recommendations for HEIs and the Latvian government. Building on both previous outputs, the team has prepared recommendations for the further development of internal funding and governance directed at the Latvian HEIs and a related set of recommendations to the Latvian government.⁴⁰ Additional, detailed information and data underpinning the recommendations presented below can be found in the two previous reports.

³⁸ Members of the World Bank higher education financing team are Dr. Nina Arnhold, Senior Education Specialist and Task Team Leader, World Bank; Adjunct Professor Jussi Kivistö, University of Tampere, Finland; Vitus Puttmann, Consultant, World Bank; Professor Hans Vossensteyn, Director of the Center for Higher Education Policy (CHEPS), the Netherlands; and Professor Frank Ziegele, Director of the Centre for Higher Education (CHE), Germany. The team would like to thank the Latvian MoES and the seven case study institutions, as well as all other sector representatives involved for the strong collaboration that has made the preparation of this report possible.

³⁹ While information on and findings of the project were discussed and disseminated more broadly, including during a workshop on 23 November 2016, seven Latvian HEIs — the University of Latvia, Riga Technical University, Riga Stradiņš University, Daugavpils University, Vidzeme University of Applied Science, the Art Academy of Latvia, and the Latvian Academy of Sport Education — joined the project as case study institutions, which allowed for more in-depth assessments and discussions.

⁴⁰ The first phase also included the development of another analytical output, a note on Latvian doctoral education and promotion (World Bank 2016b), which was prepared by Dr. Andrée Sursock, EUA Board Member and World Bank Consultant. The first phase will be succeeded by a second phase in 2017/18 that will address questions of academic selection, promotion, and remuneration. These topics are thus discussed to only a limited extent in these recommendations.

1 Internal Funding and Governance Models in Latvian Higher Education Institutions – Key Findings

1.1 Key Findings on Internal Funding

The reform of the system-level funding model has been taken up quickly by Latvian HEIs; however, the internal changes mostly pertain to the introduction of performance-based funding allocations. The resulting internal funding models fulfill many requirements for good internal funding models, but several challenges remain, which leaves room for improvement. Many good practices can be found in different HEIs in Latvia, even though the institutions are at different stages of development with respect to their internal funding models. There is neither a perfect model nor a one-size-fits-all solution. Institutions exhibit different strengths and weaknesses; all of them have developed good approaches in some areas but need to solve issues in others. This creates many possibilities for institutions to learn from each other in benchmarking processes and to exchange good practices for their mutual benefit.

Notwithstanding the many differences between the internal funding models of Latvian HEIs, focusing on key characteristics allows for an assessment of the status quo. This status quo — which has been assessed in detail in the report *Internal Funding and Governance in Latvian Higher Education Institutions: Status Quo Report* (World Bank 2017) — is depicted in Table 1 based on the requirements for good internal funding models derived from international experiences and good practices, the World Bank team members' professional expertise in the field, and criteria developed for the assessment of the Latvian system-level funding model. These requirements are outlined in detail in the report *International Trends and Good Practices in Higher Education Internal Funding and Governance* (World Bank 2016a).

A. Strategic orientation	
A.1. Aligning internal funding model with external revenue streams and reflecting national goals	<ul style="list-style-type: none"> • Performance orientation and focus on research of the second pillar of the state funding model are taken up internally • Basic alignment of external and internal incentives is given for all income streams • Alignment of incentives connects system-level policy objectives and institutional activities
A.2. Promoting institutional strategies and profiles	<ul style="list-style-type: none"> • Funding models are connected to institutional strategies in different ways (including deliberate deviations from the system-level allocation mechanisms) • Scope for use of new models in support of institutional priorities remaining • Limited use of innovation funds to stimulate profiling
A.3. Promoting unit-level objectives	<ul style="list-style-type: none"> • Unit-level specification and differentiation are not clearly promoted by the internal funding models due to the current structural particularities
B. Incentive orientation	
B.1. Creating performance rewards and sanctions	<ul style="list-style-type: none"> • Incentives are provided to units and/or individuals in most institutions • Performance orientation of state funding model's second pillar is taken up in most institutions; some institutions also provide performance incentives via other funding streams (e.g., research base funding) • Only a few performance incentives for teaching and learning and third mission exist • Challenges related to the impact of incentives exist (e.g., the lack of funding available for targeted allocations; major reliance on one income source for some institutions and units)
B.2. Providing clear and nonfragmented incentives	<ul style="list-style-type: none"> • Potential fragmentation of incentives in some institutions (due to high number of objectives/indicators; fragmentation of rewards for different types of activities)
B.3. Avoiding undesired side effects	<ul style="list-style-type: none"> • Limited incentives to collaborate across programs and units in some cases • Potential neglect of innovation through new study programs due to overall focus on research of incentive models and inflexible study-place approach • Potential lack of targeted funding incentives for less established or upcoming researchers • Incentives provided to individuals directly bear particularly high potential for unintended side effects (crowding out of intrinsic motivation)
C. Sustainability and balance	
C.1. Combining top-down and bottom-up approaches	<ul style="list-style-type: none"> • Financial autonomy and competences of units are limited
C.2. Providing a sufficient level of stability	<ul style="list-style-type: none"> • Marked differences in degree of income diversification of institutions and units (hence insufficient degree of risk spreading in at least some cases) • Funding models can forward the potential for stability provided by state funding for study places to units

Table 1 Status quo of internal funding models in Latvian higher education institutions (right column) as assessed against requirements for good internal funding models (left column)

C.3. Guaranteeing continuity in development	<ul style="list-style-type: none"> • Regular adaptations of models in at least some institutions • Communication surrounding change processes not always well developed
C.4. Balancing the overall model architecture	<ul style="list-style-type: none"> • First and second pillars established • Third pillar not developed yet within many institutions (e.g., lack of targeted support for innovative projects)
C.5. Promoting diversification of unit-level funding sources	<ul style="list-style-type: none"> • Funding models contain incentives for revenue generation activities • Revenue generation is directly supported in some institutions
C.6. Balancing the key institutional missions	<ul style="list-style-type: none"> • All missions are accounted for in internal funding models • Bias toward research in the incentives and strategic steering – reflecting the system-level funding model • Potential for better integration of missions
D. Transparency and fairness	
D.1. Ensuring transparency	<ul style="list-style-type: none"> • Basic understanding by institutions' members and transparency exist • Lack of in-depth knowledge about functioning of funding models in some parts of institutions
D.2. Supporting the perception of fairness	<ul style="list-style-type: none"> • Perception of fairness promoted by extensive discussion processes surrounding internal funding models • Extent to which field differences are taken into account remains questionable in some institutions
E. Level of autonomy and flexibility	
E.1. Guaranteeing financial autonomy and academic freedom	<ul style="list-style-type: none"> • Financial autonomy of institutions is comparatively high • Restrictions result from lack of available funds
E.2. Implementing an adequate level of regulation	<ul style="list-style-type: none"> • The corresponding level of regulation is adequate
F. Link to governance and management; practical feasibility	
F.1. Increasing reliability and availability of data	<ul style="list-style-type: none"> • Information and data required for current allocation mechanisms available for the most part • Challenges related to different sources and types of data in some cases
F.2. Ensuring administrative efficiency	<ul style="list-style-type: none"> • Administrative efficiency hampered by extensive decision-making processes and restrictions in budgeting processes
F.3. Ensuring coherence with other governance approaches and university culture	<ul style="list-style-type: none"> • Internal funding models mirror governance approaches and take into account cultural particularities of institutions
F.4. Ensuring the ability of the leadership to act	<ul style="list-style-type: none"> • Scope of decision-making rights of institutional leadership and managerial capacity in the institutions questionable (due to far-reaching competences of collegial bodies)

1.2 Key Findings on Internal Governance

HEIs in Latvia exhibit internal governance arrangements that are closely connected to a deep-rooted democratic culture and a highly interactive and inclusive approach toward decision-making processes. Comparing the internal governance structures and processes against requirements for good internal governance arrangements reveals both conformities and discrepancies. As with the assessment of internal funding models presented above, several differences among institutions related to internal governance arrangements need to be considered. However, there are again common key characteristics that enable a more general assessment of the status quo. This status quo — which has been assessed in detail in the report *Internal Funding and Governance in Latvian Higher Education Institutions: Status Quo Report* (World Bank 2017) — is depicted in Table 2 based on the requirements for good internal governance arrangements derived from international experiences and good practices, and the World Bank team members’ professional expertise in the field. These requirements are outlined in detail in the report *International Trends and Good Practices in Higher Education Internal Funding and Governance* (World Bank 2016a).

A. Strategic development and governance	
A.1. Having in place clear and precise institutional strategies aligned with institutional strengths/weaknesses and their environment	<ul style="list-style-type: none"> • All institutions engage in strategic planning • Particular attention is given to research/research strategies; some institutions have full-fledged institutional strategies • Relevance of strategies for strategic steering purposes varies (due to, for example, generic character and lack of preciseness)
A.2. Having in place action plans that structure and support the strategy implementation process	<ul style="list-style-type: none"> • Not all institutions have developed action plans
A.3. Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process	<ul style="list-style-type: none"> • Discussion processes leading to institutional strategies involve a wide range of stakeholders • Extent to which stakeholder input is taken up is questionable in some cases
A.4. Developing measures for the implementation of strategies	<ul style="list-style-type: none"> • Different instruments for strategy implementation are in place (e.g., connection to funding models) • Scope for improvement remains in many institutions (e.g., systematic communication strategies; new funding instruments)
A.5. Monitoring the strategy implementation process and adapting instruments/objectives if necessary	<ul style="list-style-type: none"> • Great variety among institutions related to strategy implementation monitoring (from hardly any monitoring at all to yearly discussions based on key performance indicators)
A.6. Securing and monitoring fitness for purpose of governance structures	<ul style="list-style-type: none"> • Fragmented structure of (heterogeneous) units and overall high complexity of internal structures • Several instances of decoupled research institutes • Attempts to consolidate academic structures and streamline governance structures in some institutions • Some deficiencies related to the connection of different higher education missions

Table 2 Status quo of internal governance arrangements in Latvian higher education institutions (right column) as assessed against requirements for good internal governance arrangements (left column)

A.7. Accompanying institutional developments with change management	<ul style="list-style-type: none"> • Various new policy instruments addressing, in particular, pillar-two funding • To be developed further; e.g., with respect to collaboration across units, integration of teaching and learning and research, and acquisition of funding for innovation
B. Autonomy and accountability	
B.1. Securing academic freedom	<ul style="list-style-type: none"> • Obligations of institutions as defined by the Law on Institutions of Higher Education (LIHE) (Section 6)
B.2. Maintaining academic integrity	<ul style="list-style-type: none"> • Specific instruments such as ethics committees and code of ethics exist in at least some institutions
B.3. Anchoring accountability measures and quality assurance in governance structures	<ul style="list-style-type: none"> • Several institutions have bodies on the central level responsible for quality assurance
B.4. Establishing adequate monitoring procedures and management information systems	<ul style="list-style-type: none"> • Selected challenges related to definitions of indicators and valid data collection methods • Comprehensive management information systems not established in most institutions
C. Good governance 1: Cooperation and participation	
C.1. Balancing responsibility of collegial bodies and personal responsibility maintaining a cooperative approach	<ul style="list-style-type: none"> • Deep-rooted democratic culture and highly interactive and inclusive decision-making processes on all institutional levels • Balance tilted toward responsibility of collegial bodies as opposed to personal responsibility
C.2. Involving external stakeholders in institutional governance and securing their proper conduct	<ul style="list-style-type: none"> • External stakeholders are involved in different ways (on central level and on lower institutional levels) • Involvement mostly in an advisory capacity (missing formal rights and responsibilities)
C.3. Developing appropriate ways of involving internal stakeholders on different institutional levels	<ul style="list-style-type: none"> • Well-developed involvement of internal stakeholders (especially due to democratic and inclusive governance processes) • Student representatives are generally well informed and strongly integrated into decision-making procedures
D. Good governance 2: Differentiation of functions and distribution of powers	
D.1. Separating strategic and management tasks framed by checks and balances	<ul style="list-style-type: none"> • Strategic and management tasks not always clearly separated
D.2. Equipping central leadership with sufficient and adequate competences	<ul style="list-style-type: none"> • Lack of competences of central leadership due to strong position of bodies of collegial self-governance
D.3. Securing efficiency and transparency of governance structures	<ul style="list-style-type: none"> • Complex governance structures with a high number of bodies and actors and extensive informal negotiation processes lead to lack of efficiency and effectiveness of internal governance processes
D.4. Establishing an adequate level of devolution	<ul style="list-style-type: none"> • Weak position of units and unit leadership • Sporadic attempts to strengthen units
D.5. Ensuring staff development and developing human resource strategies	<ul style="list-style-type: none"> • Only a few human resource development initiatives for higher education management and administration

2 Recommendations for Higher Education Institutions

Based on the assessment of the status quo in Latvia and, in particular, the analysis of case study institutions, generic recommendations for the entire Latvian higher education sector were developed. Nevertheless, not all recommendations are of equal relevance for the next steps any specific institution needs to take. Latvian HEIs are at different stages of development with respect to their internal funding models and governance arrangements, and have initiated changes in both fields starting from different points of departure resulting from, among others, their specific institutional characteristics and histories. Each institution exhibits different strengths and weaknesses. This implies that the relevance of the recommendations presented in the following can differ among institutions in terms of actions that still can be taken and in terms of urgency,⁴¹ even though some general challenges apply to the entire sector. Latvian HEIs are encouraged to use the recommendations as a checklist to identify where they already have realized good practice, where further action is needed, and which tasks would need to be tackled with priority. The presentation of the recommendations basically follows the structure of the requirements for good internal funding models and for good internal governance arrangements (see Annex 1 and Annex 2 for an overview on all recommendations). In the case of internal governance, recommendations sometimes cross the borders of some of the requirements for good internal governance arrangements to prevent duplications.

2.1 Recommendations on Internal Funding

Strategic Orientation

F1. Continue to adapt to changes in external state funding.

Latvian HEIs are currently using internal funding well as a mediating device between external revenue streams and internal resource allocations. This has been particularly evident in the activities of implementing second-pillar components rapidly after the recent changes in the state funding model. Institutions are encouraged to also use this flexibility in reacting quickly to future changes and,

⁴¹ For the case study institutions, specific recommendations, also identifying priorities for each institution, were developed and sent to them after the site visits.

where possible, to proactively anticipate future developments of the state funding model in their internal models. This could be done, for instance, by creating a pool of teaching and learning-related or research-related performance indicators – performance indicators in both areas are, for example, used by the University of Twente and the Delft University of Technology in the Netherlands (World Bank 2016a: 25–26) — for measuring and monitoring without immediately attaching funding to them, which can be flexibly taken into full use when the state funding allocation criteria are revised.

- F2. Put more effort into finding ways of translating the state funding model into a specific internal allocation model that corresponds to the institutional profile and situation.

That each institution finds its “own way” would require an internal assessment of the strengths and weaknesses of the internal funding model in use (for example, reverting to the “requirements for good internal funding models” presented above). The objective of this assessment would be to keep the “spirit” of the external funding model alive in the internal model while adapting its logic to the specific situation, culture, and strategic objectives of an institution (for example, by putting greater weight on negotiation-orientation in funding allocations as opposed to formula-based approaches if this fits better with the internal culture). Similarly, different allocation mechanisms could be used if they are better accepted internally (for example, competitive innovation funding instead of formula funding). Moreover, institutional profiles might require that additional aspects of performance funding are introduced such as institution-specific performance indicators (for example, related to regional engagement) and weights that deviate from the system-level allocation mechanisms — as, for example, at the University of Tampere in Finland (World Bank 2016a: 21–23).

- F3. Treat the development of internal allocation systems and strategy development as “two sides of the same coin.”

Internal funding models need to be aligned with strategic priorities and institutional plans. Having an institutional strategy that is not supported by the internal funding model makes its realization ineffective or even impossible. Having an internal funding model without a proper strategy and concise priorities might lead to misguided funding allocations. Effective funding models require a comprehensive institutional strategy that defines the institution’s profile, and concrete action plans that are specific enough to be supported with the funding model. Therefore, institutions are advised to develop both the institutional strategies and internal funding models in a coherent and systematic way. Some Latvian institutions have already developed good practices, but this has been limited to research strategies and related financial incentives in most cases.

- F4. Establish incentives to use specific opportunities to generate more funds for the institution.

HEIs benefit from systematically reflecting their strengths and weaknesses vis-à-vis the funding allocations by the state and other income sources. For instance, some institutions in Latvia have successfully exploited their potential to acquire funds from municipalities, which are “topped up” with performance-based allocations of the state funding model (which also provides other incentives for HEIs to acquire third-party funding under the second pillar, especially in the field

of research). In a similar way, research-intensive institutions could actively seek competitive research funding by offering co-funding or match funding for already established research projects internally, whereas regionally engaged institutions could develop business activities within the region by investing in knowledge transfer activities in those areas that appear to be most promising given the institution's profile.

Incentive Orientation

F5. Continue to strengthen the performance orientation in the internal funding model.

Latvian HEIs have taken big steps in integrating performance-oriented components into their internal funding models. This has happened in different ways with a variety of functioning approaches. Institutions are encouraged to continue on this path, taking full advantage of the momentum created by the reforms of state funding.

F6. Create a balance of incentives regarding the core missions of research, teaching and learning, and valorization.

The funding models of Latvian HEIs are currently biased in their performance orientation toward research-related activities. This is understandable as an effect of compliance with the incentives set by the second pillar of the state funding model. However, further steps of widening the scope of activities that are the target of performance incentives need to follow for the sake of creating more balanced internal funding models. Funding models should be able to incentivize all three institutional core missions, thereby creating a clear signal concerning the importance of all of them. Incentivizing all three core missions could also lead to a more integrated approach in designing the models without unnecessarily fragmenting the funding streams by institutional missions. Some HEIs already have experience with a broader range of performance indicators, for which reason interinstitutional exchange on the feasibility of the use of additional indicators is highly recommended.

F7. Support program innovation via base funding for teaching and learning, and remain sensitive in relating programs and study places to demand as far as possible within the given framework.

The fact that basic funding for teaching and learning is related to the allocation of study places should not impede innovation. Within the given framework, HEIs would be well advised to allow for the development of new, innovative study programs (and the phasing out of programs that are no longer needed), to stimulate curriculum innovation, and to remain sensitive with respect to developments in the supply and demand of study places. In this, institutions would need to consult closely with the MoES to address the needs of the Latvian society for highly educated graduates.

- F8. Experiment more with internal third-pillar elements to create incentives for realizing innovations and change, and to promote prospective performance orientation.

Latvian HEIs already possess several good practices with their internal funding pools or target agreements, and some institutions also introduced practices of providing seed funding to promising projects. In the future, a greater variety of modes of internal project funding, seed funding, and matching funds need to be developed, in parallel with using internal target agreements. Strategic funds should be used as ex-ante funding for prefunding innovation and change not only in research but also in study programs and third mission activities. At the same time, outcomes should be monitored and incentivized via the use of ex-post performance-based funding. Internal third-pillar funding could be used for improving the quality of study programs (for example, by offering competitive funding for program development initiatives), lead to the systematic prefunding of innovative projects, and create financial incentives to engender clearer and more distinctive institutional profiles.

- F9. Seek possibilities to create funding components that allow units to define performance measurement according to their own priorities (especially within larger institutions).

Formula funding systems within institutions usually apply the same indicators to all faculties and other types of units. Internal target agreements could additionally create the opportunity for units to define their own measurement of performance, increasing the “ownership” and identification with performance orientation. Institutions would therefore be well advised to allow for an adequate level of autonomy regarding the internal allocations within units (for example, between faculties and departments) while retaining the central level’s ability to secure the performance of units via adequate performance control. Unit-level strategies should generally be aligned with the overall institutional strategy (that is, strategies at the decentralized level should aggregate to common goals), but related internal autonomy should not be obstructed (that is, each decentralized unit can set different priorities). An efficient way to implement this would be a “package deal” that includes block grants allocated partly via output-based formulas and partly via negotiated funding (for example, in the form of target agreements).

- F10. Strengthen incentives for good performance by striking a balance between rewarding individuals and groups or units.

In some Latvian HEIs, part of the income from the second pillar of the state funding model is paid out as salary bonuses to individuals. Even though the low wage levels of some academic staff make the use of salary bonuses understandable in Latvia, financial incentives offered to individuals involve several risks. One of these risks is related to crowding-out effects where extrinsic rewards such as salary bonuses under certain conditions “crowd out” the intrinsic motivation (that is, the noninstrumental interest in academic work). Rewarding those dimensions of academic work that are not “extra” but can be considered a “normal” part of the work is particularly likely to trigger crowding-out effects. Moreover, individual salary bonuses can all too easily be considered unfair because the performance is often an outcome of a series of actions of multiple individuals. Therefore, institutions must find a way to strike a balance between individual incentives offered in terms of salary bonuses and incentives provided to groups and units through the internal funding model.

Sustainability and Balance

F11. Use the structure of the three-pillar model to reflect the balance in the internal funding model.

Many of the HEIs in Latvia still lack a balance in their approaches with respect to the functions of a three-pillar funding model, which are providing an adequate level of stability (first pillar); creating performance incentives (second pillar); and promoting innovation, excellence, and change (third pillar). This situation mirrors the structure of funding received from the Latvian state. Whereas basic funding and performance-oriented funding have been integrated into the internal funding models in most institutions, attempts to provide targeted funding for innovations and profile-oriented development are currently weak. Even though ESF are used to provide funding for investments in strategic projects to institutions (the third pillar), these funds often do not lead to the development of a stable innovation-oriented ex-ante funding component within institutions. Despite those challenges, institutions are advised to use the logic of the three-pillar funding model to assess their current practices. Such an assessment should lead to finding an adequate balance among the three pillars — which, for example, has been established at the KTH Royal Institute of Technology in Stockholm, Sweden, in line with its profile as a research-intensive university (World Bank 2016a: 38–39).

F12. Balance different orientations in research funding.

Latvian HEIs are coming from a difficult financial situation related to research, starting from low funding levels after severe cutbacks. A situation where every researcher has substantial per capita basic funding is simply not currently realistic. Even if the per capita calculation plays a role in state funding, it is not advisable to distribute it internally in the same way, because this would lead to fragmentation of scarce research funds. On the one hand, institutions could work to identify their priority areas in research. Prioritized areas would then need a certain degree of financial stability to be able to develop, while at the same time they should be monitored continuously, framed by funding formulas or target agreements. Focus areas could terminate and new ones could emerge, keeping up the internal competition. On the other hand, there must be research funding for new projects outside focus areas to stimulate innovation — the Technical University Aachen in Germany provides an example for a funding instrument that serves this purpose (World Bank 2016a: 30–31)—, potentially leading to the development of new areas of strengths. Introducing institution-internal “creativity funds” can also be recommended. Those funds could offer opportunities for talented young researchers, and not only for established researchers and research clusters.

F13. Use both formula funding and target agreements in internal allocations.

Combining allocation instruments allows institutions to benefit from the strengths of each of them while avoiding their problems. Designing a sound combination of funding instruments is an institution-specific process, but using formula funding *and* target agreements is a valid recommendation for all institutions. Formula funding, when combined with block grants, provides efficiency, transparency, and the legitimization of allocations while guaranteeing the internal autonomy of units. Target agreements — which have, for example, been introduced at the University of Duisburg-Essen in Germany (World Bank 2016a: 40–41) — are often

needed for effective prefunding of future developments (under the third pillar), and to apply performance measurement according to different disciplinary cultures. Target agreements can also be used to reach a balance among funding streams allocated under the three pillars, and to promote goal orientation toward the strategic objectives of the institution and units.

F14. Find a balanced approach to promote external revenue generation and to fund central infrastructure and services by retaining a share of third-party funds on the central level.

External revenue generation (that is, revenue outside of the state funding model) is essential for building and maintaining financial reserves and central funds of an institution. Central funds are often crucial for the effective promotion of institutional strategies and profiles, for example, via supporting and directing new strategic initiatives, institution-wide development activities and the overall strategic development of the institution, and via subsidizing non-revenue-generating activities critical to institutional missions and profiles. Central funds can be used as financial buffers (“rainy day funds”) equally well. Currently, some of the Latvian HEIs apply deductions to their units’ income to cover the costs of the central administration, of support services, or related to premises, or to build reserves at the central level for future investments. This approach should be continued or, where not practiced yet, introduced. The size of deductions (also known as “tax” or “overhead cost”) needs to be big enough to provide resources for necessary infrastructures and to create some financial discretion on the central level, but should not impede incentives for units to raise these funds or lead to approaches perceived as unfair.

There are different ways institutions can promote the generation of external revenues with a “win-win” approach. For instance, institutions can leave a certain percentage of the financial benefits or end-of-year surplus with the unit, or top up external revenue streams with state funds (especially with second pillar funding). A positive effect of allowing units to carry forward surpluses from one year to another is that this usually leads to better multi-year planning and curbs year-end spending on unnecessary items. As additional options for promoting revenue generation, seed funding can be offered for promising initiatives to generate external revenue, administrative support can be provided to facilitate the acquisition of projects, and, alternatively, lower or no overhead can be charged for certain types of revenue deemed strategically important (that is, a selective “tax-free” policy). A successful approach would be to formulate a package combining all or most of those approaches. To promote revenue generation effectively, it is necessary to make this topic part of the institutional strategy. That could be preceded by a systematic strengths, weaknesses, opportunities, and threats (SWOT) analysis to identify the most relevant revenue sources and risks attached to them, and to set targets and define actions for attaining them.

Transparency and Fairness

F15. Be more active – and not only reactive – in creating internal transparency on funding criteria and outcomes.

Enhancing the internal funding models’ transparency and impact requires a more thorough understanding by institutional members. However, systematic, regular

information campaigns and processes have not yet been established by Latvian HEIs. The perception of fairness requires that units and individuals know the allocation criteria, the actual distribution of funding among units, and the ways in which units can increase their income. This is likely to lead to a greater engagement in those activities that the funding models seek to incentivize. In the case of discretionary allocation decisions, it should be clear to all stakeholders how the decisions are made, and on what basis. To promote an in-depth understanding of funding models and their transparency, systematic and proactive approaches offering wide participation play a key role.

F16. Develop indicator systems with an adequate degree of complexity.

In the case of formula-based allocations, a first basic issue to consider is the share of indicators that actually measure performance, and not inputs, and their weight among all indicators. Using formula funding, however, requires careful consideration of the overall number of the performance indicators to be included in the formula. A too-low number of indicators could be viewed as unfair, because they would not be able to cover all relevant areas of performance. Too many indicators, however, lead to a lack of transparency and the fragmentation of incentives. Especially considering challenges related to a high number of indicators appears to be relevant for some Latvian HEIs. Institutions are invited to reflect on the appropriate number and weighting of indicators in accordance with their own institutional characteristics.

Autonomy and Flexibility

F17. Gradually strengthen financial autonomy of decentralized units such as faculties and institutes.

Many of the Latvian HEIs still have a highly centralized approach when it comes to budgeting and distributing other financial competences. There were important reasons for that approach: making critical decisions that became necessary during the financial crisis and the ensuing budget cuts required broad decision-making capacities on the central level. However, especially the larger institutions could now take steps toward more decentralized approaches via granting more financial autonomy to the unit level. Unit-level autonomy is an important prerequisite for the sustainable strategic development of units, allowing them to develop their own specific objectives under the broader framework of an institutional strategy. Autonomy also guarantees more flexible decisions and the ability to decide issues “on the ground,” where teaching and research are conducted.

Transitioning to a more decentralized model should assume the form of a gradual development and phased implementation. For instance, institutions can introduce a “learning year” where no real allocations are made, but units receive a calculation of how much funding they would have received if the new or revised model would have been fully effective. This can be followed by a period during which the amount of funds subject to the new allocation model is increased incrementally. One of the most important aspects in the process of designing a more decentralized model is to keep a balance between decentralized flexibility (and strategy) and the central level’s ability to finance the strategic actions in a way that aligns unit strategies with institutional strategies. Part of this balance is to avoid the emergence of “isolated” units with their own, separate budgets and strategies that

follow only their own agendas (see also recommendation G9). Implementation of the decentralized model could start with small steps, for example, by offering strategy-driven funding pools for deans and other unit leaders (such as of research institutes), which could then be followed by more comprehensive unit-level grants. The way in which unit-level financial autonomy is used should be monitored and evaluated regularly to ensure that the strategies of decentralized units align with the overall institutional strategy.

F18. Create the organizational preconditions for decentralized financial autonomy.

Decentralization of financial authority requires larger unit sizes and a coherent unit structure. Currently, some of the Latvian institutions exhibit relatively complex and incoherent structures of units with different types and sizes. A sufficient size of the units allows them to develop their own specific objectives under the broader framework of an institutional strategy. The adequate size of units depends on the circumstances and characteristics of an institution. However, the smallest units should be large enough to be sufficiently diverse and robust to spread some risks, pool resources, and capitalize on efficiencies of scale and scope. At the same time, units should be small enough to maintain a level of flexibility and a sense of collective responsibility and loyalty stemming from the identification with the unit.⁴² In all cases, organizational and financial reforms need to go hand in hand. In some cases, financial autonomy could be best enhanced by also pooling resources at the interinstitutional level.

Practical Feasibility

F19. Share information and implement formats of benchmarking and peer counselling.

Many good practices related to internal funding models can be found in Latvian HEIs. Institutions exhibit different strengths and weaknesses. All of them have developed good approaches in some areas but need to solve issues in others. Generally, institutions are at different stages of development with respect to their internal funding models. However, good ideas and practices have not spread effectively throughout the system so far. Hence, Latvian institutions would benefit greatly from having a more coordinated and facilitated exchange and mutual learning on good practices to increase the overall knowledge in the system. Having coordinated platforms and events for sharing information (for example, rotating site visits or workshops with a focus on some specific theme) would offer many possibilities for institutions to learn from each other in benchmarking processes and to exchange good practices for their mutual benefit.

F20. Monitor the impact of funding models (including potential unintended side effects) and at the same time consider issues of continuity, especially if changes are perceived to be necessary.

Every internal funding model bears the risk that the activities of units and individuals are affected in ways not foreseen by the design of the model. For that reason, the impacts of an internal funding model need to be closely monitored.

⁴² Management literature suggests units between 15 and 50 persons.

Whatever the specific side effects, their mere possibility calls for close monitoring of the effects of internal funding models to detect them as early as possible, and to take appropriate actions afterward. At the same time, internal funding models require a certain degree of continuity to develop an impact. Too frequent changes of the basic architecture and the specific mechanisms are likely to make institutions less attentive to current requirements, reducing their orientation toward those activities that are the target of financial incentives. Changes that last for less than three years cannot be evaluated properly and lead to instability. Nevertheless, the adaption of internal funding models can become necessary, but changes in general need to be made cautiously and based on a sound assessment of the previous impact of the models. Taking all this into account, it appears reasonable to conduct a more detailed evaluation of substantially reformed internal funding models about three years after the changes were introduced.

F21. Promote human resource development in higher education management.

Effective internal funding (and governance) models require that the institutional and unit-level leaders and administrators possess the required management skills and competences with regard to strategic management, change management, and an understanding of the dynamics of using different incentive mechanisms (see also recommendation G14). In particular, a general shift from traditional administrative tasks to a proactive management and development approach — which itself has not been completed in all institutions in Latvia — leads to different skills needs. These skills can be developed with staff training schemes aimed particularly at serving the needs of those who are or will be holding leadership posts. At the moment, comprehensive management training schemes for staff members, academics, and administrators do not exist in Latvian HEIs, despite some initiatives such as ad-hoc trainings, and mentoring and coaching programs. Since these would be required, Latvian HEIs should consider establishing and implementing human resource development strategies that address those needs. In doing so, institutions could revert to training opportunities provided by different institutions in various European countries tailored to the particularities of HEIs.

F22. Develop integrated management information systems and use available systems whenever possible.

Comprehensive management information systems (MIS) that deliver data of a sufficient quality do not exist in all Latvian HEIs. When considering the establishment of comprehensive MISs, institutions could look for data sets that are already available, for example, from their participation in U-Multirank. These data are not yet used for institution-internal purposes, and provide a European reference frame for multidimensional performance measurement. Reverting to the data set from U-Multirank, in which many institutions in Latvia participate and which is promoted by the government, could also lead to benefits related to nationally aligned data (see also recommendation P6).

2.2 Recommendations on Internal Governance

G1. Formulate SMART institutional strategies based on a SWOT analysis.

Most Latvian HEIs have developed strategic documents and general institutional strategies, even though some focus primarily on research. In many cases, strategies are substantive documents that address a broad spectrum of themes and ambitions, bringing together all activities that the institutions engage in. Not all strategies make clear the institution's profile yet. However, some are devised in a more targeted way, identifying key priority areas and specific targets to be achieved. It is recommended that HEIs formulate their strategies in a "SMART" way (and based on a SWOT analysis): specific, measurable, acceptable, realistic, and time-limited. Designed that way, strategies can give direction to the institution by demonstrating their strengths, weaknesses, and particular profile or niche in a specific way, with clear ambitions that can be achieved realistically within the time span of the strategic plan.

G2. Keep the communication on the strategy focused and make transparent how various stakeholders contributed.

Strategic plans are supposed to be "lived" by an organization. This requires that the key messages are used repetitively inside the institution to make sure that as many internal stakeholders as possible know what ambitions, norms, objectives, and targets to adhere to. HEIs would also be well advised to demonstrate and openly communicate about these ambitions, norms, objectives, and targets in various policy documents and meetings at the central and faculty level. The same applies to the contributions that different groups and individuals have made to achieve the strategic objectives. Potential activities in that respect are celebrating milestones that were achieved (for example, an annual celebration honoring those who have won international research grants), and monitoring progress toward education innovations and communicating the progress within the wider HEI community via the institutional newspaper and website, and news items.

G3. Ensure actual implementation of the strategy and translate the strategy into policies aimed at achievable goals.

As stated, a strategy needs to "live" in an organization. This implies that if an HEI has formulated a particular objective (for example, to increase the number of PhD holders), specific strategic action plans need to be adopted (for example, to allow units to recruit more PhD holders, to allow and stimulate staff to obtain a PhD, and to make the number of PhD holders an issue of regular debate among the rectorate and deans, or deans and department heads). The action plans can also be implemented into target agreements or performance contracts among the various levels in an organization.

G4. Monitor implementation progress, for example, by keeping track of key performance indicators.

The realization of strategic plans can be made visible by translating the key strategic priorities into concrete and measurable targets that are then documented and recorded periodically. Forms in which this can be done are, among others,

annual performance overviews, performance contracts, annual reports, and improvement plans of teaching programs. Procedures like those can subsequently provide input to regular meetings among the institutional leaders and managers of different levels: rector, deans, department heads. A central MIS can be of great help in that respect, when it includes all basic data that can inform strategic decision making and the wider HEI community on the status of the HEI in various areas. In developing the MIS, the institutions can greatly benefit from making use of the data that are already collected (see also recommendation F22).

- G5. Develop further internal quality assurance procedures such as an annual improvement plan and report, and create units or positions with a clear mandate of taking on responsibility for quality assurance.

Most Latvian HEIs deploy some form of quality assurance and prepare their study programs for accreditation. To embed quality assurance more fully and continuously within the institution (that is, also during the period between two accreditations) and to transform it from an externally prescribed duty into an essential part of the HEI's operations, there needs to be a place within institutions where the responsibility for monitoring and facilitating quality assurance is located. This can be implemented in the form of a central quality assurance unit, administrators appointed as quality assurance managers, or academic staff members that assume that function on a part-time basis. It is furthermore important that this responsibility is used actively, and that it leads to concrete results, in particular, to tools and guidelines (for example, on how to monitor program quality and translate the insights gained into quality enhancement activities) via which teaching and research staff, departments, and faculties can easily create transparency on and have benchmarks to improve the quality of their activities. One possible approach is annual reports and improvement plans for study programs that address the major progress toward strategic (quality) objectives and the intended improvements to be achieved the next year. Despite the administrative anchoring of quality assurance, quality remains a shared responsibility of all members of an institution.

- G6. Develop accountability mechanisms that measure (individual) performance without jeopardizing academic freedom.

Complementing the previous recommendation, some mechanism that allows for a periodic assessment of individual staff members and units can be useful in the governance and authority relationships within an organization, particularly for promoting the transparency of authority relationships — one example for such a mechanism is the “academic scorecard” — instrument introduced at the Münster University of Applied Sciences in Germany (World Bank 2016a:70). This can be achieved at least partially via an MIS, which can include data on individuals, but also via an annual personal overview on main activities and performances in the areas of, among others, teaching, research, and project work. Past performance and envisaged contributions to the unit as well as career plans can be discussed in an annual appraisal talk between staff members and unit leaders.

- G7. Develop a simple and transparent governance structure with as few overlaps and duplications of functions and positions as possible.

Some Latvian HEIs have complex organizational structures with various institutes, faculties, academic and practical departments, centers, study programs, and

administrative services. Many of those units are necessary to structure the various tasks that HEIs need to fulfill. Nevertheless, it appears that over time some institutions have grown into organizations with a multitude of organizational units and structures that may exhibit a range of duplications in functions, responsibilities, and tasks. In addition, individuals may be members or heads of multiple units that stand in vertical or horizontal authority relations to each other. One example is formed by the governance councils of study directions that have been implemented in most HEIs. However, their role is not always clearly defined. In those cases, it is an open question whether they are part of the overall internal quality assurance structure, whether they focus on strategic or operational aspects, and whether they form the prime link to employers. In some cases, external representatives can be involved both in advisory boards and in the governance councils of study directions. Against this backdrop, some HEIs could greatly benefit from reassessing the functionality of their internal governance structures — as, for example, the Technical University Munich, Germany, did (World Bank 2016a: 80).

G8. Consider forming larger institutional subunits, but do not perceive size as a goal in itself, and design internal mergers carefully.

Some HEIs are about to reform their internal organizational structures by forming larger units and thereby reducing their overall number. The trend toward larger units can be observed in many countries. The rationale behind this is to overcome barriers among units to stimulate internal, multidisciplinary cooperation, and to build units with a critical mass, especially, for research — reasons that, among others, also motivated the comprehensive internal restructuring process at the Technical University Dresden, Germany, which furthermore exhibits an elaborate design of the transition process (World Bank 2016a: 60). Internal mergers, however, might lead to conflicts and a situation where no real collaboration takes place and the unit members simply continue to do what they've always done. HEIs therefore need to focus on approaches of change management accompanying such processes. For instance, there needs to be intensive communication, internal scouting for joint interests in research, and a competition for the best concepts for interdisciplinary study programs. Larger units have the potential for more self-steering on the faculty or institute level, so that internal mergers can be combined with greater autonomy on the decentralized level (see also recommendation F18).

G9. Integrate research institutes to increase mass, stimulate innovation, and forge stronger links among teaching and learning and research.

Some Latvian HEIs feature research institutes that function semi-autonomously within the institution. Bringing those structurally and practically closer to academic departments and faculties would help stimulate closer research collaboration among the various academics that work in similar research domains. This could be done by ensuring that those research institutes are integrated into the HEIs' governance structures and strategic development and by promoting links and exchange between those research institutes and other institutional subunits — or, where appropriate (see also recommendation G8), by formally integrating research institutes under or into subunits. Irrespective of the approach chosen, increased innovativeness, greater efficiency, and a stronger basis for collaboration with external partners could be achieved. In addition, academics that predominantly teach would be brought closer to the research portfolio of the institution,

which can inspire and innovate teaching programs. For the same reasons, institutions could in some cases search for possibilities to realize structural synergies also at the interinstitutional level.

- G10 Distribute authority appropriately and clearly among organizational levels, and find the right balance between top-down and bottom-up relations among them in decision-making processes.

The legal framework to some extent regulates the authority distribution within Latvian HEIs, but leaves institutions some flexibility in allocating powers among organizational levels. Ultimately, a lot of decision-making power is located at the central level with the rector, senate, and constitutional assembly. To become more flexible and reactive to external developments, some larger Latvian HEIs exhibit a tendency to provide lower levels such as faculties and departments with more autonomy — as, for example, also the Free University of Berlin, Germany, did to complement the introduction of a performance-oriented funding system (World Bank 2016a: 81)—, for example, by providing them with budgets from second-pillar funding. However, it remains unclear in many cases whether there is a clear and transparent distribution of authority and responsibility within institutions. It is therefore recommended — along with an assessment of the efficiency of internal organizational structures mentioned above — that responsibility, autonomy, and authority relationships of the different organizational levels be clarified and possibly redefined.

- G11. Strengthen decision-making powers of key management positions while balancing academic and managerial self-governance in an adequate way, and analyze critically the checks and balances for all aspects of decision making.

Academic self-governance, that is, decision making by collegial academic bodies such as the senate, councils, a science commission, or a budget commission, plays a major role in Latvian HEIs. This is quite different from the development in many European countries, where, on the one hand, the role of leaders on the different levels (rectors, vice-rectors, deans, and so forth) is strengthened, but, on the other hand, increased accountability of these decision makers, combined with personal responsibility, leads to a system of checks and balances. A good governance system must create an adequate balance between academic and managerial self-governance, because each of these forms of decision making in HEIs has its pros and cons. Academic self-governance via collegial bodies including academics, administrative staff representatives, and students ensures internal acceptance and bases decisions strongly on the principles of democracy, but is time-consuming and tends to produce egalitarian decisions. The collegial character of decision making could lead to a situation of what might appear as a collective lack of responsibility, because there is no clear person responsible. Managerial self-governance makes decision making efficient and flexible, and more easily allows for setting clear priorities. Strategies with actual focuses and organizational reforms are more likely to be feasible and successful with clear personal responsibility. The danger related to managerial self-governance lies in autocratic decisions. In a system of sound checks and balances, the powers of collegial bodies and individual leaders are balanced. Latvian HEIs would be well advised to conduct a critical assessment of their decision-making structures, and the respective checks and balances. It would be particularly important to reflect on whether there is currently an imbalance toward exaggerated academic

self-governance, and whether steps could be taken to increase the relevance of managerial self-governance, without endangering the important basic principles of internal democracy — key developments in Europe in this respect (for an overview see World Bank 2016a: 71–72; 76–81) can provide points of reference for such a reflection and for potential steps taken afterwards. For example, benchmarks from other countries show that it can work well to let a collegial academic body decide on the principles of resource allocation, but to let the rector decide on the yearly allocation based on those principles. Decisions on prefunding of new initiatives, for example, can then be made in the rectorate.

G12. Design clear roles, responsibilities, and rights related to the involvement of external stakeholders in internal governance.

Currently, external stakeholders can be represented in Latvian HEIs in various ways via advisory boards at the central and decentralized level, for example, for study programs (including the governance councils of study directions), for research programs, and for central management issues such as in the form of the convent of counsellors. In most cases, it is not entirely clear whether the external stakeholders have an authoritative or an advisory role. Therefore, ensuring straightforward formal links among institutions and their bodies staffed with external stakeholders is highly recommended — and also fully in line with recent developments in many European higher education systems (for an overview on key trends related to the roles and responsibilities of external stakeholders in internal governance see World Bank 2016a: 72–75). Introducing a distinct role, and allowing external stakeholders to assume the role of “critical friends” and promoters of strategic thinking (without mixing them up with internal authorities such as senates) could, for instance, take place by granting them formal rights to veto institutional strategies. In any case, external stakeholders need to be vested with sufficient institutional support in terms of information and decision-making capacity provided to them — as, for example, the experience with university councils in Germany reveals (World Bank 2016a: 74). One specific area where closer links between external stakeholders such as the industry and HEIs could be particularly beneficial would be the strengthening of innovation capacity by developing closer ties in the area of human capital development. Governance arrangements ensuring mutual representation could play a supportive role in that regard.

G13. Keep students and staff well-informed, and take up their initiatives.

As stated in recommendation G2 concerning the communication of the institutional strategy, communication and the transparent sharing of information is important to keep members of an organization involved and committed. This means that successful organizations need to pay substantive attention to regular and objective communication toward their internal audience. However, this does not imply that staff representatives and students necessarily have to have decision-making powers on all matters, since this can negatively impact flexibility and innovation (see also recommendation G11). What is important, is to value the contributions that internal stakeholders, including students, make, and to support them as far as possible. For example, student representatives appeared as drivers for change in teaching and learning in several Latvian HEIs. They should therefore be intensively involved in reform processes, also being encouraged to start initiatives in areas of concern to them.

- G14. Actively develop management and administration skills among (interested) staff to create a pool of (future) managers and leaders, and to facilitate a culture of change management.

Latvian HEIs need to face rapid developments and changes, which often receive considerable support from various actors. However, integrating new functions, responsibilities, and tasks (for example, quality assurance, decentralized budgeting, and internationalization) requires careful and efficient management by individuals or organs with the expertise, mandate, and skills to find optimal solutions that balance the interests and opportunities in any given situation. The tasks and responsibilities emerging from this cannot be executed well without experience and training in the field, which institutions need to promote actively. Of course, different HEIs can collaborate to offer professional development programs in an efficient and effective manner. On a broader note and with a view to academic integrity, support schemes and trainings covering ethic-related contents addressing all academics could be another option in the field of staff development.

2.3 Considerations on Shared Challenges in the Near Future

Despite differences among Latvian HEIs with respect to their current internal funding models and governance arrangements, challenges that almost all of them need to address in the short to medium term can be identified. As discussed, differing institutional characteristics and states of development imply that the recommendations presented above need to be seen as a potential checklist that allows individual institutions to choose those issues that are of particular relevance to them. Nevertheless, some recommendations apply to almost all institutions and can furthermore be tackled already in the near future.

In the field of internal funding, Latvian HEIs can already today start with selected adaptations of their internal funding models and with setting the course for potential future reforms. Building on those efforts, additional common tasks need to be addressed in the medium term. To lay the groundwork for future reforms of internal funding models, all HEIs would be well advised to start monitoring their internal funding models and their impact (F20) as soon as possible. Institutions could furthermore engage in benchmarking processes and initiate an inter-institutional exchange on good practices in the field (F19). Complementing those efforts to prepare future reforms but also supporting the current impact of internal funding models, a key task shared by the entire Latvian higher education sector is to develop necessary human resources in higher education management (F21). Related to the current impact of funding models, HEIs also need to consider how to increase the transparency of internal funding models (F15). Taking a look at the medium term, a set of tasks related to potential improvements of internal funding models that all institutions need to tackle looms, namely, reflecting on the models from the perspective of a balanced three-pillar model (F11), finding the right balance between performance incentives directed at individuals and groups or units (F10), and reinforcing the overall focus on performance (F5).

When it comes to internal governance, short-term options such as advancing managerial skills exist, and additional tasks will emerge in the medium term related to processes of strategic planning. Institutions need to initiate developments in the field of internal governance in the short term by promoting management and administration skills of selected staff members (G14), and by intensifying the communication on their institutional strategies (G2). In addition, a major set of tasks will emerge in the medium term once the period covered by the current institutional strategies comes to an end. When developing new strategies, HEIs need to pay particular attention to formulating them in a SMART way (G1), consider options for ensuring an actual implementation of the strategy via adequate instruments (G3), and make sure that the implementation progress is monitored (G4).

3 Recommendations for the Government

Reforms on the institutional level are in many cases at least partly dependent on the external framework, requiring the government to establish conditions conducive to the Latvian HEIs' reform efforts in the fields of internal funding and governance. The main focus of this report has so far been on the institutional level in accordance with the level of analysis in the previous two reports (World Bank 2016a; 2017). However, the institutional level is not independent from the external framework. That raises the question of whether there is a need for further development on the state level to create the right framework for institution-internal developments of internal funding and governance. Key options are presented in the recommendations below that address both fields separately. Fortunately, there is the political will in Latvia to use ESF funding to promote that development. Recommendations on which mechanisms could be used in that respect, and which objectives would be key to pursue, are presented as well.

3.1 Recommendations for Government Policies on Internal Funding

P1. Allow for more internal dynamics and for support for innovative new programs under the first pillar of the state funding model.

While a fundamental reform of the study place model might only be envisaged for the future, it is recommended that any revision of the model take into account not only existing study programs, but also allow for the support of innovative new programs, and make the study place allocation overall more dynamic (for example, by also supporting multidisciplinary and joint degree programs). The government's plan to increase the funding amount per study place could prove to be crucial in that respect because additional funding is very important for strengthening the teaching and learning function. However, it would be important to ensure that the teaching and learning mission is not only supported via additional funding under the first pillar, but also via additional funding for that mission under the second pillar to introduce teaching and learning performance indicators (for example, covering the number of graduates or international students), and under the third pillar to establish funding pools for innovations in teaching and learning (see also below).

- P2. Extend the performance orientation under the second pillar of the state funding model to teaching and learning.

Widening the current focus of performance incentives beyond the field of research, a component that provides incentives for performance in teaching and learning (for example, with graduates, exams, or credit points as possible indicators) could be added to the second pillar. Also worthy of consideration is how the employability of graduates⁴³ could be monitored and reflected in terms of funding under this pillar.

- P3. Clearly show how the deployment of ESF funding contributes to strategic targets and sustainable actions.

While in the longer term the inclusion of other funds under the third pillar would be desirable, the use of ESF funds for promoting innovation seems to be a suitable approach in the medium term. Irrespective of the source of funds, there needs to be a visible connection between the ways in which the funding is used and the strategic objectives on both the state and the institutional level, with a particular focus on the sustainability of the activities supported.

- P4. Increase the usability and effectiveness of the state funding model by sorting funding streams and mechanisms to the appropriate pillars.

The system-level funding model is based on the separation of three pillars with different functions, to which the respective allocation mechanisms are connected. The model's steering potential and impact could be increased by ensuring that the different funding streams and mechanisms currently implemented in Latvia are sorted to the different pillars according to their function, as recommended in the first World Bank reimbursable advisory service (World Bank 2014). This could, for example, mean rearranging the model in such a way that the performance-oriented parts of the allocation of the first-pillar research base funding, particularly the number of awarded doctoral degrees, could become part of the second pillar.

- P5. Promote the integration of all core missions into institution-internal funding models.

To support institutions in fulfilling their core activities, it would be important to establish the right framework for the integration of teaching and learning, research, and valorization in internal steering mechanisms. Relevant aspects of such an institution-internal integration via external integration are the gradual transition from the separate staff categories of professor (meaning teacher) and researcher toward a model in which most academics perform both teaching and research tasks, and an integrated funding model supporting the idea that teaching, research, and valorization form an integrated work portfolio of academic staff members (which was already started with the three-pillar model). This does not imply that there cannot be staff categories that focus on either teaching or research, or that the allocation of time among different tasks cannot

⁴³ The team was informed that a performance indicator covering the employability of graduates is under preparation by the MoES. Such an indicator would ideally capture employment outcomes considering differences among fields and regions. The design of the indicator could benefit from being conducted jointly with the sector, among others, to account for that complexity.

differ among academics. What is important, however, is that professors, as the leading academic figures, are always also researchers, even though the time allocated to different types of activities can differ from one professor to another. More generally, it would be important to conduct a thorough reflection of the current staff structures in the higher education sector. In the medium term, it will be important to assure that all supported missions of HEIs are reflected in the higher education legislation.

P6. Introduce coherent data requirements.

It would be beneficial to the Latvian higher education sector if similar data were collected for different purposes such as national statistics, quality assurance, performance measurement by the government, and international transparency tools like U-Multirank. The reporting of data would at best be adapted to the needs related to the current funding formula system and other external data requirements. That way, a coherent approach with one database for various purposes could be created, while also providing a good basis for institution-internal MISs.

P7. Ensure and communicate the reliability of external framework conditions for internal developments.

The three-pillar model on the state level is being introduced step by step. That makes it important to have a clear plan and schedule for the implementation of additional components of the model, which also need to be communicated actively. In particular, institutions would need to know in advance for how many years selected allocation criteria will be effective (with longer periods of four to five years being preferable to shorter periods). In addition, keeping track of the effects of the reforms by analyzing their impact on HEIs — which the project of which this report is a part did at an early stage to enable first reactions — at a later stage would be advisable.

3.2 Recommendations for Government Policies on Internal Governance

P8. Stimulate higher education institutions to produce well-targeted and realistic strategic plans.

The Latvian government would be well advised not only to request HEIs to develop strategic plans, but also to promote their formulation in a SMART way — that is, specific, measurable, acceptable, realistic, and time-limited (see also recommendation G1) — and that they actually give direction to institutions in terms of a unique profile and a distinct role within the Latvian higher education sector (which would also require an effective communication of the strategy), integrating the different core functions of HEIs. Designed that way, strategic plans can also help foster open and transparent dialogue between HEIs and the ministry on how institutional strategies and actions contribute to national strategies.

P9. Implement and communicate the national strategy.

Like institutional strategies, the national strategy is to inform the dialogue among the ministry, HEIs, and additional stakeholders involved in higher education, and should also be developed in a SMART way. To have an impact, it needs to be communicated widely and strategically, and translated into various policy instruments that are prioritized and executed at the appropriate time and in the appropriate sequence. The contribution of HEIs to the strategy can be stimulated through different policy instruments such as funding arrangements (for example, funding formulas and performance agreements), regulations (for example, laws and regulations that widen or restrict the range of activities institutions can engage in), organizational measures (for example, new innovative programs and degrees), and information mechanisms (for example, information on study programs and their outcomes that can inform prospective students). In line with the development trend in the overall higher education governance approach in Latvia revolving around institutional autonomy, indirect steering mechanisms (as opposed to direct regulatory influence), which set targets but grant HEIs autonomy in deciding how to attain them, are particularly relevant in that respect.

P10. Monitor the implementation progress of the national strategy, for example, by keeping track of key performance indicators.

At the national level, relevant information on the higher education sector needs to be collected to inform, among others, public policy, funding and governance instruments such as performance agreements (for additional information on the connection between monitoring results and funding instruments like performance agreements see World Bank 2014: 22–23, 39–44), and international statistical needs. It is important for all those purposes to reach an agreement on common definitions and a shared understanding of relevant data (ibid.), which are supposed to reflect the essence of the country and individual HEI strategic priorities. This could be supported by a national MIS. Going forward, relevant indicators could include, for example, the number of graduates or international students (see recommendation P1), while ensuring that data collection at the national level, institutional level, and through instruments such as U-Multirank is well aligned.

P11. Stimulate excellent research and the integration of teaching and research.

Given the limited research-related resources currently available in Latvia, it is key that they are used efficiently and effectively. That requires smart organization of the research capacity and facilities in the system, in particular, since research as one of the core functions of HEIs also constitutes an important aspect of graduate education. Many countries apply a strategy of “focus and mass” in which larger groups of researchers with common interests are concentrated in larger units, for example, by merging research institutes and HEIs. In addition to creating substantive research groups that are more likely to be successful in the application for external resources (for example, European Union (EU) projects and industry contracts), that opens the possibility of connecting academics with a strong teaching role to their more research-oriented peers, which fosters up-to-date teaching practices and innovation. The practical implementation of restructuring processes could be achieved via a combination of top-down financial support for bottom-up internal (and probably also external) consolidation efforts, as was

used for consolidation efforts in Denmark, in the fields of research and teaching.⁴⁴ Setting incentives at the central level and allowing HEIs to choose strategic alliances increases ownership and, in most cases, enhances the likelihood of successful collaboration. That could be supported through stimuli that are already used, such as financial support for the involvement of students in research activities. However, additional incentives would be needed, which could include ESF support for joint research units, which are established as a first step toward more comprehensive strategic alliances or mergers. In general, that approach might be preferable to restructuring by detailed planning at the central level.

P12. Promote the development of a quality culture within institutions and related procedures such as annual improvement plans and reports.

The government can facilitate the development of a quality culture within institutions by increasing the importance attached to quality assurance on the higher education policy agenda, and by supporting HEIs to develop such cultures, for example, through enhancing the connection and exchange of good practices among institutions, by providing support for the fostering of closer stakeholder relations with the aim of increasing quality of provision (see recommendations G12 and G13), through targeted training for institutional leadership and other staff (see also recommendations G14 and G15), and through support for ‘change agents’, that is, institutional quality champions. Again, such activities and related quality enhancing structures could be supported by ESF-funded programs. All activities in that field would need to take into account the Standards and Guidelines for Quality Assurance in the European Higher Education Area (ESG) (ENQA 2015).

P13. Facilitate transparent governance structures within institutions.

Laws and regulations regarding the governance structures (that is, the entirety of formalized decision-making and management arrangements) of HEIs need to be clear and provide transparent definitions of roles, responsibilities, and levels of autonomy of the various bodies and actors. Also future legislation needs to indicate what HEIs can decide by themselves. The government could furthermore stimulate greater decentralization within institutions, for example, by simultaneously strengthening the powers of deans, reducing the powers of collegial self-governance bodies, and enclosing the decision-making rights in a checks-and-balances system, which should be based on further analysis, for example, via functional reviews (see recommendations G7 and option ESF6), and might require subsequent adjustments of the legal framework. Clarity and transparency are also needed regarding the roles, responsibilities, and expectations of external stakeholders in advisory or supervisory bodies (such as the councils of counsellors and the governance councils of study directions — see recommendation G12) and in quality assurance procedures. In that respect, it is advisable that institutions are clearly aware of whether they are expected to give certain responsibilities to such bodies and stakeholders, or whether they are free to decide on their involvement (see World Bank 2016a: 72–75). In general, it would be best if the government defined general principles (*ibid.*) which are then specified by

⁴⁴ The potential benefits of consolidation were already identified and discussed in a first World Bank reimbursable advisory service on higher education funding in Latvia (World Bank 2014).

the institutions within their organizational autonomy, thereby striking a balance between necessary sector-wide standards and the essential institutional autonomy (see also recommendation P16). For instance, a law or regulation could state that external stakeholders should have an explicit say on the institutional strategy, but the way in which that is implemented is decided by each HEI. Similarly and with a view to greater organizational effectiveness (see recommendation G7 and World Bank 2017: 49–50, 52–53), the regulatory framework could determine that there should be a separation between internal legislative power (for example, concerning general principles of funding allocations or internal rules) on the one hand, and executive power or operational management (for example, responsibility for yearly allocations or the execution of rules) on the other hand, without determining all potential details of the implementation of such a separation.

P14. Keep students and staff well informed.

The government can set guidelines for how HEIs inform their staff and students to ensure their contribution to a balanced institutional development (guidelines as they have been developed, for example, by the European Students' Union (2011) might serve as a source of inspiration for the government), which would be particularly relevant in case there is an internal adjustment of decision-making powers. In that respect, such an involvement does not necessarily imply providing students and staff members with ultimate decision-making powers (in collegial bodies). As discussed (see recommendation P13), finding the right balance between sector-wide principles and institutional autonomy is also important in this respect (see also recommendation P16).

P15. Actively develop management and administration skills among (interested) staff members to create a pool of upcoming managers and leaders.

It is recommended that the management capacity development in the higher education sector (see recommendations F21 and G14) be supported by the government. That can be done by providing separate funds for that purpose, for example, in the form of ESF-funded programs supporting trainings (see option ESF4), by promoting a more centralized higher education management development program in which HEIs collaborate or jointly determine their needs, or by assigning the responsibility to one of the HEIs (without subsequent direct involvement of the government but potentially supported by ESF).

P16. Preserve the autonomy of higher education institutions.

Any future attempt to promote certain developments within HEIs needs to take into account the potential impact on the autonomy of institutions, which is a fundamental component of the overall higher education governance approach in Latvia that contributes to the system's efficiency and effectiveness, and should therefore be preserved.

3.3 Options for the Use of European Structural Funds

The improvement of governance in Latvian HEIs and assistance with strategy implementation are the key objectives of the strategic background of ESF funding when it comes to support for internal funding and governance.

The strategic framework in which the potential allocations of ESF funding are embedded includes the “National Reform Programme of Latvia for the Implementation of the ‘Europe 2020’ Strategy” and the “Operational Programme ‘Growth and Employment.’” Within that framework, there is a wider range of ESF programs for 2014–20 from which HEIs in Latvia can benefit, some of which are still in a development phase. Of particular importance for the fields of internal funding and governance addressed in this report is specific objective (SO) 8.2.3, which aims at better governance within HEIs and which has as one of its core objectives supporting institutional strategy implementation, but also SO 8.2.2 aiming at strengthening the capacity and competences of academic staff members, and SO 8.2.1 aiming at the development of competitive study programs in EU languages and joint doctoral programs. Potential options for using ESF funding to promote internal funding and governance in Latvian HEIs within the discussed framework are the following, which cover basic considerations concerning the use of ESF funding and specific objectives that could be covered by ESF-funded programs.

Basic Considerations

ESF1. There is no single best funding measure to be used for ESF funding. Developments would need to be addressed with a variety of targeted financial support measures. The new three-pillar funding model currently under development reflects the priorities of the MoES, and constitutes an overarching frame on the system level, and additional funding would at best be distributed as part of this model to support those priorities.

ESF2. One way in which ESF funding could be used would be to finance a systematic third-pillar component with target agreements on the state level in the form of a funding pool (linked to target agreements) for either innovative projects or to support the development of institution-specific profiles. Innovative projects to be funded by such a pool of resources could include experiments with new study programs or the improvement of the quality of existing programs (see also recommendation F8). In past years, ESF funds were used to make institution-specific investments. A systematic link to the third pillar would mean framing the funding through an explicit link to institutional strategies, also measuring the impact on the attainment of strategic objectives at the institutional and national level (see also recommendation P3).

Specific Objectives

ESF3. An integrated database that creates the technical basis for institution-specific MISs could also be an important target of funding. Efforts to create such a database would benefit from taking into account the need (on the side of HEIs) for a sufficient data quality, the relevance of natio-

nally aligned data, and the potential that existing datasets that are currently not used for that purpose bear (see recommendations F22 and P6). In addition, the possibilities for HEIs to use MISs need to be considered, for example, as a source of information for strategic decision making and steering (see recommendation G4), or as an accountability instrument supporting authority relationships (see recommendation G6).

- ESF4. ESF funding could be used to promote competence development in higher education management (which is supposed to be supported by SO 8.2.2). Possibilities for that include establishment of a respective unit at one HEI (potentially, also in collaboration among the Baltic states to create a critical mass), supporting formats of peer learning for decision makers, and targeted trainings in higher education management (see also recommendation P15). Any form of support for higher education management competence development would need to account for the diversity of potential beneficiaries (ranging from the central-level and unit-level leaders to administrators) and the variety of skills needs (ranging from strategic management and an understanding of the dynamics of using different incentive mechanisms to the implementation of quality assurance instruments) (see recommendations F21 and G14), while any assessment would need to be based on the agreed learning outcomes of the respective programs. That way, Latvia and its HEIs could become part of a European community revolving around academic training in higher education management, possibly also providing impulses to expand applied research on HEIs.
- ESF5. Promotion of the strategic development of institutions is a particularly important purpose and an avowed activity to be supported by SO 8.2.3. The institutional strategies, which are anchored under the strategy of the MoES, are an important point of reference in that respect. Potential funding instruments and mechanisms that HEIs could deploy for strategy implementation are, among others, strategic or innovation funds of the rectorate, innovative research funds (for example, dedicated to high risk research outside existing institutional profile areas), study program development funds, young researcher funds, and matching funds for EU projects (see also recommendation F8; for details and examples see World Bank 2016a: 29–33). All these mechanisms could be supported via ESF funding. An important question to be addressed here is co-funding modalities, for example, arrangements where the MoES provides financial support that is reinforced by HEIs. Generally, a sensible approach would be for HEIs to establish and conceptualize targets, complemented by MoES-initiated peer review procedures that check the quality of internal instruments, such as whether performance orientation is guaranteed and whether mechanisms are competitive.
- ESF6. For the further development of institution-internal decision-making structures, funding could support HEIs with functional reviews of their governance structures, leading to detailed concepts for institutional checks and balances. Key questions that need to be covered by a functional review concern: the complexity and transparency of governance structures, for example, potential duplications in functions, responsibilities, and tasks, and potential multiple memberships of individuals in units that stand in vertical or horizontal authority relations to each other (see recommendation G7); the appropriate distribution of authority among organizational

levels (see recommendation G10), including matters of financial autonomy of decentralized units (see recommendations F17 and F18); connections to potential changes of academic structures (see recommendations G8 and G9); an adequate balance between academic and managerial self-governance with sufficient decision-making powers of key management positions (see recommendation G11); and appropriate ways of involving external stakeholders (see recommendation G12) and internal stakeholders (see recommendation G13).

ESF7. Another reasonable option for using ESF funding is the further development of quality assurance structures and processes, one of the activities explicitly envisaged under SO 8.2.3. That could be done through support for individual institutions or could take the form of a project involving all Latvian HEIs. One option would also be to establish a competitive fund that supports innovative proposals and good practice approaches in the field of quality assurance that could then be replicated by other institutions. In this, it would be important to promote that quality assurance is embedded comprehensively as an essential part of the HEIs' operations in the form of a quality culture (for example, via targeted training for institutional leadership and other staff, or via support for 'change agents', that is, institutional quality champions), and to support the institutionalization of quality assurance within HEIs and the development of suitable quality assurance instruments (see recommendations G5 and P12).

ESF8. Finally, to create a stronger basis for teaching and research quality and excellence, ESF funding could be used to support initiatives to intensify collaboration and, in some cases, mergers, among HEIs, their faculties, and research institutes. Support programs in that respect need to account for the potential conflicts and critical outcomes of mergers (for example, the absence of actual collaboration despite a formal merger) (see recommendation G8). A recommendable approach that mitigates several of the challenges related to (internal) restructuring processes — and which could be either used directly by the ESF-funded program or supported via the program — consists in providing top-down support for bottom-up efforts, that is, establishing incentives but leaving the choice to the institutions or units in question (see recommendation P11). In addition, it is important to keep in mind that questions of internal restructuring are also closely related to questions of decentralized financial autonomy (see recommendation F18).

3.4 Considerations on Priorities for the Near Future

Some of the possibilities for the Latvian government to promote internal funding and governance within HEIs can be implemented in the short term, whereas others are long-term tasks or need to be attuned to related activities within institutions. A first set of the recommendations presented above could already be addressed during the next round of the annual funding negotiations between the MoES and HEIs, for example, considering how to increase the dynamic of first-pillar funding allocations within institutions and how to enable support for innovative new programs (P1). The upcoming design of ESF-funded programs provides the opportunity to implement another recommendation in the near future,

namely, to ensure that the programs contribute to strategic targets on the national and the institutional level, and that this connection is made clear (P3). It would also be relevant for the Latvian government to reflect on the future development of financial (and other) framework conditions for HEIs and to communicate their reliability actively (P7) as soon as possible. Complementing related efforts of HEIs, the government could offer support for the development of management and administration skills within institutions (P15) already in the short term. In the medium term, two tasks stand out: introducing coherent data requirements for institutions (P6), also in connection to the establishment of a centralized higher education information system, and promoting institutional strategies that are well-targeted and realistic (P8). Long-term tasks for the government concern more comprehensive undertakings such as the development of a national strategy, including adequate communication mechanisms (P9) and progress monitoring instruments (P10), and substantive changes to the system-level funding model such as extending the performance orientation of the second pillar of the state funding model to the field of teaching and learning (P2). Finally, additional options for supporting HEIs with their reform efforts and for promoting the right framework conditions in the form of specific programs funded via ESF would need to be attuned to the strategic priorities emerging on the national and the institutional level, and the respective timelines.

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Annex 1

Overview on Recommendations on Internal Funding for Higher Education Institutions, Related Selected Recommendations for the Government, and Related Options for the Use of European Structural Funds

The following table contains the requirements for good internal funding models (first column), the status quo of internal funding in Latvian HEIs (second column), the recommendations on internal funding for HEIs (third column), related selected recommendations for the government⁴⁵ (fourth column), and related options for the use of ESF funding⁴⁶ (fifth column).

Recommendations that apply to more than one category are listed under each relevant category.

Requirements for Good Internal Funding Models	Status Quo of Internal Funding in Latvian Higher Education Institutions	Recommendations on Internal Funding for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
A. Strategic orientation				
A.1. Aligning internal funding model with external revenue streams and reflecting national goals	<ul style="list-style-type: none"> Performance orientation and focus on research of the second pillar of the state funding model are taken up internally Basic alignment of external and internal incentives is given for all income streams Alignment of incentives connects system-level policy objectives and institutional activities 	<ul style="list-style-type: none"> Continue to adapt to changes in external state funding. (F1) Put more effort into finding ways of translating the state funding model into a specific internal allocation model that corresponds to the institutional profile and situation. (F2) Treat the development of internal allocation systems and strategy development as "two sides of the same coin." (F3) Establish incentives to use specific opportunities to generate more funds for the institution. (F4) 	<ul style="list-style-type: none"> Ensure and communicate the reliability of external framework conditions for internal developments. (P7) 	<ul style="list-style-type: none"> ESF5. Promotion of the strategic development of institutions is a particularly important purpose and an avowed activity to be supported by SO 8.2.3. The institutional strategies, which are anchored under the strategy of the MoES, are an important point of reference in that respect. Potential funding instruments and mechanisms that HEIs could deploy for strategy implementation are, among others, strategic or innovation funds of the rectorate, innovative research funds, study program development funds, young researcher funds, and matching funds for EU projects. All these mechanisms could be supported via ESF funding.
A.2. Promoting institutional strategies and profiles	<ul style="list-style-type: none"> Funding models are connected to institutional strategies in different ways (including deliberate deviations from the system-level allocation mechanisms) Scope for use of new models in support of institutional priorities remaining Limited use of innovation funds to stimulate profiling 			
A.3. Promoting unit-level objectives	<ul style="list-style-type: none"> Unit-level specification and differentiation are not clearly promoted by the internal funding models due to the current structural particularities 			

⁴⁵ The full set of recommendations for the government on internal funding is presented above in chapter 3. Recommendations for the government that are related to more than one requirement or recommendation for HEIs are listed multiple times in the table.

⁴⁶ In the following table, only those potential options for the use of ESF funding that address specific objectives have been taken up in a shortened form as compared to the main text. Options for the use of ESF that are related to more than one recommendation are listed multiple times in the table.

Requirements for Good Internal Funding Models	Status Quo of Internal Funding in Latvian Higher Education Institutions	Recommendations on Internal Funding for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
B. Incentive orientation				
B.1. Creating performance rewards and sanctions	<ul style="list-style-type: none"> • Incentives are provided to units and/or individuals in most institutions • Performance orientation of state funding model's second pillar is taken up in most institutions; some institutions also provide performance incentives via other funding streams (e.g., research base funding) • Only a few performance incentives for teaching and learning and third mission exist • Challenges related to the impact of incentives exist (e.g., the lack of funding available for targeted allocations; major reliance on one income source for some institutions and units) 	<ul style="list-style-type: none"> • Continue to strengthen the performance orientation in the internal funding model. (F5) • Create a balance of incentives regarding the core missions of research, teaching and learning, and valorization. (F6) • Support program innovation via base funding for teaching and learning, and remain sensitive in relating programs and study places to demand as far as possible within the given framework. (F7) • Experiment more with internal third-pillar elements to create incentives for realizing innovations and change, and to promote prospective performance orientation. (F8) 	<ul style="list-style-type: none"> • Extend the performance orientation under the second pillar of the state funding model to teaching and learning. (P2) • Promote the integration of all core missions into institution-internal funding models. (P5) • Allow for more internal dynamics and for support for innovative new programs under the first pillar of the state funding model. (P1) • Ensure and communicate the reliability of external framework conditions for internal developments. (P7) 	
B.2. Providing clear and nonfragmented incentives	<ul style="list-style-type: none"> • Potential fragmentation of incentives in some institutions (due to high number of objectives/ indicators; fragmentation of rewards for different types of activities) 	<ul style="list-style-type: none"> • Seek possibilities to create funding components that allow units to define performance measurement according to their own priorities (especially within larger institutions). (F9) • Develop indicator systems with an adequate degree of complexity. (F16) • Monitor the impact of funding models (including potential unintended side effects) and at the same time consider issues of continuity, especially if changes are perceived to be necessary. (F20) • Strengthen incentives for good performance by striking a balance between rewarding individuals and groups or units. (F10) 		
B.3. Avoiding undesired side effects	<ul style="list-style-type: none"> • Limited incentives to collaborate across programs and units in some cases • Potential neglect of innovation through new study programs due to overall focus on research of incentive models and inflexible study-place approach • Potential lack of targeted funding incentives for less established or upcoming researchers • Incentives provided to individuals directly bear particularly high potential for unintended side effects (crowding out of intrinsic motivation) 			

Requirements for Good Internal Funding Models	Status Quo of Internal Funding in Latvian Higher Education Institutions	Recommendations on Internal Funding for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
C. Sustainability and balance				
C.1. Combining top-down and bottom-up approaches	<ul style="list-style-type: none"> Financial autonomy and competences of units are limited 	<ul style="list-style-type: none"> Seek possibilities to create funding components that allow units to define performance measurement according to their own priorities (especially within larger institutions). (F9) 	<ul style="list-style-type: none"> Ensure and communicate the reliability of external framework conditions for internal developments. (P7) 	
C.2. Providing a sufficient level of stability	<ul style="list-style-type: none"> Marked differences in degree of income diversification of institutions and units (hence insufficient degree of risk spreading in at least some cases) Funding models can forward the potential for stability provided by state funding for study places to units 	<ul style="list-style-type: none"> Gradually strengthen financial autonomy of decentralized units such as faculties and institutes. (F17) Create the organizational preconditions for decentralized financial autonomy. (F18) Monitor the impact of funding models (including potential unintended side effects) and at the same time consider issues of continuity, especially if changes are perceived to be necessary. (F20) 	<ul style="list-style-type: none"> Promote the integration of all core missions into institution-internal funding models. (P5) 	
C.3. Guaranteeing continuity in development	<ul style="list-style-type: none"> Regular adaptations of models in at least some institutions Communication surrounding change processes not always well developed 	<ul style="list-style-type: none"> Use the structure of the three-pillar model to reflect the balance in the internal funding model. (F11) 		
C.4. Balancing the overall model architecture	<ul style="list-style-type: none"> First and second pillars established Third pillar not developed yet within many institutions (e.g., lack of targeted support for innovative projects) 	<ul style="list-style-type: none"> Experiment more with internal third-pillar elements to create incentives for realizing innovations and change, and to promote prospective performance orientation. (F8) 		
C.5. Promoting diversification of unit-level funding sources	<ul style="list-style-type: none"> Funding models contain incentives for revenue generation activities Revenue generation is directly supported in some institutions 	<ul style="list-style-type: none"> Balance different orientations in research funding. (F12) 		
C.6. Balancing the key institutional missions	<ul style="list-style-type: none"> All missions are accounted for in internal funding models Bias toward research in the incentives and strategic steering – reflecting the system-level funding model Potential for better integration of missions 	<ul style="list-style-type: none"> Use both formula funding and target agreements in internal allocations. (F13) Establish incentives to use specific opportunities to generate more funds for the institution. (F4) Find a balanced approach to promote external revenue generation and to fund central infrastructure and services by retaining a share of third-party funds on the central level. (F14) 		

Requirements for Good Internal Funding Models	Status Quo of Internal Funding in Latvian Higher Education Institutions	Recommendations on Internal Funding for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
D. Transparency and fairness				
D.1. Ensuring transparency	<ul style="list-style-type: none"> • Basic understanding by institutions' members and transparency exist • Lack of in-depth knowledge about functioning of funding models in some parts of institutions 	<ul style="list-style-type: none"> • Be more active – and not only reactive – in creating internal transparency on funding criteria and outcomes. (F15) • Develop indicator systems with an adequate degree of complexity. (F16) 		
D.2. Supporting the perception of fairness	<ul style="list-style-type: none"> • Perception of fairness promoted by extensive discussion processes surrounding internal funding models • Extent to which field differences are taken into account remains questionable in some institutions 			
E. Level of autonomy and flexibility				
E.1. Guaranteeing financial autonomy and academic freedom	<ul style="list-style-type: none"> • Financial autonomy of institutions is comparatively high • Restrictions result from lack of available funds 	<ul style="list-style-type: none"> • Gradually strengthen financial autonomy of decentralized units such as faculties and institutes. (F17) • Create the organizational preconditions for decentralized financial autonomy. (F18) 		
E.2. Implementing an adequate level of regulation	<ul style="list-style-type: none"> • The corresponding level of regulation is adequate 			
F. Link to governance and management; practical feasibility				
F.1. Increasing reliability and availability of data	<ul style="list-style-type: none"> • Information and data required for current allocation mechanisms available for the most part • Challenges related to different sources and types of data in some cases 	<ul style="list-style-type: none"> • Share information and implement formats of benchmarking and peer counselling. (F19) • Monitor the impact of funding models (including potential unintended side effects) and at the same time consider issues of continuity, especially if changes are perceived to be necessary. (F20) • Promote human resource development in higher education management. (F21) • Develop integrated management information systems and use available systems whenever possible. (F22) 	<ul style="list-style-type: none"> • Actively develop management and administration skills among (interested) staff members to create a pool of upcoming managers and leaders. (P15) • Introduce coherent data requirements. (P6) 	<ul style="list-style-type: none"> • ESF3. An integrated database that creates the technical basis for institution-specific MISs could also be an important target of funding. • ESF4. ESF funding could be used to promote competence development in higher education management (which is supposed to be supported by SO 8.2.2). Possibilities for that include establishment of a respective unit at one HEI (potentially, also in collaboration among the Baltic states to create a critical mass), supporting formats of peer learning for decision makers, and targeted trainings in higher education management.
F.2. Ensuring administrative efficiency	<ul style="list-style-type: none"> • Administrative efficiency hampered by extensive decision-making processes and restrictions in budgeting processes 			
F.3. Ensuring coherence with other governance approaches and university culture	<ul style="list-style-type: none"> • Internal funding models mirror governance approaches and take into account cultural particularities of institutions 			
F.4. Ensuring the ability of the leadership to act	<ul style="list-style-type: none"> • Scope of decision-making rights of institutional leadership and managerial capacity in the institutions questionable (due to far-reaching competences of collegial bodies) 			

Annex 2

Overview on Recommendations on Internal Governance for Higher Education Institutions, Related Selected Recommendations for the Government, and Related Options for the Use of European Structural Funds

The following table contains the requirements for good internal governance arrangements (first column), the status quo of internal governance in Latvian HEIs (second column), the recommendations on internal governance for HEIs (third column), related selected recommendations for the government⁴⁷ (fourth column), and related options for the use of ESF funding⁴⁸ (fifth column).

Recommendations that apply to more than one category are listed under each relevant category.

Requirements for Good Internal Governance Arrangements	Status Quo of Internal Governance in Latvian Higher Education Institutions	Recommendations on Internal Governance for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
A. Strategic development and governance				
A.1. Having in place clear and precise institutional strategies aligned with institutional strengths/weaknesses and their environment	<ul style="list-style-type: none"> All institutions engage in strategic planning Particular attention is given to research/research strategies; some institutions have full-fledged institutional strategies Relevance of strategies for strategic steering purposes varies (due to, for example, generic character and lack of preciseness) 	<ul style="list-style-type: none"> Formulate SMART institutional strategies based on a SWOT analysis. (G1) Keep the communication on the strategy focused and make transparent how various stakeholders contributed. (G2) Ensure actual implementation of the strategy and translate the strategy into policies aimed at achievable goals. (G3) Monitor implementation progress, for example, by keeping track of key performance indicators. (G4) 	<ul style="list-style-type: none"> Stimulate higher education institutions to produce well-targeted and realistic strategic plans. (P8) Stimulate excellent research and the integration of teaching and research. (P11) Facilitate transparent governance structures within institutions. (P13) 	<ul style="list-style-type: none"> ESF5. Promotion of the strategic development of institutions is a particularly important purpose and an avowed activity to be supported by SO 8.2.3. The institutional strategies, which are anchored under the strategy of the MoES, are an important point of reference in that respect. Potential funding instruments and mechanisms that HEIs could deploy for strategy implementation are, among others, strategic or innovation funds of the rectorate, innovative research funds, study program development funds, young researcher funds, and matching funds for EU projects. All these mechanisms could be supported via ESF funding.
A.2. Having in place action plans that structure and support the strategy implementation process	<ul style="list-style-type: none"> Not all institutions have developed action plans 	<ul style="list-style-type: none"> Develop a simple and transparent governance structure with as few overlaps and duplications of functions and positions as possible. (G7) 		
A.3. Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process	<ul style="list-style-type: none"> Discussion processes leading to institutional strategies involve a wide range of stakeholders Extent to which stakeholder input is taken up is questionable in some cases 			

⁴⁷ The full set of recommendations for the government on internal governance is presented above in chapter 3. Recommendations for the government that are related to more than one requirement or recommendation for HEIs are listed multiple times in the table.

⁴⁸ In the following table, only those potential options for the use of ESF funding that address specific objectives have been taken up in a shortened form as compared to the main text. Options for the use of ESF that are related to more than one recommendation are listed multiple times in the table.

Requirements for Good Internal Governance Arrangements	Status Quo of Internal Governance in Latvian Higher Education Institutions	Recommendations on Internal Governance for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
A.4. Developing measures for the implementation of strategies	<ul style="list-style-type: none"> • Different instruments for strategy implementation are in place (e.g., connection to funding models) • Scope for improvement remains in many institutions (e.g., systematic communication strategies; new funding instruments) 	<ul style="list-style-type: none"> • Consider forming larger institutional subunits, but do not perceive size as a goal in itself, and design internal mergers carefully. (G8) • Integrate research institutes to increase mass, stimulate innovation, and forge stronger links among teaching and learning and research. (G9) 		<ul style="list-style-type: none"> • ESF6. For the further development of institution-internal decision-making structures, funding could support HEIs with functional reviews of their governance structures (see also recommendation G7), leading to detailed concepts for institutional checks and balances. • ESF8. To create a stronger basis for teaching and research quality and excellence, ESF funding could be used to support initiatives to intensify collaboration and, in some cases, mergers, among HEIs, their faculties, and research institutes.
A.5. Monitoring the strategy implementation process and adapting instruments/objectives if necessary	<ul style="list-style-type: none"> • Great variety among institutions related to strategy implementation monitoring (from hardly any monitoring at all to yearly discussions based on key performance indicators) 			
A.6. Securing and monitoring fitness for purpose of governance structures	<ul style="list-style-type: none"> • Fragmented structure of (heterogeneous) units and overall high complexity of internal structures • Several instances of decoupled research institutes • Attempts to consolidate academic structures and streamline governance structures in some institutions • Some deficiencies related to the connection of different higher education missions 			
A.7. Accompanying institutional developments with change management	<ul style="list-style-type: none"> • Various new policy instruments addressing, in particular, pillar-two funding • To be developed further; e.g., with respect to collaboration across units, integration of teaching and learning and research, and acquisition of funding for innovation 			

Requirements for Good Internal Governance Arrangements	Status Quo of Internal Governance in Latvian Higher Education Institutions	Recommendations on Internal Governance for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
B. Autonomy and accountability				
B.1. Securing academic freedom	<ul style="list-style-type: none"> Obligations of institutions as defined by the Law on Institutions of Higher Education (LIHE) (Section 6) 	<ul style="list-style-type: none"> Develop further internal quality assurance procedures such as an annual improvement plan and report, and create units or positions with a clear mandate of taking on responsibility for quality assurance. (G5) 	<ul style="list-style-type: none"> Promote the development of a quality culture within institutions and related procedures such as annual improvement plans and reports. (P12) 	<ul style="list-style-type: none"> ESF7. Another reasonable option for using ESF funding is the further development of quality assurance structures and processes, one of the activities explicitly envisaged under SO 8.2.3. That could be done through support for individual institutions or could take the form of a project involving all Latvian HEIs. ESF3. An integrated database that creates the technical basis for institution-specific MISs could also be an important target of funding.
B.2. Maintaining academic integrity	<ul style="list-style-type: none"> Specific instruments such as ethics committees and code of ethics exist in at least some institutions 	<ul style="list-style-type: none"> Develop accountability mechanisms that measure (individual) performance without jeopardizing academic freedom. (G6) 		
B.3. Anchoring accountability measures and quality assurance in governance structures	<ul style="list-style-type: none"> Several institutions have bodies on the central level responsible for quality assurance 			
B.4. Establishing adequate monitoring procedures and management information systems	<ul style="list-style-type: none"> Selected challenges related to definitions of indicators and valid data collection methods Comprehensive management information systems not established in most institutions 			
C. Good governance 1: Cooperation and participation				
C.1. Balancing responsibility of collegial bodies and personal responsibility maintaining a cooperative approach	<ul style="list-style-type: none"> Deep-rooted democratic culture and highly interactive and inclusive decision-making processes on all institutional levels Balance tilted toward responsibility of collegial bodies as opposed to personal responsibility 	<ul style="list-style-type: none"> Strengthen decision-making powers of key management positions while balancing academic and managerial self-governance in an adequate way, and analyze critically the checks and balances for all aspects of decision making. (G11) 	<ul style="list-style-type: none"> Facilitate transparent governance structures within institutions. (P13) Keep students and staff well informed. (P14) 	<ul style="list-style-type: none"> ESF6. For the further development of institution-internal decision-making structures, funding could support HEIs with functional reviews of their governance structures (see also recommendation G7), leading to detailed concepts for institutional checks and balances.
C.2. Involving external stakeholders in institutional governance and securing their proper conduct	<ul style="list-style-type: none"> External stakeholders are involved in different ways (on central level and on lower institutional levels) Involvement mostly in an advisory capacity (missing formal rights and responsibilities) 	<ul style="list-style-type: none"> Design clear roles, responsibilities, and rights related to the involvement of external stakeholders in internal governance. (G12) Keep students and staff well-informed, and take up their initiatives. (G13) 		
C.3. Developing appropriate ways of involving internal stakeholders on different institutional levels	<ul style="list-style-type: none"> Well-developed involvement of internal stakeholders (especially due to democratic and inclusive governance processes) Student representatives are generally well informed and strongly integrated into decision-making procedures 			

Requirements for Good Internal Governance Arrangements	Status Quo of Internal Governance in Latvian Higher Education Institutions	Recommendations on Internal Governance for Higher Education Institutions	Related Selected Recommendations for the Government	Related Options for the Use of European Structural Funds Funding
D. Good governance 2: Differentiation of functions and distribution of powers				
D.1. Separating strategic and management tasks framed by checks and balances	<ul style="list-style-type: none"> Strategic and management tasks not always clearly separated 	<ul style="list-style-type: none"> Strengthen decision-making powers of key management positions while balancing academic and managerial self-governance in an adequate way, and analyze critically the checks and balances for all aspects of decision making. (G11) 	<ul style="list-style-type: none"> Facilitate transparent governance structures within institutions. (P13) Actively develop management and administration skills among (interested) staff members to create a pool of upcoming managers and leaders. (P15) 	<ul style="list-style-type: none"> ESF6. For the further development of institution-internal decision-making structures, funding could support HEIs with functional reviews of their governance structures (see also recommendation G7), leading to detailed concepts for institutional checks and balances.
D.2. Equipping central leadership with sufficient and adequate competences	<ul style="list-style-type: none"> Lack of competences of central leadership due to strong position of bodies of collegial self-governance 	<ul style="list-style-type: none"> Develop a simple and transparent governance structure with as few overlaps and duplications of functions and positions as possible. (G7) 	<ul style="list-style-type: none"> Distribute authority appropriately and clearly among organizational levels, and find the right balance between top-down and bottom-up relations among them in decision-making processes. (G10) 	<ul style="list-style-type: none"> ESF4. ESF funding could be used to promote competence development in higher education management (which is supposed to be supported by SO 8.2.2). Possibilities for that include establishment of a respective unit at one HEI (potentially, also in collaboration among the Baltic states to create a critical mass), supporting formats of peer learning for decision makers, and targeted trainings in higher education management.
D.3. Securing efficiency and transparency of governance structures	<ul style="list-style-type: none"> Complex governance structures with a high number of bodies and actors and extensive informal negotiation processes lead to lack of efficiency and effectiveness of internal governance processes 	<ul style="list-style-type: none"> Actively develop management and administration skills among (interested) staff to create a pool of (future) managers and leaders, and to facilitate a culture of change management. (G14) 		
D.4. Establishing an adequate level of devolution	<ul style="list-style-type: none"> Weak position of units and unit leadership Sporadic attempts to strengthen units 			
D.5. Ensuring staff development and developing human resource strategies	<ul style="list-style-type: none"> Only a few human resource development initiatives for higher education management and administration 			

