ESF Project no. 8.3.6.1/16/I/001 «Participation In International Educational Studies»

World Bank Reimbursable Advisory Service on Higher Education Internal Funding and Governance in Latvia

Internal Funding and Governance in Latvian Higher Education Institutions: Status Quo Report

---

13 February 2017

Table of Contents

LIST OF EXAMPLES

LIST OF FIGURES

LIST OF TABLES

List of 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 institutional 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 stocktaking 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 support[1] **addressing the internal funding models, governance arrangements and human resource policies of Latvian higher education institutions started in 2016.**[2] 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.[3]

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 higher education financing team[4] 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

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

[2] 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.

[3] 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.

[4] 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.

more broadly, including during a workshop on 23 November 2016,[5] 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,[6] 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.[7] 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.

[5] The workshop agenda can be found in Annex 1.

[6] 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.

[7] 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.[8] In 2016, EUR 85.6 million[9] 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.

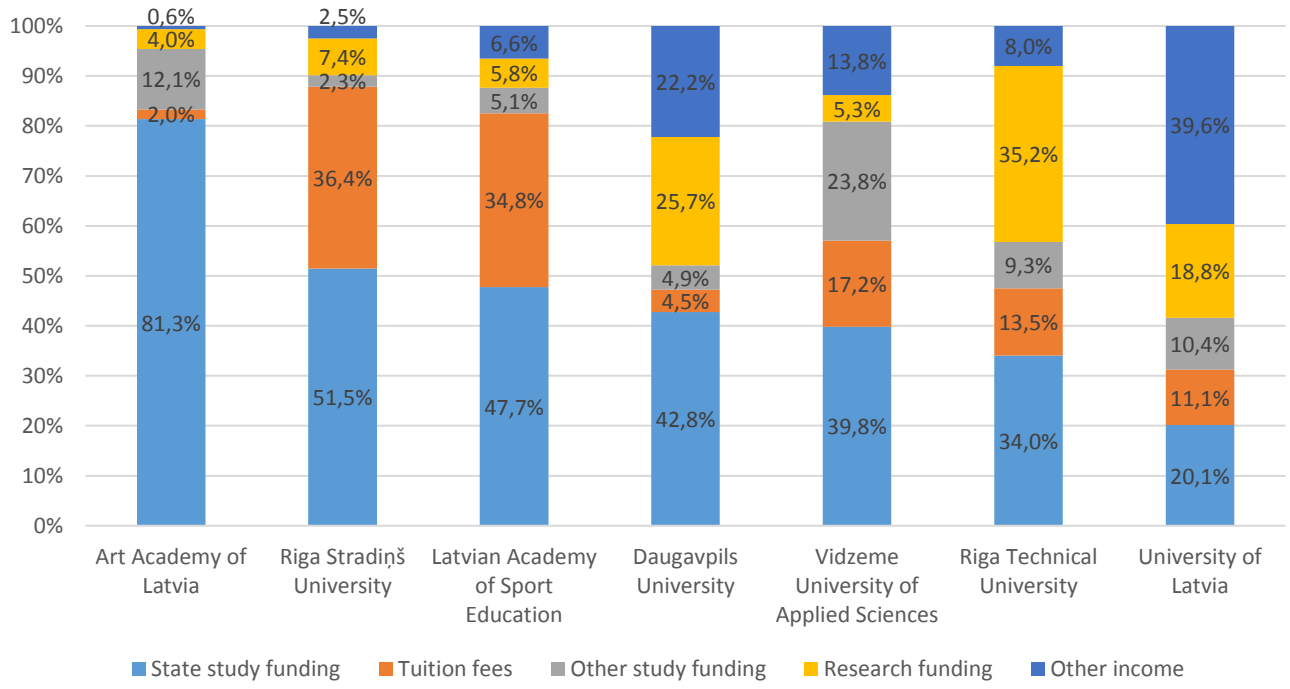
Under the second pillar, EUR 6.5 million was distributed in 2016 on the basis of performance on five criteria, that is, a fixed sum for each of the following criteria was designated among institutions:

- 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)
- 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.

[8] 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.
[9] Data on funding allocations under the different pillars of the state funding model have been provided by the MoES.

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.[10] 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.[11] 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.

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

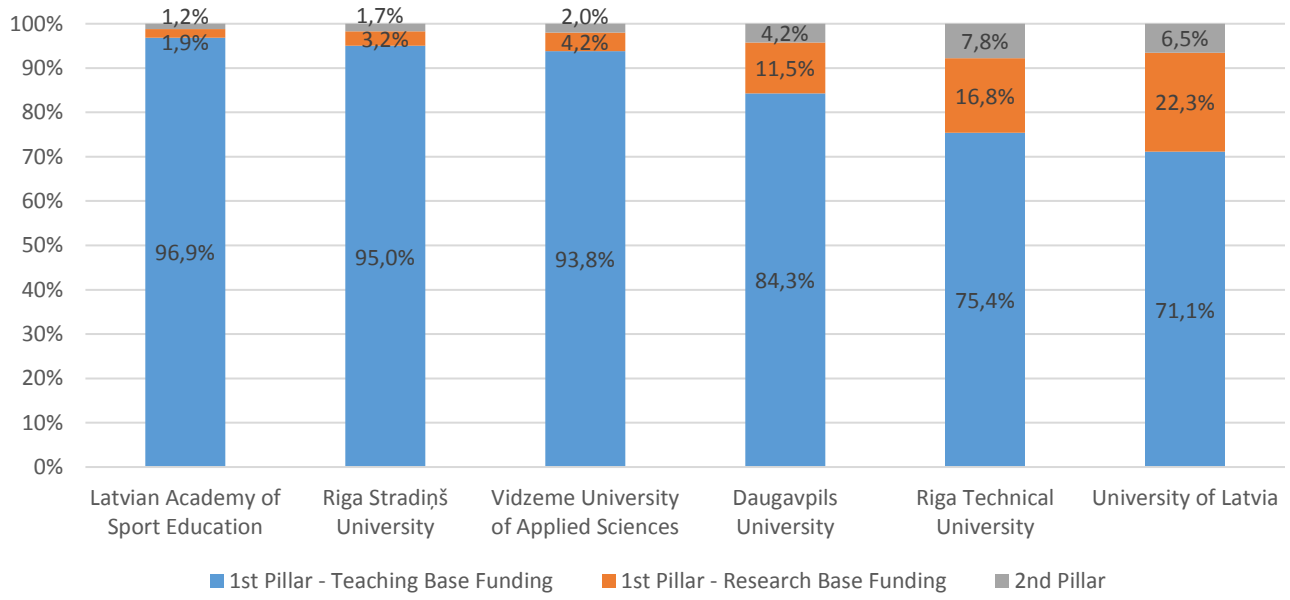
[10] Due to its particular characteristics, the third funding pillar will be touched on only briefly in the following subsections, but will be discussed more comprehensively under the heading of an overall balanced funding model (see "2.2 Balance and Context").

[11] 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.

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.

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.

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 reallocations,[12] 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,[13] 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; adaptions 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

[12] 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.

[13] 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.

funding for study places[14] (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 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-

[14] 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).

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 funding[15] allocations from the state to institutions exhibit greater fluctuations. Despite an overall increase 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 percent 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 percent 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

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

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, externally funded 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.[16] 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

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

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"[17]—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 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

[17] 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 lifelong 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.

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.[18] 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

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

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 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-intense 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 adaptions 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 multidimensional 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.

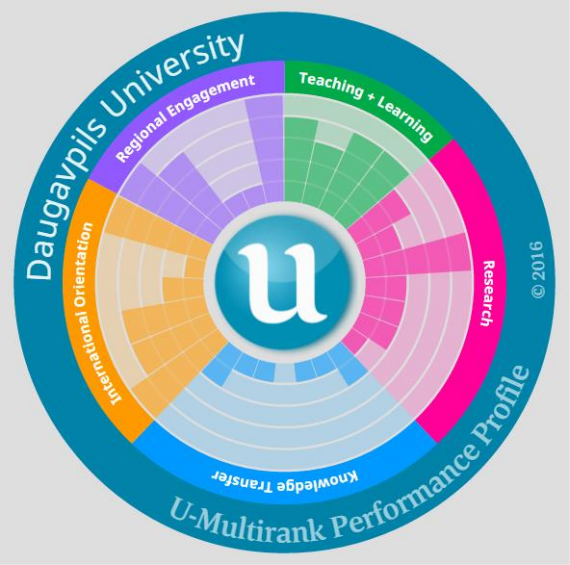


Figure 3. U-Multirank profile of Daugavpils University (www.umultirank.org)

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"[19]—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

[19] See footnote 17.

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 adaptions. 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 adaptions 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.

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	• 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	• 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	• 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	• 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	• 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	• 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	• Financial autonomy and competences of units are limited
C.2. Providing a sufficient level of stability	• 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	• Regular adaptions of models in at least some institutions • Communication surrounding change processes not always well developed
C.4. Balancing the overall model architecture	• 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	• Funding models contain incentives for revenue generation activities • Revenue generation is directly supported in some institutions
C.6. Balancing the key institutional missions	• 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	• 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	• 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	• Financial autonomy of institutions is comparatively high • Restrictions result from lack of available funds
E.2. Implementing an adequate level of regulation	• The corresponding level of regulation is adequate
F. Link to governance and management; practical feasibility	
F.1. Increasing reliability and availability of data	• 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	• Administrative efficiency hampered by extensive decision-making processes and restrictions in budgeting processes
F.3. Ensuring coherence with other governance approaches and university culture	• Internal funding models mirror governance approaches and take into account cultural particularities of institutions
F.4. Ensuring the ability of the leadership to act	• Scope of decision-making rights of institutional leadership and managerial capacity in the institutions questionable (due to far-reaching competences of collegial bodies)

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 autonomy 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 Incentives"), 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.[20] 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.

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

[20] 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.

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 stakeholder 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	• 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	• Not all institutions have developed action plans
A.3. Basing strategies on in-depth analyses and involving internal stakeholders in the strategy development process	• 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	• 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	• 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	• 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	• 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	• Obligations of institutions as defined by LIHE (Section 6)
B.2. Maintaining academic integrity	• 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	• Several institutions have bodies on the central level responsible for quality assurance
B.4. Establishing adequate monitoring procedures and management information systems	• 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	• 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	• 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	• 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	• Strategic and management tasks not always clearly separated
D.2. Equipping central leadership with sufficient and adequate competences	• 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	• 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	• Weak position of units and unit leadership • Sporadic attempts to strengthen units
D.5. Ensuring staff development and developing human resource strategies	• 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.

References

Antonowicz, D., and B. Jongbloed. 2015. "University Governance Reform in the Netherlands, Austria, and Portugal: Lessons for Poland." Warsaw: Ernst & Young Poland. http://doc.utwente.nl/97592/1/Raport_SP_University_governance_ENG.pdf.

de Boer, H., and J. File. 2009. "Higher Education Governance Reforms Across Europe." Brussels: European Centre for Strategic Management of Universities (ESMU). http://doc.utwente.nl/88691/1/c9hdb101 modern project report.pdf.

Eurydice. 2008. "Higher Education Governance in Europe. Policies, structures, funding and academic staff." Brussels: Eurydice. http://eacea.ec.europa.eu/education/eurydice/documents/thematic_reports/091EN.pdf.

Frey, B. S., and R. Jegen. 2001. "Motivation Crowding Theory." *Journal of Economic Surveys* 15: 589–611.

Middlehurst, R. 2004. "Changing Internal Governance: A Discussion of Leadership Roles and Management Structures in UK Universities." *Higher Education Quarterly* 58 (4): 258–279.

VUAS (Vidzeme University of Applied Sciences). 2016. "Vidzeme University of Applied Sciences Strategy 2016–2020." http://www.va.lv/sites/default/files/via_strategy_2016-2020.pdf#overlay-context=en/page/strategy.

World Bank. 2014. "Higher Education Financing in Latvia: Final Report." Washington, DC: World Bank. http://viaa.gov.lv/files/news/24067/lv_hef_r3vsub_190922014_c_final.pdf.

World Bank. 2016a. *International Trends and Good Practices in Higher Education Internal Funding and Governance*. Washington, DC: World Bank.

World Bank. 2016b. *Latvian doctoral studies and promotion system*. Washington, DC: World Bank.

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

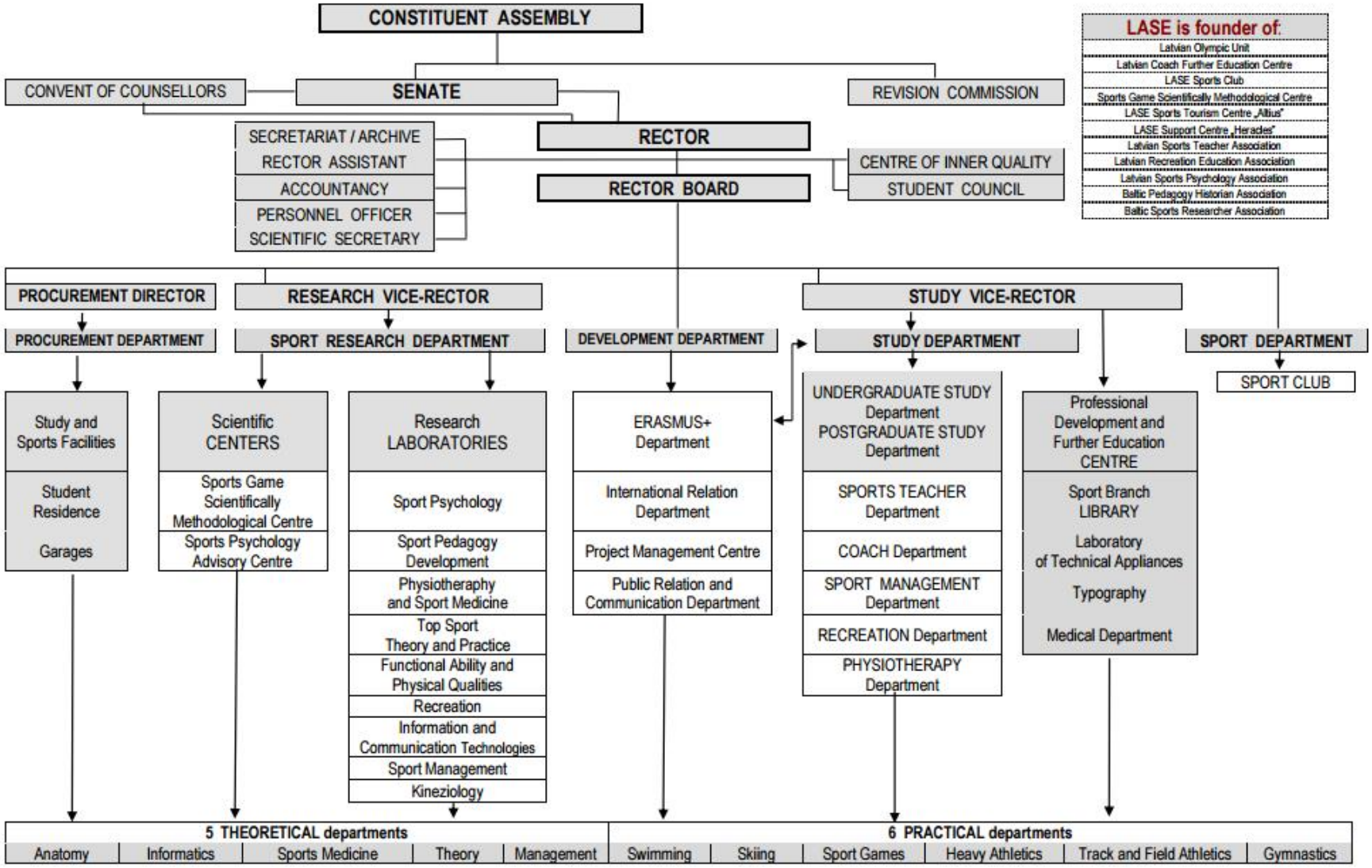
University of Latvia, Academic Center for Natural Sciences, Room 223

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

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

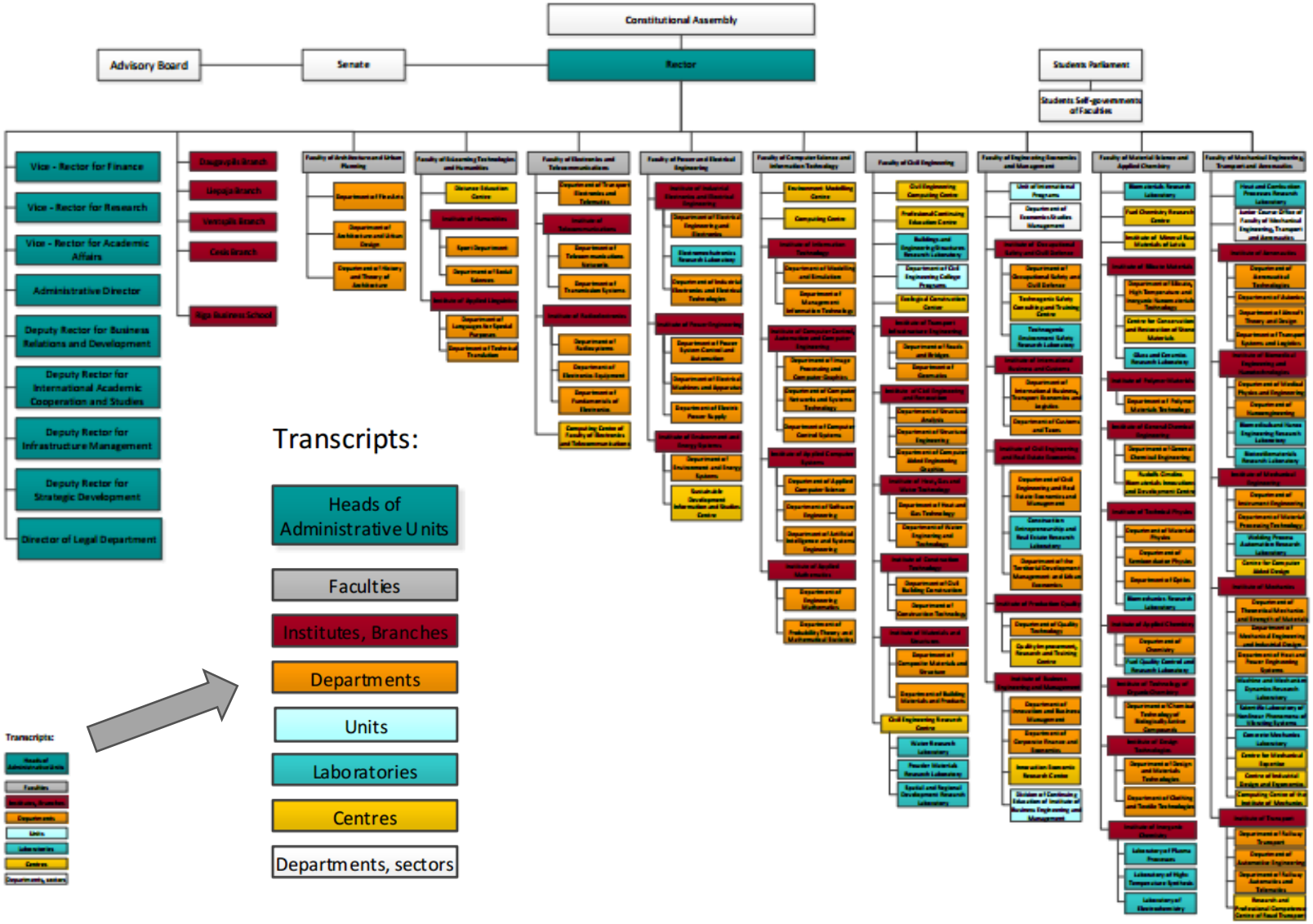
Annex 2 – Organization Charts

Latvian Academy of Sport Education



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

Riga Technical University



Source: Riga Technical University, http://www.rtu.lv/writable/public_files/RTU_rtu_structure_may_2016_eng.pdf.