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"OVERALL AUDIT SERVICE AWARD" - WINNER 2009
Annual *Charity Finance* survey

not for profit | charity mergers

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There is increasing focus within the charity sector on the issue of collaborative working between charities. This can range from simple networking through joint ventures to full merger or take-over. A Charity Commission survey (published as *RS 4 Collaborative Working and Mergers*) showed:

- 22% of all charities work collaboratively in one form or another
- 5% of charities exist as a result of merger
- 13% of large charities have either merged or actively considered merger in the last 10 years

Indeed the Government Strategy Unit report *Private Action Public Benefit* recommended that the Charity Commission should provide specific advice to facilitate mergers, possibly by creating a dedicated internal unit. Although the Commission claims that the legal barriers to merger are few, mergers can sometimes falter because of legal difficulties. The report therefore also suggested that a package of legal measures be introduced that will facilitate the process as well as the administrative running of charities generally (see Appendix 1). The Commission has welcomed these recommendations.

In addition many funding bodies are increasingly looking for collaboration amongst charities as a means of achieving economies and some grant makers are even offering financial support to assist research into merger in certain areas where there are perceived to be too many similar charities.

Thus collaborative working and mergers are issues that are increasingly likely to be on the agenda for many charities.

why consider collaboration or merger?

The reasons behind the impetus to merge or to work collaboratively have been referred to as the "Three E's"; *Economy, Efficiency and Effectiveness*.

The survey showed benefits accruing from collaborative working as:

- sharing knowledge - 59%
- joint service delivery - 49%
- sharing resources to increase efficiency - 40%

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The survey showed that there is a tendency for collaborative working to be adopted much more readily by larger charities (72%) than by smaller ones (39%) whilst 78% of respondents indicated that they undertake no form of collaborative activity. Given the potential benefits the Charity Commission is likely to seek to encourage more collaboration.

The reasons given by respondents for having sought a merger were as follows:

- increase efficiency - 54%
- rescuing a charity in difficulties - 44%
- prevent duplication of services - 42%

Of the charities included in the survey, 44% reported an improvement in their service delivery and 35% a reduction in administration costs. Although more than one third of charities stated that the effect of their merger was neutral, very few felt that they were worse off as a result of a merger. However it should be noted that another independent survey has indicated that 90% of charity mergers fail to live up to expectations.

Charity Commission encouragement of mergers and collaboration

The Charity Commission is keen to encourage collaborative working and mergers within the charity sector to the extent that they increase efficiency. However it recognises that it is also important that there is no loss of diversity nor of the flexibility of charities to adapt to changing circumstances and needs.

In addition to the legislative changes summarised in Appendix 1, the Commission wishes to see more active promotion and pursuit of collaboration and mergers. For example it is looking to encourage sector professionals and umbrella bodies to look for areas of charitable activity which could be managed more efficiently and of over-provision or inefficient duplication of resources. Trustees are also encouraged to keep the matter under review.

collaborative working

As far as collaborative working is concerned trustees should be seeking to identify potential benefits that might be generated for their organisation and its beneficiaries. They should conduct regular strategic reviews of the charity's position and of possible collaborative arrangements. To this end charity trustees should familiarise themselves with the factors that are critical to the success of such arrangements.

These factors include ensuring that the collaboration values the independence of each party and that the participants have compatible aims, activities and organisational structures.

The nature and extent of the collaboration will determine what is required in terms of a legal agreement. At the very least, there must be a clear understanding and definition of the responsibilities and commitments of each party as well as of the limits to which one party can make commitments that bind the other.

Legal agreements should be proportionate to the levels of risk and complexity involved. It should always be remembered that a charity's assets, employees, volunteers and reputation could be put at risk. Care is needed to ensure that any agreement does not place restrictions on the trustees' ability to act in the best interests of their charity. In addition, the agreement should ensure that the charity's assets will only be used for purposes which are entirely consistent with its charitable objectives. This is particularly important in instances where assets are to be transferred overseas.

In most agreements it would be normal to expect a termination clause. The absence of such a clause may prove to be unduly restrictive if the collaboration is deemed to be unsuccessful and disputes may be time-consuming and expensive.

mergers

Many of these factors are also important when considering mergers and again trustees should be alive to the possible benefits that might accrue from a merger. In addition, as this is a much more significant step, it is even more important that the trustees are aware of the factors that are critical to ensuring the success of any merger. These factors can be broadly categorised as the "Five C's "

clarity of vision

Both parties to any merger need to have a clear vision of what they are seeking to achieve. A hazy idea of goals is not enough. Trustees must be very specific in defining what they want to get out of any project.

It is helpful to address at the start major issues such as:

- the structure of the new charity's trustee body
- the name and brand of the new organisation
- the role and position of the chief executive

culture

This is perhaps the most important factor to any merger. The Charity Commission indicates that its casework shows that differences in culture and working practices can often cause a merger to fail. However an organisation's culture is difficult to define in practice. It will encompass such matters as objectives, methods of achieving objectives, organisational structure and relationships with the outside world.

Surveyed charities identified cultural integration as a critical factor but it was only achieved where each party was fully aware of the ethos of the organisations involved. This highlights the next key ingredient to a successful merger.

communication

Good communication is vital from the start of the merger process. There must be clear statements of intent and of desired outcomes. The needs of all stakeholders must be borne in mind, including those of beneficiaries, staff, volunteers, members and the public at large.

A proposed merger can give rise to a great deal of uncertainty amongst staff. Knowledge that the organisation for which they work is undergoing significant change can trigger a search for alternative employment.

Trustees therefore need to give much thought to the staffing levels required in the new organisation and careful management will be necessary if morale is not to suffer. Furthermore, employment law is extremely complex and in all but the simplest situations, legal advice should be sought.

constitutional arrangements

Careful consideration should be given to the constitutional arrangements that will best facilitate the operation of the new charity over the long term. In addition, it will be necessary to check that each party has the power within its existing constitution to enable the merger to take place. If not, Charity Commission assistance will be needed.

cost control

It is permissible for charity monies to be used to fund the costs of a merger. However, costs should be budgeted for and kept under regular review.

In addition to the legal, professional and other direct costs involved there will inevitably be less tangible costs. Most mergers will be demanding in terms of the time and energy of trustees and management. Short-term disruption and stress are probably unavoidable.

This means that speed will be of the essence. Trustees must endeavour to maintain momentum and a timetable should be drawn up at the beginning of the process and adhered to as far as is practicable. However the need for proper planning is also critical. A balance between these two, often conflicting, needs will have to be established.

One of the costs incurred will be in conducting appropriate research and background checks on the party to a merger. A brief consideration of the extent to which this process, known as "due diligence", is applicable is set out below.

due diligence

Due diligence is a key element to trustees' management of risk. To protect their own charity's interests they must ensure that there are no unforeseen liabilities or commitments for which they will become responsible as a result of the merger. Although a full blown due diligence review, such as would be used in a commercial environment, is not normally called for in a merger between charities, there should be some form of review process. The extent of this will be dependent upon the size and complexity of the merger.

Subject matter for the review may include:

- ensuring that there are no uninsured liabilities
- the implications of the Transfer of Undertakings (Protection of Employment) Regulations 1981 (known as "TUPE Regulations")
- tax and VAT implications
- intellectual property rights

In response to changing and increasing demands many charities are going to be forced into looking towards collaborative working and mergers. The environment in which a charity works and the needs of beneficiaries will be key elements in determining how trustees should react. In selecting what, if any, action they should take they will need to consider:

- what is your charity seeking to achieve?
- what are the specific needs of the activities it undertakes?
- for service providers, what are your aims for the volume, range and geographical coverage of services?
- how much time, money and effort are you prepared to invest?
- what risks are you prepared to take?

Appendix 2 sets out a summary of the principal advantages and disadvantages of both collaborative working and mergers.

appendix 1

Proposed legal measures to facilitate the evolution of charities and mergers

- charity Commission review to be undertaken with the aim of relaxing the conditions for changing a charity's purposes
- raise the threshold allowing small charities to make certain changes (such as transferring assets and modifying objects) from £5,000 to £10,000 of annual income.
- the criteria and procedure for transferring property or changing objects to be broadened and simplified
- make it easier for trustees to make administrative amendments to their governing documents
- speed up formal scheme-making procedures and reduce the cost to charities by making advertising of the changes a matter of Commission discretion
- include specific provision in legislation for the new legal vehicle for charities, the Charitable Incorporated Organisation, to facilitate transfers and mergers
- provide for the benefit of all future legacies and gifts to transfer automatically to the newly incorporated or merged charity
- produce regulatory guidelines on due diligence in charity mergers, based on a light-touch approach.

appendix 2

A summary of the advantages and disadvantages of collaborative working and mergers

mergers - the advantages

- economies of scale - a primary attraction for merger will be the likely cost savings that will accrue to a larger organisation
- avoidance of duplication of provision
- ease of attracting funding and/or staff - the perception of an organisation as large and vibrant may assist it in its search for staff and/or funding
- Increased opportunities - partners, such as Local Authorities, may be more ready to enter a contractual arrangement with a larger organisation
- cross-fertilisation of ideas - the best practice from each of the merged entities can be adopted
- reduced dependence on a particular source of funds.

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mergers - the disadvantages

- legal - the restraints of constitutions or other legal factors can sometimes be a barrier
- costs can be heavy - inevitably there will be a cost involved in any merger. There will not only be legal and professional fees but also time and effort will undoubtedly be required from trustees and management. Disruption and stress will be unavoidable, at least in the short term
- staff uncertainty - the knowledge that the organisation that they work for is undergoing significant change will almost certainly be unsettling for employees and may well result in a search for an alternative job
- reversing the decision is difficult - the costs of extricating a charity from an unsatisfactory merger are prohibitive.

collaborative working - the advantages

- autonomy can be retained - thus uniqueness and ethos can be protected
- disruption is minimised
- staff may perceive it as less threatening
- flexibility can be maximised - by maintaining independence the ability to adapt to changing circumstances can be retained
- many of the advantages of merger can still accrue - for example economies of scale, cross-fertilisation of ideas and enhanced ability to attract staff might still be achieved to some extent.

Collaborative working - the disadvantages

- the problems of small size tend to remain
- time - although less time-consuming than a merger, establishing collaborative links can still require a good deal of time and effort
- over-reliance on others - may be a danger that specifically needs guarding against.

about haysmacintyre

haysmacintyre, Chartered Accountants and business advisers, works with over 550 charities and not for profit organisations in the UK and overseas. Our services include the full range of audit, tax, VAT and comprehensive advisory services. Our multi-disciplinary specialist team has extensive sector experience working for a diverse range of charities. We are based in one location which ensures an integrated and comprehensive approach to our clients' requirements.

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