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Charity mergers:
Tackling the issues in practice

Key findings and recommendations

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Preface

How did this paper come about?

In November 2007, KPMG and Macquarie (supported by The Young Foundation, The Prince's Trust and Business in the Community) hosted a two day Social Innovation Summit, the aim of which was to bring together leaders from business, government and the community, to develop new ways for the three sectors to work more proactively together.

An overwhelming message from the two days was the need for society to focus its investment (public, private and third sector) on those actions which are effective in dealing with social issues and to scale them up. In other words, rather than creating a plethora of initiatives, we should seek to replicate the success of existing models.

One of the issues discussed was the sheer number of charitable organisations that exist, often with similar objectives. Furthermore, there was concern expressed that there are comparatively few resources available to enable such organisations to work more collaboratively should they wish to. This notwithstanding, it was recognised that there have been some notable examples of charities that have taken up the challenge and united to create an even more powerful force than the sum of the individual parts.

As a result, Social Finance and KPMG decided to devote resource to exploring the issues and barriers associated with charity mergers.

To merge or not to merge – is that therefore the only question?

Clearly not; merger is merely one option in a whole spectrum of working arrangements that may be appropriate, ranging from joint research and development projects, to sharing building facilities and back office services, to merger. Time and space preclude a full debate about the relative merits of the different collaborative working arrangements available to a charity in this report; hence the focus on merger. However, it is recognised that:

> *'many of the motivations and influences that cause merger to be a considered option, may also be successfully addressed through other imaginative approaches to joint working'.*[1]

What is important, particularly in an economic downturn when potential shortcomings in existing practices can be more readily exposed is that – in line with the 'Hallmarks of an Effective Charity'[2] – decision makers:

> *'consider whether collaborations and partnerships with other organisations (including the possibility of merger) could improve efficiency, the use of funds and the delivery of benefits and services to beneficiaries'.*[3]

Within this context, Appendix 1 of the full report provides an overview of some of the alternative collaborative working options available to charities, along with a short list of recently published literature on this topic, as a reference point for readers wishing to consider these options in more detail.

Executive summary

Background

The Charity Commission facts and figures summary at 31 March 2009[4] provides the following overview of the charity sector:

Charity facts and figures – overview	
Number of main charities (1)	168,500
Total annual income (£bn) (2)	49.94
% of main charities with an annual income < £10,000	47.2%
% of main charities with an annual income < £100,000	76.6%
% of total annual income received by this 76.6% of charities	4.0%
% of main charities with an annual income > £500,000	5.4%
% of total annual income received by this 5.4% of charities	88.6%

Notes:
1 Where main charity is defined as one that is required to prepare accounts and to send an Annual Return to the Charity Commission or, if their income is less than £10,000, inform the Commission of changes to the information held on the Register. Subsidiary/linked charities are each linked to a main charity and do not report their financial results in their own right
2 Where annual income figures are based on Annual Gross Income reported by charities in their Annual Returns. Annual Gross Income differs from the Total Incoming Resources reported in the statement of Financial Activities in a number of ways which are not replicated here but which can be found on the Charity Commission website

These numbers could suggest duplication in effort, time, cost and resources across charities, resulting in inefficiency and unhealthy competition. Whilst some plurality of organisations in the sector is critical to its success[5] many, including government, suggest that organisations merging would streamline the sector and allow charities to deliver better on their mission. These views are built on the premise that, rather than destroying the great value that an organisation has delivered to date, merger could create a synergy; a situation where the whole is greater than the sum of the parts.

Outline of the paper

Charity mergers: Tackling the issues in practice is not focussed on making the case for organisations to merge. It is aimed to support those who are considering, or in the process of, a merger.

Drawing on information from a combination of a review of literature and case study interviews, the paper will:

- provide Trustees and senior management teams of charitable organisations with a useful reference point and "food for thought" when appraising and/or undertaking a merger;
- introduce a "merger framework" which can be used by organisations as a high level structure to guide them through the key steps in a merger;
- share techniques and best practice methods that have been used to tackle merger issues in practice;
- shed some light on whether, in practice, mergers actually deliver the benefits they set out to achieve; and
- make recommendations for interventions and developments to improve the resources available to organisations contemplating a merger.

Our research has primarily been developed through semi-structured case study interviews with eleven organisations that have recently merged. We have also conducted interviews with market practitioners, and sent out supplementary questionnaires to gather further data. (A more detailed description of sources can be found in Appendix 3 of the full report.)

Incorporating the private sector

The primary driver of a transaction in the private sector is to enhance shareholder value. However, the primary objective of a merger in the charitable sector is to:

> *'better meet the needs of their beneficiaries and to make the best use of their charitable funds and property'.*[6]

As a result, much of the existing literature on charitable mergers does not draw lessons from the private sector, dismissing it as inappropriate or not comparable.

However, at a practical level, the "success" of a merger is determined by the ability of an organisation to:

- plan ahead and identify key risk issues early-on in the process;
- obtain upfront buy-in from management teams;
- bring together two sets of people and two working cultures; and
- integrate systems and processes.

These preconditions to a merger transcend any sector divide. As such, we have drawn on private sector experience where appropriate, in part because there has been more research undertaken into the key success factors.[7]

Limitation

The focus of *Charity mergers: Tackling the issues in practice* is primarily on organisational, strategic and managerial matters rather than legal issues. Clearly, reference will need to be made to the latter in certain circumstances. However, such comment will be restricted and, where appropriate, will direct the reader to a more detailed analysis in alternative literature.

Any reference made to legal issues is based on English law and therefore does not cover cross-border mergers.

Charity mergers: Tackling the issues in practice cannot in any way be regarded as a definitive guide to the law on charity mergers, or as a substitute for appropriate legal advice.

Mergers involving 'multi-cellular charities' (for example those involving federations or branches) are beyond the scope of the report.

Why now?

Impact of the current economic climate

The need to proactively manage an organisation is particularly pressing in the present economic environment where there is a growing body of research which suggests that charities are no more recession proof than any other part of society. For example, a recent Charity Commission Economic Survey reported that the economic downturn has impacted 52% of organisations. Of those respondents, 58% reported a reduction in their income level. Furthermore, 61% reported that they were concerned that the work they did or activities they funded would be greatly affected as a result of the recession; and this at a time where demand for services is *increasing*.[8]

As such, charities are faced with similar difficult decisions to their private sector counterparts as to their future sustainability. One option available is merger. As outlined in Appendix 2a of the full report, there have been a number of past initiatives launched by the Government and other organisations with at least a partial remit to stimulate interest in the potential merits of charity mergers. Furthermore, there are established sector organisations such as the National Council for Voluntary Organisations (NCVO) and bassac which provide guidance and advice in this regard.

Yet despite this, the charity sector has not seen high levels of M&A activity and certainly not at the levels in the private sector.[9] This in itself is not necessarily a bad thing, if the lack of merger activity is attributable to up-to-date strategic analysis which demonstrates that a charity will more effectively achieve its charitable objects on a stand-alone basis. However, it would be inappropriate if in fact it was a consequence of resistance to change, fear of merger or lack of support from within the sector to facilitate it.

As such, following the announcement by the Government in March of this year of the £16.5 million "modernisation fund", established to provide funding to pay for advice and guidance for those charities considering merger or collaborative working,[10] it seems an appropriate time to provide a "How to" guide for Trustees and senior management in order to help organisations think through their options with regard to merger and guide them through the process.

Key findings

The detailed analysis found in the full report highlights the complexities, best practice techniques and critical success factors at each stage of the process. However, there are a number of critical, over-riding messages:

1) In order to evaluate the merits or otherwise of merger, it is vital that a charity first understands itself. This necessitates rigorous strategic management and objective assessment of an organisation's purpose, mission and values, both current and anticipated.

2) Our research suggests that personal and emotional attachments to individual organisations contemplating a merger must be identified upfront and channelled appropriately, in order that opportunities for more effective delivery of a charity's objects are not jeopardised by minority interests wishing to preserve the status quo. 'Open and frank discussion about the fears and concerns individuals have about loss of autonomy for an organisation should help clarify misunderstandings, create compromises and articulate the advantages to be gained from a lesser degree of autonomy.'[11]

3) Embarking on a merger can be a costly process and a charity must take this into account as part of any wider cost-benefit analysis in advance of embarking upon a merger. However, as the full report explores in more detail, costs can be proactively managed.

   Pro-bono advice or grant funding were two of the most commonly cited cost saving initiatives amongst the case study organisations. In addition, effective use of existing internal resources, via short term secondments and interim positions, reduced the amount of work outsourced to external advisers.

4) The Chief Executive of the merged organisation should be appointed early. In this way, uncertainty is reduced and a focus is given to the leadership of the organisation.[12] It is generally inappropriate to engage two Chief Executives, even in a short term capacity. Joint leadership can lead to uncertainty and fragmentation within the newly merged organisation and procrastination in decision making.

5) A key success factor amongst the case study mergers was the ability for organisations to move forward together in a process of collaboration rather than re-negotiation. Unless a change in circumstances dictated otherwise, it is important that previously agreed issues do not re-surface and derail the process and that commitment to cross-organisational buy-in is maintained. Regular reinforcement of the original rationale for merger can be used as a tool to dispel last minute nerves and re-focus discussion.

6) Our findings show that well timed, co-ordinated and regular communication is critical to the success of a merger. 'Trust and collaboration are built through continuous dialogue. Communication processes need to flow in all directions; up and down, side to side.'[13] Establishing a 'pecking order' of how and when different stakeholder groups should be communicated with can focus efforts and ensure that the most difficult to reach groups are given sufficient opportunity to buy-in to the merger.

7) Formal closure of the transaction is far from the end of the road in a successful merger. The merged organisation must keep its foot on the pedal post transaction in order to drive the organisation forward, fully integrate the operations and realise the synergies that it set out to achieve.

Recommended actions

It is hoped that *Charity mergers: Tackling the issues in practice* will, through the sharing of best practice techniques and practical experience, encourage decision makers within charities to seriously consider whether merger is a viable, strategic option for their organisation.

However, further action is required in order to give more organisations an opportunity and incentive to assess the relative merits of merger.

Independent facilitation

While researching the paper and conducting interviews it became apparent that engaging an external facilitator to oversee the merger process can make a real difference. Whilst a facilitator cannot make formal decisions relating to the merger, they can play a pivotal role in engaging and co-ordinating the key elements of the process, ensuring that momentum is maintained at each stage.

Whilst there are currently a small number of organisations that offer a facilitation service to not-for-profit organisations, there are a number of initiatives that could be developed to increase transparency and improve the service available to organisations contemplating merger.

"The need to proactively manage an organisation is particularly prevalent in an economic environment where there is a growing body of research which suggests that charities are no more recession proof than any other part of society."

Increased evaluation of charity mergers

Each of the case-study organisations that contributed to this paper proclaimed that the merger they had been involved in was a 'success.' However, there has been limited formal evaluation to this effect. If charity mergers have increased the ability of organisations to deliver against their charitable objects, then tangible evidence of this is required in order to enhance the profile of merger within the sector.

We therefore recommend that research is conducted across a range of mergers, ideally starting before they are completed and continuing from approximately two years following the transaction. This would benefit from a degree of objectivity and anonymity in order that an honest and independent assessment is achieved and useful information made available to the sector.

Merger specific training for Trustees

Many Trustees will have no experience of conducting a merger. In order to invigorate strategic thinking in this regard, a training programme is required to increase awareness of the merger process at a practical level and challenge pre-conceptions at an emotional level.

Creation of a brokering intermediary

Our research revealed that there is a perceived need for a brokering intermediary in the charitable sector, which would undertake a role akin to that of an investment bank in the private sector. A number of the individuals interviewed felt that, whilst they were not averse to merger, they did not know which organisations to approach to instigate initial discussions. Interestingly, this conclusion is echoed by recent research into not-for-profit M&A activity in America, which advocated investment in 'an organisational marketplace through which nonprofits can explore merger options safely and receive support in making wise decisions around how and with which organisations to explore merger.'[14]

Provision of structured, short-term financing

Whilst there is a place for grant income, in order to achieve scale with regard to helping charities to meet the costs involved in exploring and executing a merger, it is necessary to create a more sustainable funding mechanism, which is itself run by people with experience of merger.

Whilst the recently announced £16.5 million Government backed modernisation fund is welcome news, and appears to have moved contemplation of strategic restructuring options up the agenda of some organisations, the fund is only intended to be in existence for a year which is not long enough to have a strategic impact on the current position.

References

1 Mather, B (2000). *Merging Interests*. The Baring Foundation, p6.

2 The 'Hallmarks of and Effective Charity' is a publication produced by the Charity Commission as guidance material to help Trustees to improve the effectiveness of their Charity.

3 Charity Commission (2008). *CC 10 - The Hallmarks of an Effective Charity*, p8.

4 www.charitycommission.gov.uk/registerofcharities/factfigures.asp.

5 As the Cabinet Office strategy unit publication 'Private Action, Public Benefit: Providing Flexibility for Charities to Evolve and Merge' says:'Let a thousand flowers bloom because diversity benefits the sector by harnessing enthusiasm, providing choice and, at times, encouraging competition… organisations operating in the same area may in fact be approaching the problem from a different perspective.'.

6 Charity Commission "Checklist for Mergers" obtained from www.charitycommission.gov.uk/.

7 The bulk of the information used to provide this comparison is drawn from two recent KPMG surveys into M&A activity in the private sector: "The Morning After – Driving for Post Deal Success" (drawn from fieldwork undertaken between August and October 2005, and published in January 2006) and "All to Play for – Striving for Post Deal Success" (drawn from fieldwork undertaken between April 2008 and July 2008, and published in October 2008.).

8 Carol Goldstone Associates (2009). *Economic Survey of Charities,* p 2 and p 7.

9 Obtaining accurate figures of the number of mergers that have taken place in the sector in recent years is difficult, as an organisation is only required to report a merger on the Register of Mergers maintained by the Charity Commission if, broadly speaking, they have used a 'Vesting Declaration' to enact the transfer (albeit that any merger can be notified voluntarily if desired). However, the recently published Voluntary Sector Governance Survey 2008 suggests that charity mergers remain rare, with only 6% of respondents having been involved in such activity. The author recognises the limitations that arise in survey response data and quotes this purely as an indicative figure, in the absence of actual, formal merger statistics.

10 HM Government (2009). *Real Help for Communities: Volunteers, Charities and Social Enterprises.*

11 La Piana, D (2008). *The Nonprofit Mergers Workbook: Part 1. The Leader's Guide to Considering, Negotiating and Executing a Merger*, p71.

12 NCVO (2008). *Model of Collaborative Working – Merger,* p7.

13 Devine, M (2002). *Getting the People Issues Right*, p151.

14 Cortez, A, *et al.* (2009). *Nonprofit M&A: More Than a Tool for Tough Times,* p11.

FULL REPORT:

Charity mergers: Tackling the issues in practice

For a full copy of the report, including details of the 'merger framework' and case study examples, please refer to our website, where the publication is available to download or print:

www.socialfinance.org.uk

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