MATCH POINTS

A research summary of mergers among charities and social enterprises

Social Investment Business

Eastside Primetimers

By Elliot Bidgood

Foreword

We are proud to jointly introduce this report, clarifying an area that we believe is vital for good charity governance, but which also continues to be an unknown for many VCSE organisations that might benefit from considering it as an option.

In the past five years, detailed research and engagement with charity managers by Eastside Primetimers have provided a clear picture of a sector not yet able to harness the potential demonstrated by the rare mergers we have seen. The aim of our two organisations at the outset of this work was to uncover what practical and knowledge-related barriers are preventing VCSEs from pursuing merger with greater confidence. This is essential for understanding how support can best be structured to address their real needs.

We feel this report goes a long way towards that, candidly interviewing a variety of grant-makers, social investors and, of course, VCSE chief executives that have explored or gone through mergers and identifying common themes in their experiences.

It is based on this work that we plan to explore a pilot that provides a mix of support, grants and repayable capital to enable more VCSEs to pursue merger and get the support they require.

Richard Litchfield
Chief Executive,
Eastside Primetimers

Nick Temple
Chief Executive,
Social Investment Business

Special Thanks

Barbara Gelb (Together for Short Lives), Jonathan Senker (VoiceAbility) Wayne Myslik (Migrants Resource Centre) and London Irish Centre Charity for participating in case studies and supplying images.

We would also like to thank the 18 charity chief executives who participated in interviews, and representatives from CAF Venturesome, Key Fund, Lloyds Bank Foundation, CAN, Access Foundation, Barrow Cadbury Trust, Big Society Capital, City Bridge Trust, Power to Change, Big Lottery Fund, Fidelity UK Foundation and Joseph Rowntree Foundation for interviews or providing referrals to charities. David Floyd and Social Spider CIC assisted with carrying out and collating the interviews for this report. Oliver Monty designed this report for Social Investment Business.

Rationale for Research

Mergers are rare amongst Voluntary, Community and Social Enterprise (VCSE) organisations, with 50-70 concluded annually out of over 160,000 charities registered with the Charity Commission. Other charities go into liquidation rather than planning sufficiently in advance to find a suitable merger partner and safeguard their services, with the result that their services are placed under extreme uncertainty or are lost altogether.

This comes in a context where the VCSE sector faces funding challenges in the post-2010 environment and an increasingly complex and competitive public services commissioning market. This has led to heightened discussion in the sector of merger as a consideration for VCSEs seeking to fulfil their objectives under these circumstances. Though diversity and local responsiveness are rightly prized in the sector, it is also the case that duplication, economies of scale and competition for scarce resources are factors that need to be taken into account. It is reasonable to argue that there should be a measured increase in the amount of consolidation compared to the static picture we see in practice, which support could help bring about. Potential unrealised benefits from merger include:

- Making resources go further and strengthening confidence in the sector by reducing duplication of activity and fundraising
- Reducing competition over limited contracts and grants
- A better offer to beneficiaries by bringing together a greater set of services, talents and experience
- Boosting capacity to compete for larger and more complex contracts.

Based on the potential need for more and better mergers, we wished to test whether more can be done to make it easier and cheaper for VCSEs to explore and undertake merger. Our feasibility research was guided by four main questions:

1. **To what extent can the barriers to merger be remedied by finance and support?**
2. **Is there demand for finance and support from VCSE organisations considering merger?**
3. **Is there an interest in a merger fund from charity funders and social investors?**
4. **How would such a fund need to be structured in order to be both impactful and attractive to funders?**

Approach

Eastside Primetimers and Social Spider CIC were commissioned to carry out feasibility research to assess impressions around merger and a potential fund among both VCSE and funder organisations. In-depth, qualitative interviews were conducted with representatives of both types of organisations:

- Managers of 21 small and medium VCSE organisations that had explored or been through merger were interviewed, to get a picture of their experiences and views. Questions explored their situation, experiences and attitudes around merger, rationales, barriers, risks, opportunities, types of funding and support desired (and their experiences of existing availability), whether a merger fund would help, how it could be structured, and attitudes to repayable finance as a component

- Representatives of 13 investors and grant-makers were interviewed about impressions of overall merger activity in the charity sector, their previous engagement with merger funding through their organisations, their potential interest in a fund and how it could best be structured.

Since the sample of VCSEs was a snapshot of smaller organisations who were exploring, had attempted, or had completed mergers, the aim was to get a qualitative picture of the views of those who are open to merger as an option or have practical experience of it. Our sample was therefore not intended to be reflective of the entire charity sector, though we do know from a CAF survey in February 2017 that 10% of their sample of chief executives planned a merger in the next year.

Key Findings

1. There are many different motivations for mergers and it is important to understand the different types

A desire for growth (financial, geographic or in social impact) was commonly cited as a rationale, but financial difficulty or other related push factors (general austerity, loss of grants, competition for contracts or need to reduce overheads) were also present in over half of cases. In some cases the two aims can mix – one charity chief executive spoke of "stability through growth" as an aim. Chief executive retirements were also an enabling factor in a few cases.

Our research suggests support should be focused on smaller organisations in difficulty and looking to restructure. Many of the smaller organisations that do merge tend to seek merger from a troubled position, while many more organisations either liquidate or limp on from an ineffective position without realising the full potential of their social impact. Done right, "turnaround" mergers with struggling small charities can create greater impact for beneficiaries than the status quo by preserving vital services, and potentially act as platform for the later growth of these services.

2. There are multiple barriers to mergers that must be overcome before mergers can even be explored, including:

- **Institutional opposition or attitudinal barriers** – a feeling that merger just wasn't considered by other organisations or that protectiveness and "egos" could be a blockage ("it's just not done" in the sector, observed one chief executive)

- **Boards** – resistance from trustee boards was cited by over half of those we spoke to as a barrier to merger, as boards were often felt to be risk-averse (though often chief executives felt that outright hostility to the concept of a merger was a problem with other organisations' boards, rather than their own)

However, while our interviews confirmed that attitudinal barriers are clearly a factor and that mergers are felt to be a rarity, they also established that financial, practical and resource constraints were common issues for those organisations that are actively exploring merger. It is in the latter cases that targeted provision of finance and support could make a difference and assist with a step-change toward more and better mergers.

It also may be the case that a fund could induce more consideration of mergers in the sector by "legitimising" it as an option. Further, the practical advice from advisors that some chief executives voiced the need for could help them navigate the concerns of boards, stakeholders and potential partners more effectively.

3. There are also real financial barriers to successful mergers

At least ten organisations mentioned finance and costs, and it was an issue for small organisations in particular.

"Cost is definitely a big factor … [mergers are] not cheap."

"Although in the long-term there's going to be benefits, up front you do need to think about the legalities of it, the due diligence process and paying for that."

Costs cited by respondents were often based on estimates of the fixed costs of earlier-stage support, so not all related to the full merger process and later integration stages. Based in part on the answers given and also on background research, here are some estimates of the range of costs experienced at different stages:

Different stages of support and estimated costs

Stages	Cost (range)
1) Exploration Stage	£5,000 - £15,000
Merger readiness plans: assessing readiness, options and next steps	£1,000 - £2,000
Search service to help organisations find partners	£4,000 - £14,000
2) 'Deal stage' - Planning & Due Diligence	£25,000 - £85,000
Project managing and planning	£10,000 - £20,000
Due Diligence	£5,000 - £15,000
Legal	£5,000 - £10,000
Key staff backfill costs	£5,000 - £40,000
3) Integration, Refinancing and Growth	£100,000 - £250,000
Integration – restructuring/redundancies, systems, branding, stabilisation	Flexible
Key staff backfill costs	£5,000 - £40,000
Refinancing – restructuring existing loans and exits to social investors for the effective recycling of social finance	Flexible
Growth – business planning, marketing spend, new staffing, development capital	Flexible

4. Support from peers and practical expertise are highly sought after

- A lack of knowhow in organisations that had not been through merger before was raised. Others who had been through merger previously attributed their confidence about the process primarily to their own existing experience

- As well as funding for 'nuts and bolts' technical assistance (legal, due diligence, pensions advice etc), there was a desire expressed for general advice or peer support – a "coach" of sorts to guide them, help them ask the right questions and negotiate better terms for their organisation (separate from the more impartial due diligence role independent consultants play)

- Project management or backfill – in relation to capacity and resource issues that were frequently raised unprompted, temporary funding for additional staff was suggested as a means to either provide ongoing project management or enable senior staff to do so without neglecting other vital functions

"The trustees wanted me to spend a lot of time going to look for a merger, but you've got to run the organisation, do the fundraising and keep to the strategy at the same time."

"Another job on top of the day job."

- Partner search and matching – some organisations felt they knew their logical partners well, but this kind of support can suit earlier stage organisations. External support could also help organisations search more strategically, rather than resorting to 'quick-fix' mergers with familiar local organisations that in practice may have similar problems

This feedback gives us an insight into what kinds of support specifically would make a difference to the practical challenges organisations exploring merger have faced, and has demonstrated demand among our cohort.

5. A specific programme – if structured appropriately – could help organisations considering merger

Organisations that have explored or experienced merger feel that a fund providing support and funding would be helpful, with caveats about how it would be designed:

"Finance would be helpful because we had to expend a lot of resource to get to the place we did and there would have been a lot more if we'd gone further."

"Getting some advice and support around [merger] would be helpful to the smaller charities because it is a bit scary. I tried to look for some expertise and couldn't find any."

"If that had been available to us, we'd have probably merged long before now."

"Support would be useful given that it's something we've never engaged in as an organisation before. Mergers very rarely come for free, so finance in some shape or form would facilitate that."

"It's definitely going to be good to have support, guidance, mentoring, legal and financial advice."

"It would have to add towards the longevity and the sustainability."

"I don't think it would make me more likely to consider it but I think it would make the process easier. I'm not going to see the fund and think 'ooh, there's a fund available let's go and do it' whereas I might do that for other funding streams."

Case study: Together for Short Lives

In October 2011 Children's Hospices UK (£3.6m income pre-merger) and the Association of Children's Palliative Care (£866k income) underwent a merger, following a decision in February 2011 and seven months of rapid integration. They are now the leading UK charity that helps and speaks out for children and their families to enable them to have as fulfilling lives as possible, and the very best care at the end of life.

The key aim of the merger was to create one voice for children's palliative services with a higher combined profile, achieving more together than separately. Financial headwinds in the sector and fundraising were a key factor, so merger was explored as an option from an economic standpoint.

After several years of intermittent discussion about a possible merger, a key "catalyst" for the merger was a proactive offer from True Colours Trust, a Sainsbury family charitable trust. True Colours Trust provided a small grant to the predecessor charities to enable a study of the feasibility of merger, to be undertaken by an independent consultant. The feasibility study very quickly indicated that a merger would make good sense for a range of reasons and this was presented to both Boards, who were then in support of taking the discussions to the next level.

The merger was always intended to be a merger of equals – to this end, the senior management teams were brought together and an open process was held for the role of CEO of the new charity, with one of the two former CEOs appointed to the role through this process.

At the time of the merger, the new charity undertook some work around their Theory of Change to facilitate the development of the strategy of the new organisation. The work involved both previous chief executives and some of the board members, and helped to inform the strategy of the newly-combined senior management team.

Six years on, chief executive Barbara Gelb reported that the merger is still viewed as a greatly positive move, with divisions between the two predecessor organisations no longer felt operationally. Relationships with other palliative care charities were managed to reassure them about the presence of a new large organisation, but Gelb has reported that the sector generally recognises the benefits of the merger.

Recommendations

We recommend a pilot 'Pathfinder' programme with six outline aims:

Pathfinder

1. Facilitate both more and better mergers and unlock expected social returns.
2. Increase number of mergers from 50-70 to around 80-100 a year in the next five years.
3. Bring about an increase in smaller organisations feeling empowered to better protect and expand socially valuable services they provide.
4. Increase funder confidence in being able to provide active support for mergers.
5. Greater and better use of impact measurement pre- and post-merger.
6. Potentially use learnings from a pilot to inform future larger scale delivery.

The Pathfinder could be designed to be flexible and incorporate a mix of grant, direct funded support and repayable loan finance. Any structure could then provide different kinds of support and finance at each of three stages, or focus on one of them:

- **Exploration Stage:** assessing the readiness of VCSE organisations for merger, perform work with their boards, and search services to help them find partners
- **'Deal stage'- Planning & Due Diligence:** direct support and funding to make deals happen (business cases, due diligence, help negotiating, accountancy and legal support, and covering staff backfill costs)
- **Integration, Refinancing and Growth:** funding the costs of post-merger integration (restructuring, systems, branding and stabilisation), refinancing of loans, and post-merger growth strategy (business planning, marketing spend, new staffing, development capital)

A distinction would be made between a need for grant funding (in the initial stages) and loan finance (later). This is based on the fact that VCSEs expressed concern about the risks of marrying repayable finance to the exploratory and developmental stages of a merger, while at the integration and growth stages there are substantial costs that could later unlock greater financial returns.

The availability of grant funding and support will enable more organisations to explore options with confidence and undertake initial work. This could be delivered with a specific focus on restructure and recovery work within portfolios.

However, the role of loan finance in the later stages will also strengthen incentives and enable more extensive post-merger support, potentially strengthening the execution of mergers and tying them more to a long-term, transformational strategy. Further, the use of repayable finance will allow capital to be recycled back into other projects.

A flexible fund structure would also allow organisations that need less support at earlier stages (e.g. those with an identified partner or part-way through a deal) to still be eligible for integration and growth support through the loan finance.

Conclusions

- **There is some evidence of demand for a fund worth £500k to £1m, initially supporting 8-15 VCSEs over 2-4 years, with the prospect of a larger fund if successful.**
- **We believe that a Pathfinder programme can create and draw attention to good practice around mergers and for pursuing broader restructure and recovery work within portfolios.**
- **Such a programme will require partners to work together to make it work. Interested partners can act as 'boosters' by publicising this work and referring VCSE organisations in their investee portfolio that might benefit from support.**

Find us at:
2nd Floor, CAN Mezzanine
7-14 Great Dover Street
Borough
London
SE1 4YR

T: 020 3096 7900
enquiries@sibgroup.org.uk

www.sibgroup.org.uk

Social Investment Business