

A review of not-for-profit mergers
for 2014/5

THE

GOOD
MERGER

INDEX



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Foreword



FOREWORD

I am delighted to introduce this second edition of the Good Merger Index, exploring merger activity in the not-for-profit sector for 2014/5.

With two years of data, we can now start to comment on trends, but we've also aimed to make improvements and add analysis to follow pertinent lines of enquiry. For instance, we have included a dedicated chapter on housing associations (Chapter 6), allowing us to compare their unique merger environment with that of charities and social enterprises – this yields some interesting contrasts.

One of the main findings from our core charity data this year, however, has been that consolidation activity has stayed relatively static. This surprised us given that the scale of the challenges faced by the sector – not least economic - are throwing down a gauntlet for charity leaders to innovate, reduce duplication and partner to make the most of scarcer resources. The same can be seen in the housing sector, where fewer than 20 associations merged in a sector of 1,700.

Another of our new additions this year – a section on financial drivers (Chapter 5.2) - shows that charities transferring or merging their assets are likely to be in deficit. This corroborates the received wisdom that charity mergers tend to be “rescues” of organisations in

distress, rather than strategic moves designed to actively strengthen their position and transform their services.

This paints a picture of a sector failing in its responsibility to encourage sensible planning, and should serve as a wake-up call to sector leaders, managers and board members. In light of the current trends in consolidation activity, it is clear that the sector needs both more mergers and better mergers.

The findings bring into question whether board members are routinely exploring strategic options before charities run into trouble. Beyond the mergers covered in this Index, we should be mindful that early action could have found a home for the essential services of high-profile charities that eventually failed, such as BeatBullying and Kids Company.

The findings also question whether the Charity Commission and funders could be doing more to influence, shape and rationalise the sector. In our new Housing chapter, we have contrasted the proactive role the Homes and Communities Agency (HCA) plays with the softer role of the Commission.

I hope that this second edition of our Index will be a valuable resource, informing these much-needed and sensitive discussions as not-for-profit organisations face the challenges ahead.



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Executive Summary

In our second Index, we found 61 charity and social enterprise deals which concluded in 2014/5 and we reviewed 45 of these in detail. We also report on 8 housing association deals.

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Key Findings – Charities and Social Enterprises

In our second Index, we found 61 charity and social enterprise deals concluded in 2014/5 and we reviewed 45 of these in detail. We have also reported on 8 housing association deals.

We found the level of consolidation appeared static and broadly in line with the previous year, despite financial difficulties in the sector and heightened debate about duplication.

The 89 organisations involved in the main 45 charity mergers collectively turned over £811m, or some 2% of total voluntary sector income¹. In the housing sector, we've looked at 16 housing providers that participated in mergers, which collectively turned over £765m (5% of the social housing sector income).²

We have assessed the value of mergers by the amount of income/turnover notionally changing hands through the transfer of these assets.³ In 2014/5, this was £110m for charity deals and £360m for the housing association deals.

Accounting for the shorter time period we studied this year, the number of deals has remained fairly stable compared to 2013/4⁴, but the value of the charity deals has fallen.⁵ However, two big deals that year (St Mungos-Broadway and Save the Children-Merlin) dwarfed those done this year. Excluding these deals, the average size of mergers was fairly consistent across both years - an average of £2.4m income changed hands in 2014/5, against £1.8m for 2013/4.

Our data gives a picture of a couple of large transformative deals annually, while the majority involved small or local charities and brought about incremental changes. In many cases, these organisations had existing relationships or were part of the same federation (e.g. local YMCAs or Crossroads organisations).

We noted a sharp rise in the number of deals structured as straight takeovers in 2014/5, where the transferring organisation was fully integrated (62%, up from 43% in 2013/4).

Genuine mergers continued to account for about one-fifth of all deals (18%), although the language used in announcements did not reflect this. In over half, we found that “merger” continued to be used to describe arrangements (56%).

53% of transferring organisations had made losses in the most recent financial year before their merger, which confirmed our view that financial distress is a key driver for charity mergers. This may explain the rise in full takeovers, as smaller charities would have had limited negotiating power to establish subsidiaries due to their financial situation.

Some mergers were driven by strategy, however – we noted mergers by Addaction/KCA and Richmond Fellowship/Aquarius, which brought drug, alcohol and mental health services together to meet commissioning demands for greater cross-disciplinary provision.

Finally we reviewed which sub-sectors were more likely to see organisations combine forces. Health and social care dominated, as it did last year. Leisure trusts were also active - they were involved in 3 of the top 10 deals, which represented about 5% of all leisure trusts in England & Wales. Infrastructure organisations, notably local Councils for Voluntary Service (CVSs), were another point of interest – 20 CVSs have merged in the past two years. In both cases, significant reductions in local authority funding has compelled organisations to take their futures into their hands by consolidating.

1 NCVO Almanac 2015 reported the overall turnover of the sector was £40.5bn <http://data.ncvo.org.uk/>

2 The HCA has reported Housing Association sector turnover as £15.6 billion in 2014 <http://bit.ly/1LsbuAA>

3 We have used this as an indicator for consistency with our ranking last year and because cash does not actually change hands in not-for-profit deals – “value” is therefore simply measured by the income value of the organisations in question.

4 The Index includes 61 deals in a 12 month period from 2014 to 2015. The first Good Merger Index found 90 deals in a 16 month period for January 2013 to April 2014, but if crudely readjusted, the equivalent would have been 68 deals in 12 months for 2013/4.

5 Deals in the 2013/4 Index were worth £223m, or £167m after being readjusted for an equivalent time period. This compares with £110m for 2014/5.

Key Findings – Housing Associations

We looked at housing associations to take a more comprehensive view of consolidation across the not-for-profit sector in England & Wales (Chapter 6). There were far fewer deals, but due to their stock, they involved the transfer of some £1.6bn of net assets (against £49.5m transferred for charities).

We also noted that 3 out of the 8 deals made use of group structures, although each of these structures had its own peculiarities – one involved an established group structure (with autonomous subsidiaries joining a clear managing parent), while two involved mergers to form new emerging groups.

The HCA as the regulator for social housing takes a proactive approach in mergers, stepping in with failing housing providers and scrutinising all proposed deals. The hand of the regulator may become heavier still given the current fiscal and policy environment for social housing. This role is vastly different to the laissez-faire approach of the Charity Commission.

What can we conclude from these findings?

Overall, the figures continued to show that only a tiny portion of the whole not-for-profit sector engaged in merger – some 129 charities out of well over 160,000⁶ and some 16 housing associations from a total of 1,700.

Moreover, for those that do occur, our data on the surplus/deficit positions of organisations involved implied that financial distress was often a bigger driver than clear-headed planning (though some mergers do show encouraging forethought, such as those we mention above that responded to the commissioning environment).

Our conclusion is therefore that a real step change towards more and better consolidation will only take place when: 1) boards routinely explore merger from a position of strength and 2) the Charity Commission takes on a more proactive role, exercising powers to stimulate and regulate mergers.

Finally we noted that group structures are more commonly adopted in the housing association sector as a means to bring organisations together under one roof. Further examination of this could strengthen the charity sector, as mergers that involve groups and subsidiaries will often tend to better suit the needs of specialist charities that want to retain their autonomy and identity within a larger structure.

Given the current financial and policy pressures faced by housing associations, especially the majority with small stock sizes, we expect a rapid increase in consolidation will take place. Contrary to some views, we recommend that housing associations continue to consider group structures as an attractive vehicle for realising consolidation of not-for-profit entities.

6 NCVO Almanac 2015 <http://data.ncvo.org.uk/>

CONSOLIDATION SNAPSHOT

We have analysed **45** charity and social enterprise deals in detail, involving 89 organisations.

Among charities and social enterprises, **129**

These deals involved the transfer of **£110.2m** of income in Assets

organisations undertook **61** deals in the last year

£49.5m were transferred The combined income for these

89 organisations was

Over **15,600** people were employed by charities involved in mergers, roughly **2%** of the charity workforce

£810.8m

Sector hotspots were **Health & Social Care** (43% of organisations involved),

In the housing sector, **16** housing associations

Intermediaries (16%), **Justice** (10%), **Community** (7%), **Employment** (6%)

undertook 8 deals

The largest deal

was the formation of **Breast Cancer Now**

Mergers represented:

18%, Takeovers: **62%**, Subsidiaries: **13%**, **and Sport** (5%)

The most active organisations were **GLL, NCVO**

Group Structures: 7% There were no Asset Swaps

and **CentrePoint**, which each completed 2 deals

Methodology

3

The key points about our methodology

- ▶ Our original research objective was to identify and collect data on mergers that occurred in the financial year 2014/5. As many mergers are finalised in early April to coincide with the year-end, we selected a 12 month period running up to April 30th 2015.
- ▶ For the purposes of comparison, it is important to note that our original Index looked at a longer time 16 month period (January 2013 to April 2014). However, when we readjusted our previous 2013/4 figures for an equivalent 12 month period we found that crudely, the rate of mergers appeared steady overall.
- ▶ We have endeavoured to record mergers only when they had been completed, or when we were confident that they had been. The consequence was that some mergers, although announced, were not counted because they concluded after April 2015.
- ▶ Our geographic focus is England and Wales, although there is one merger that brings together Redwings, an English organisation, with a Scottish one, Mountains Animal Sanctuary.
- ▶ This year, we fulfilled a previously-stated ambition to broaden out the study to the wider not-for-profit sector and so it includes examples of mergers among Community Benefit Organisations, such as leisure trusts and housing associations (the latter of which are analysed separately in their own section). Although there can be overlap because some housing associations can have charitable status and/or own charity subsidiaries, we nevertheless analysed them separately because they have very different characteristics to the traditional charity sector.
- ▶ The main challenge has continued to be to identify the deals, as not all mergers require immediate registration. We used two main sources in order to find merger deals – public registries and media announcements:
 - **Public registries.** The Charity Commission maintains a limited list of registered mergers. However, this only covers situations where a merger or takeover has occurred and the transferring organisation is dissolved. From a list of 180 mergers, we removed cases where deals happened in past years but were only now being registered, internal reorganisations and tiny organisations with little publicly available information. This meant that many small benevolent funds were omitted, for example. To reflect our added focus on housing associations, we also consulted a list of housing sector mergers obtained from the Homes and Communities Agency.
 - **Media.** We reviewed trade press to find deals at the point of announcement, including deals reported in Third Sector, Civil Society, Charity Times, Inside Housing and Social Housing. We also tracked announcements on social media and local news websites, which helped us find announcements about smaller local charities. Many of these transactions have not yet been recorded on the Charity Commission register.
- ▶ For each deal we then collected financial and non-financial information by referring to the Charity Commission website, Companies House, DueDil, press releases, organisation websites and Eastside Primetimers' own records.

- ▶ Key figures are generally provided as percentage breakdowns, except for Housing (Chapter 6), where the level of activity is small enough to be looked at more directly. Sample sizes for different sets of data vary based on what was publicly available and we have stated sample sizes to give a clear picture of this.
- ▶ Deal size is difficult to assess because transactions do not have a cash value as in the private sector. We have therefore used a proxy by assessing the amount of income/turnover of the organisations which are transferring over into a new arrangement. In the case of mergers, both organisations' income is used because we judge that a new organisation is in effect being created. We also collected data on net assets and transfers.
- ▶ We use a non-legal framework to classify different types of merger. This framework is based on Richard Gutch's work in the 2012 Good Merger Guide and then was adapted through peer-review for the 2013/4 Index.

This year our classifications provoked further discussions among our team, particularly about group structures and branding options. We have made small refinements to these definitions to make them more reflective of what we are observing on the ground.

- ▶ We again used the NCVO's UK Civil Society Almanac to draw comparisons to the wider sector.
- ▶ One of the challenges for understanding not-for-profit mergers is language. Terms like 'merger' and 'acquisition' are borrowed from the private sector and sometimes do not fit well with the not-for-profit sector, where cash is not usually changing hands. For the sake of this report, we use 'merger' in two ways: firstly, in a general sense to describe any strategic change that involves the exchange of assets/liabilities, and secondly, in a specific way to describe a genuine 'merger of equals' that is described in detail in our framework.

Types of Merger Explained

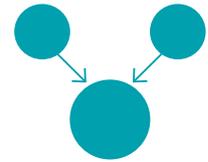
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Our methodology is based on a framework first devised by Richard Gutch in the Good Merger Guide, 2012, which we developed further for the first Good Merger Index in 2014. The framework has been updated slightly during this second edition of the Good Merger Index, but we still classify not-for-profit mergers into one of the following five types: [merger](#); [takeover](#); [subsidiary model](#); [group structure](#); and [exchange of services](#).

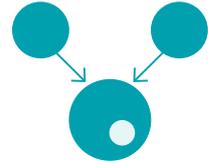
Each type of merger deals with the issues of identity, the composition of leadership teams (specifically the senior executives and the Trustees), branding and the language used in communications in different ways.

While the legal structures are important, our framework is primarily a management guide. For this reason our definitions will in places conflict with that used by lawyers. We make no apology for this and would encourage readers to become familiar with the management concepts outlined below.

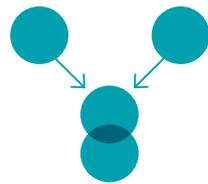
1 Merger



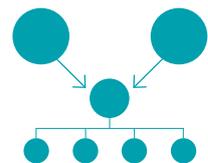
2 Takeover



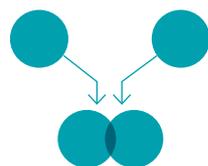
3 Subsidiary model



4 Group Structure



5 Exchange of Services

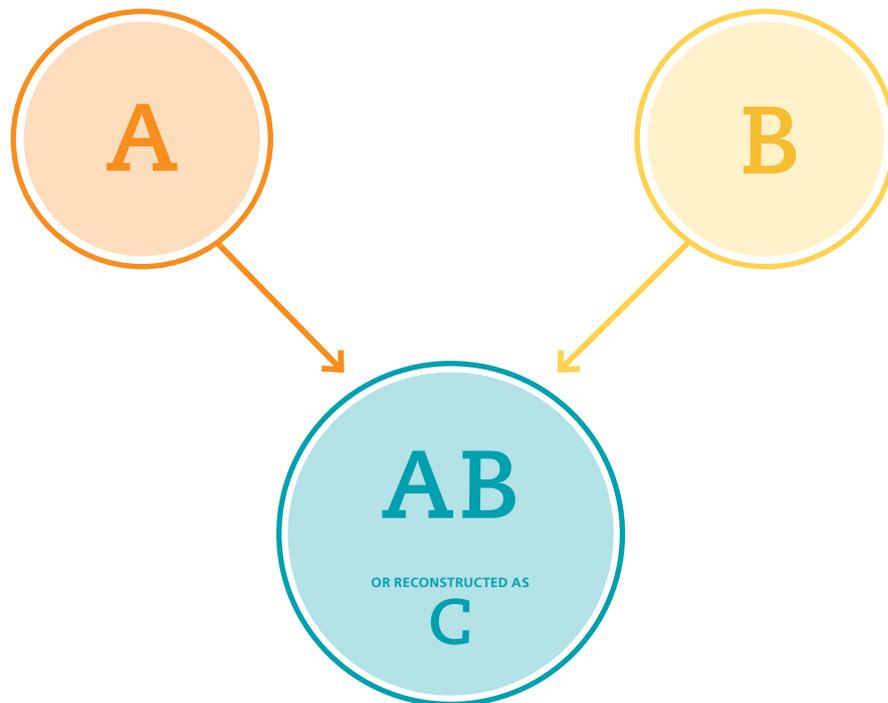


1 Merger

Two or more organisations join to form a new organisation either through:

- i) Organisation A transferring its assets and activities to Organisation B. Organisation B then establishes a new identity with a new leadership team; or
- ii) Organisation A and Organisation B transfer their assets and activities into a new Organisation C and then either dissolve/become dormant or continuing trading as subsidiaries as part of a group structure.

EXAMPLE. A newly-registered charity, branded Breast Cancer Now, was created from a merger of Breakthrough Breast Cancer and the Breast Cancer Campaign, bringing together two of the three biggest charities with this specialism. The new board features a mix of trustees from both predecessor organisations. A majority of directors at Breast Cancer Now at the point of merger had come from Breakthrough, while the new chief executive, Baroness Delyth Morgan, had been leading Breast Cancer Campaign since 2011 (though she had previously been Breakthrough CEO from 1995 to 2005).



- ▶ Often acknowledgement in the new brand identity of two organisations coming together, or a completely neutral new brand is created;
- ▶ Governance of the new organisation must be representative of the two merging organisations

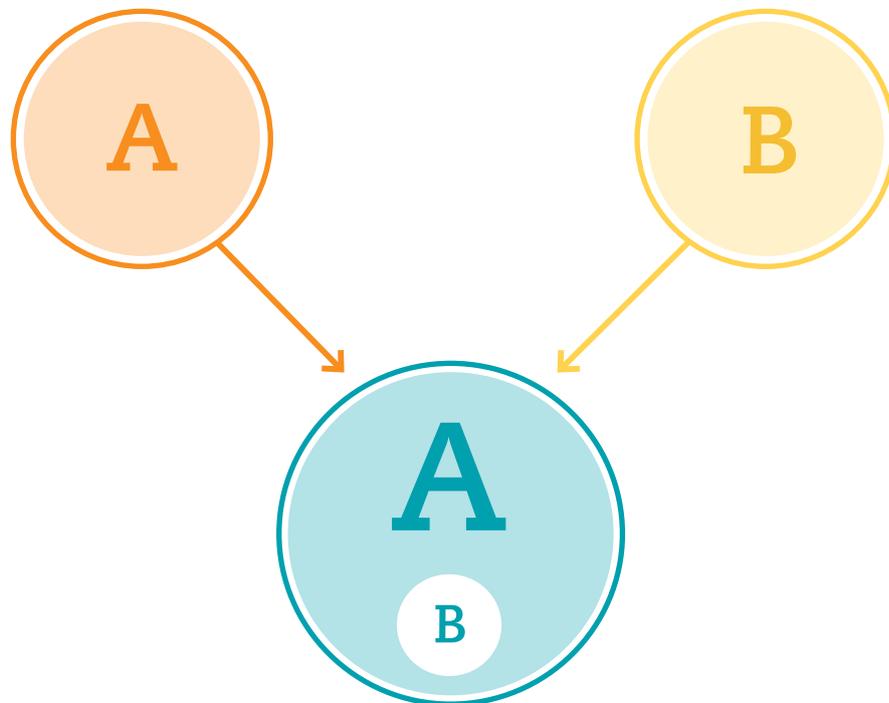
- ▶ Evidence that the top executive team for the newly enlarged organisation has balanced representation from the legacy organisations;

2 Takeover

Organisation B transfers its assets and activities to become part of Organisation A.

- ▶ The transferring organisation is dissolved or exists but remains dormant;
- ▶ The identity of the acquired organisation is either lost after the takeover, or is retained but only as a service or project;
- ▶ Executives from the acquired organisation do not hold roles at the same level of seniority as they did before;
- ▶ The Trustee Board of the acquired organisation is disbanded and stood down.

EXAMPLE. The Manchester-based charity Addiction Dependency Solutions (ADS) took over a Staffordshire substance abuse charity, Adsis, in July 2014. The Adsis website now redirects to ADS, which appears to be known as ‘One Recovery Staffordshire’ as a service within ADS. Adsis was de-registered from the Charity Commission in August 2014. The senior management and board of ADS appear largely unchanged, though Adsis’ former Acting CEO is now Director of Strategic Development with ADS.

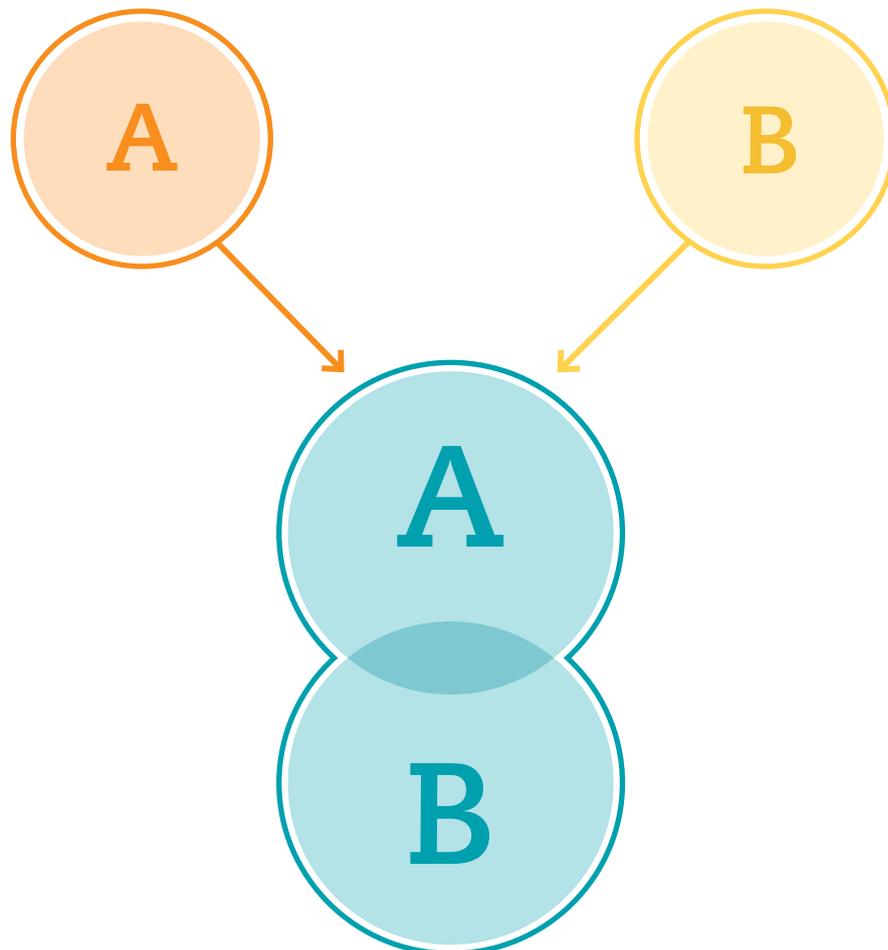


3 Subsidiary

This type of takeover is achieved by Organisation B becoming a 'wholly owned' subsidiary of Organisation A.

- ▶ The transferring organisation retains a separate Board and identity;
- ▶ Job losses at management level are minimised;
- ▶ Ultimate control is nevertheless retained by the acquiring organisation;
- ▶ Only a minority involvement, if any, of Trustees from Organisation B on the main board of Organisation A;
- ▶ Could be a step towards the formation of a group structure.

EXAMPLE. In October 2014 it was announced that Addaction, a UK-wide provider of substance misuse services for adults, young people and families, was acquiring KCA (providing mental health, substance abuse and family services in the South East) as a wholly-owned subsidiary. The KCA name and website have remained separately. Anne Chapman and William Willis - former vice-chair and chair of KCA - are now on the Addaction board, but they also continue to chair KCA's separate board.



4 Group Structure

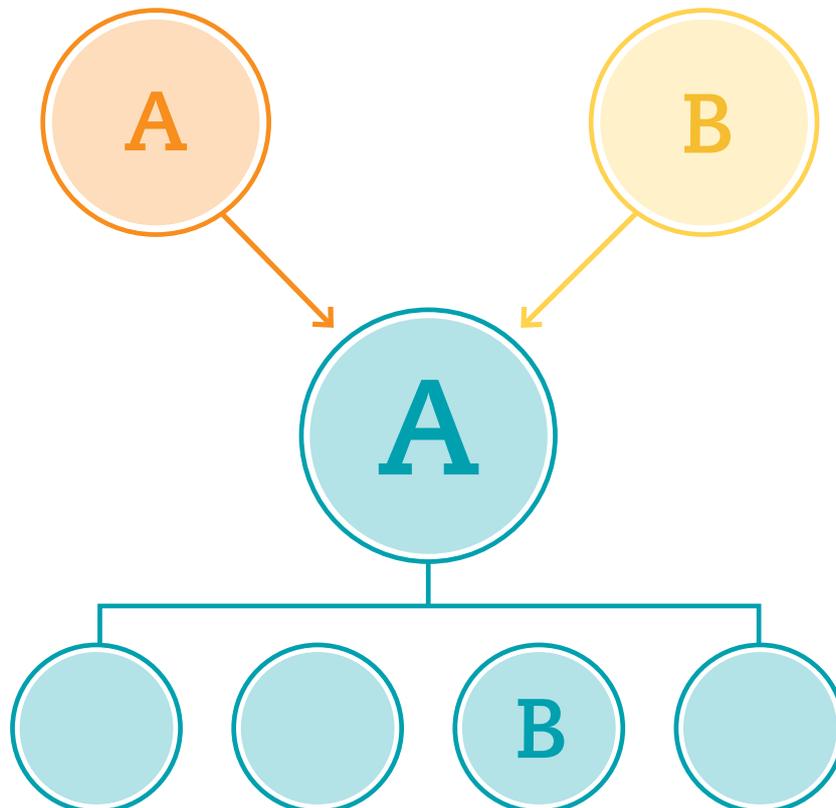
One or more organisations transfer activities and assets to become part of a group and operate as one of a number of wholly-owned subsidiaries. In more developed groups, particularly those in the housing association sector, front line services and accountability is largely pushed down to the subsidiaries and the group company has responsibility for overall management and central services. This is similar to a Conglomerate or Holding Company model in the private sector. The first deal to establish a group is often structured as a merger (see for instance City South Manchester and Eastland Homes creating One Manchester) but then the expansion of the group will be achieved through takeovers of other organisations.

- ▶ The parent group owns two or more subsidiaries, each with their own governance;
- ▶ The identity and brand of the subsidiaries are retained, and distinct to the parent, but with a reference to being part of a larger group;

▶ There is a group CEO and Chair who have key leadership roles and they devolve executive powers to separate individuals who have responsibility for running the subsidiaries;

▶ Different models of governance can be created which means that it is possible for Trustees to continue to have a role at the subsidiary level;

EXAMPLE. Leisure social enterprise GLL, which started as a council spin-out in the London borough of Greenwich in 1993, continued to expand this year, adding two leisure trusts in the North of England – Carlisle Leisure and North Country Leisure – to its group structure. North County Leisure has become a wholly-owned subsidiary of GLL, while retaining its own branding and its system of local boards. While GLL plans to make Carlisle the administrative hub for its northern operations, Carlisle Leisure will be keeping local governance.

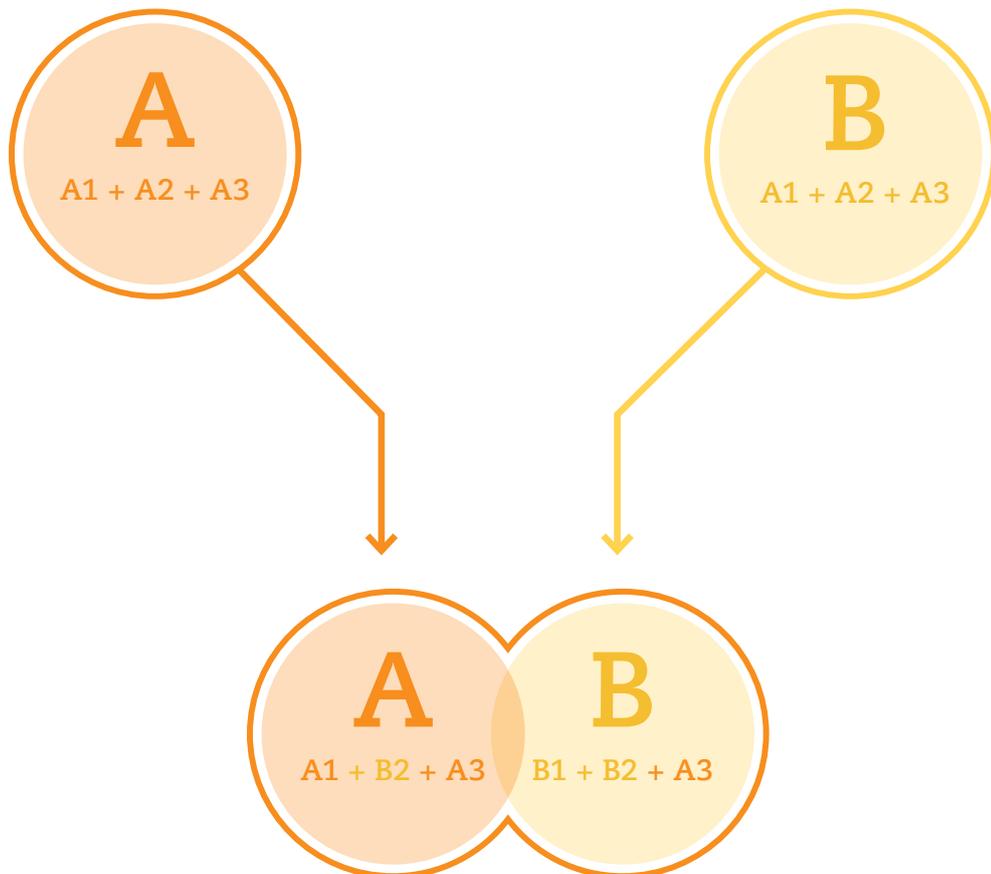


5 Swapping services (and assets)

The transfer or swapping of services, and in some cases assets, in order to help organisations to achieve a more balanced portfolio of activities, income and cost.

- ▶ The identity of the service that is moving is absorbed into the branding of the acquiring organisation;
- ▶ Employees will be TUPE'd;
- ▶ No impact on legal structures or the Trustees of either organisation.

EXAMPLE. No examples of this model were seen this year. In our 2013/4 Index, Platform 51 transferred some of its services to the charity Changing Lives, closed some other services, and rebranded Platform 51 as the Young Women's Trust.



Charity and Social Enterprise Deals

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5.1 TOP 20 DEALS

We present here the top 20 mergers of the 2014/5 Index, ranked according to the size of income transferred.⁷

In 2014/5 there were two large deals worth more than £10m of income. The merger of Breakthrough Breast Cancer (£16.5m turnover) and Breast Cancer Campaign (£12m) tops our ranking this year, with a combined income of over £28m. It is also by far the largest in terms of net assets transferred, with over £20m changing hands. Addaction's takeover of the charity KCA is the other big transfer that took place, with KCA becoming a subsidiary of Addaction. The Breast Cancer Now and Addaction-KCA deals alone represented around 42% of the income value of all charity deals we recorded (and would have still ranked #4 and #5 if housing deals were incorporated).

The top 20 deals represent the vast majority of the value of mergers in the sector. We estimate that they contributed approx 90% of the total amount of income that changed hands across the whole of the charity sector.

Notable in the top 20 this year are leisure trusts, which are involved in 3 of the biggest 6 deals for 2014/5. National leisure social enterprise GLL took over two trusts in the north of England, but Anglia Community Leisure's merger into Abbeycroft also features highly, again due

to their income figures being merged for the purposes of our ranking. Consolidation in this sector is being driven by commissioning pressures - councils are retendering contracts for local leisure centres with more difficult terms and the loss of such a contract can be fatal for small trusts, acting as an incentive to join a larger structure. Retaining contracts was cited as a driver for GLL's takeover of Carlisle Leisure in Cumbria, for example.

One complex merger was seen in Leeds, where three separate health advocacy charities officially merged into a consortium they had previously co-managed, Advonet. The combined incomes of these four puts the newly-enlarged Advonet in ninth place in our ranking. This can be seen as a valuable example of decisive action being taken to reduce duplication between charities providing very similar functions.

There were three examples of organisations undertaking multiple mergers in 2014/5. Along with GLL's two deals, the NCVO took over Charities Evaluation Services and the Mentoring and Befriending Foundation (MBF), to build on its infrastructural role in the sector. The MBF deal also complements the volunteering dimension of the NCVO's mission that it has stressed of late (in the 2013/4 Index, we noted NCVO's merger with Volunteering England to this end).⁸

⁷ For 'mergers of equals', income figures combined both organisations transferring into the new entity. For takeovers, subsidiaries and groups, the figure refers to the income of a single transferor organisation.

⁸ Beyond the top 20, homeless charity Centrepoint conducted two mergers: it took on Bradford Foyer - which effectively became a local branch in Bradford - and the national Homeless Football Association

Top 20 Deals Ranking ⁹

	Transferee	Transferor	Type of Deal	Size by income transferred	Size by Net Assets transferred
1	Breast Cancer Now	1) Breast Cancer Campaign 2) Breakthrough Breast Cancer	Merger	£28,492,507	£20,151,000
2	Addaction	KCA	Takeover	£18,076,000	£2,804,000
3	GLL	North Country Leisure	Group Structure	£8,925,538	-£123,279
4	Abbeycroft Leisure	Anglia Community Leisure	Merger	£7,581,426	£4,067
5	Richmond Fellowship	Aquarius	Group Structure	£7,261,671	£1,978,905
6	GLL	Carlisle Leisure	Group Structure	£6,500,000	£11,233
7	East Kent Crossroads	Crossroads Care West Kent	Merger	£3,047,243	£1,931,510
8	Gofal	Esgyn	Takeover	£2,395,791	£421,951
9	Advonet	1) Advocacy Support 2) Leeds Advocacy 3) Advocacy for Mental Health & Dementia	Merger	£2,392,099	£622,482
10	St Loye's Foundation	Community Care Trust	Takeover	£2,332,024	£227,488
11	mcch	DGSM - Your Choice	Group Structure	£2,328,169	£1,206,764
12	Redwings Horse Sanctuary	Mountains Animal Sanctuary	Takeover	£2,032,737	Unknown
13	JW3 Trust	London Jewish Cultural Centre	Takeover	£1,923,118	£1,894,096
14	Rehabilitation for Addicted Prisoners Trust (RAPt)	Blue Sky Development & Regeneration	Takeover	£1,648,040	£227,739
15	Young Enterprise	pfege	Takeover	£1,419,185	£2,377,598
16	Foyer Federation	Changemakers	Takeover	£1,150,878	£110,197
17	Parachute Regiment Charity	Parachute Regiment Afghanistan Trust	Merger	£1,135,062	£3,103,404
18	Fitzroy Support	The Leo Trust	Takeover	£1,103,464	£2,033,608
19	NCVO	Charities Evaluation Services	Takeover	£1,003,380	£617,721
20	NCVO	Mentoring and Befriending Foundation (MBF)	Takeover	£880,644	£364,445

⁹ 'Size by income/net Assets transferred' figures were the most recent available annual income figures for the transferor organisation(s) in the deal – for equal mergers, income and asset figures of both/all organisations are combined.

5.2 FINANCIAL DRIVERS

A new feature in the Index this year is a look at the financial position of charities engaging in merger, reviewing their surplus/deficit as a percentage of turnover.

More than half of transferor charities are in loss (53% of them), compared to 24% of acquiring charities making losses. Moreover, not only are a substantial majority of acquiring/transferee organisations in surplus, but 44% of them are growing at rate of more than 3% a year. Interestingly, the top deal of the year – the equal merger that formed Breast Cancer now - involved two loss-making organisations coming together to shore up their financial positions.

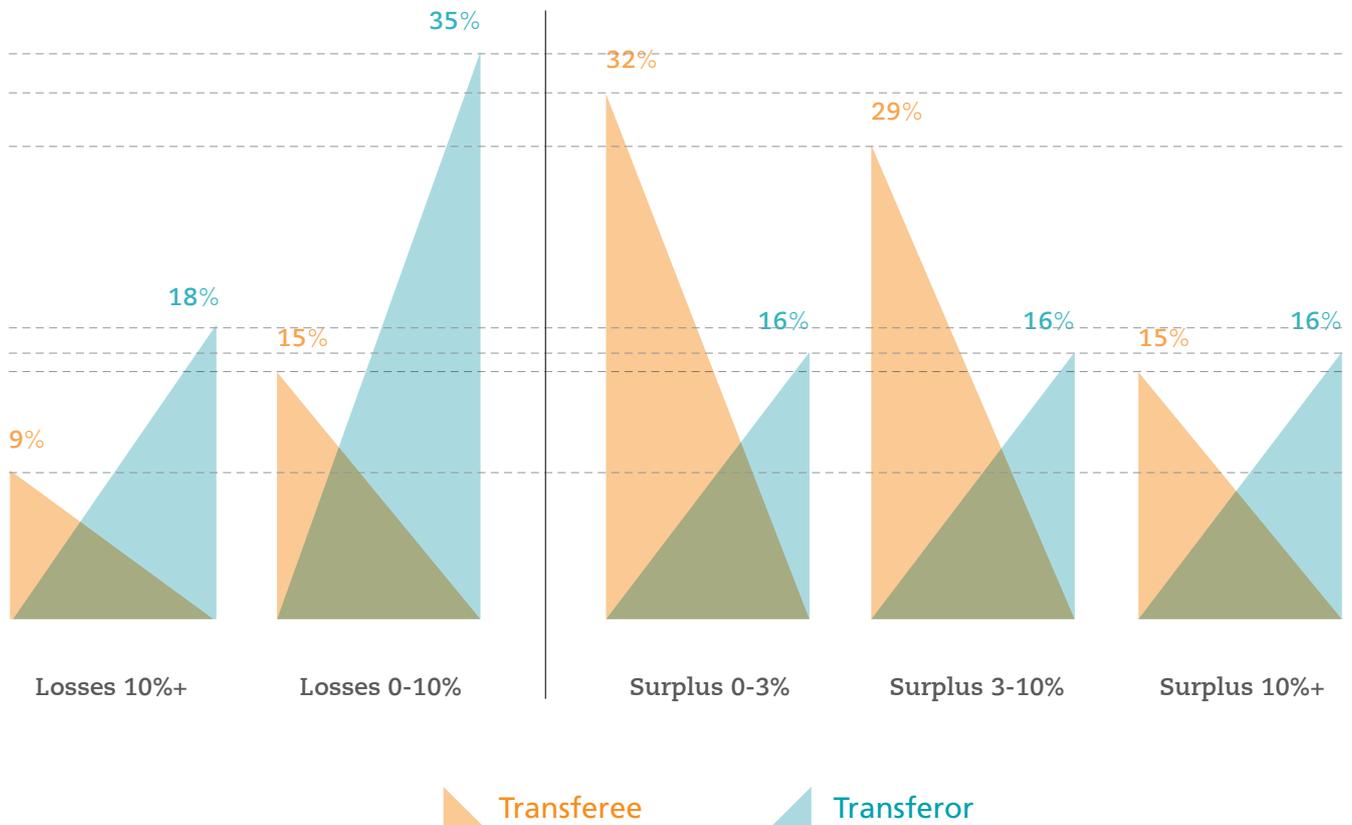
This analysis appears to confirm that many charity mergers are constructed as “rescues”, where a smaller charity in financial distress seeks merger with a larger, more stable organisation in order to safeguard its services from closure.

We are of the view that this type of deal has become more of a feature of the sector in recent years due to funding instability.¹⁰

If so, this is not necessarily a positive sign for the sector. Mergers are often better when they are proactively sought from a position of strength, as part of a clear strategy to increase the social impact of the charity and enhance outcomes for its beneficiaries. Mergers conducted on this basis allow the organisations to fully review their options and negotiate a better deal for themselves. For example, small charities that are specialist in a particular service area or well-rooted in a community will have a clear value proposition if seeking to join a larger organisation or group, and will often be in a better position to retain services or negotiate for autonomy.

Manually adjusted so that for merger deals both organisations are counted as transferors.

Sample size: 85 organisations.



¹⁰ <http://blog.cfg.org.uk/index.php/mergers-during-the-recession-why-werent-there-as-many-as-expected/>

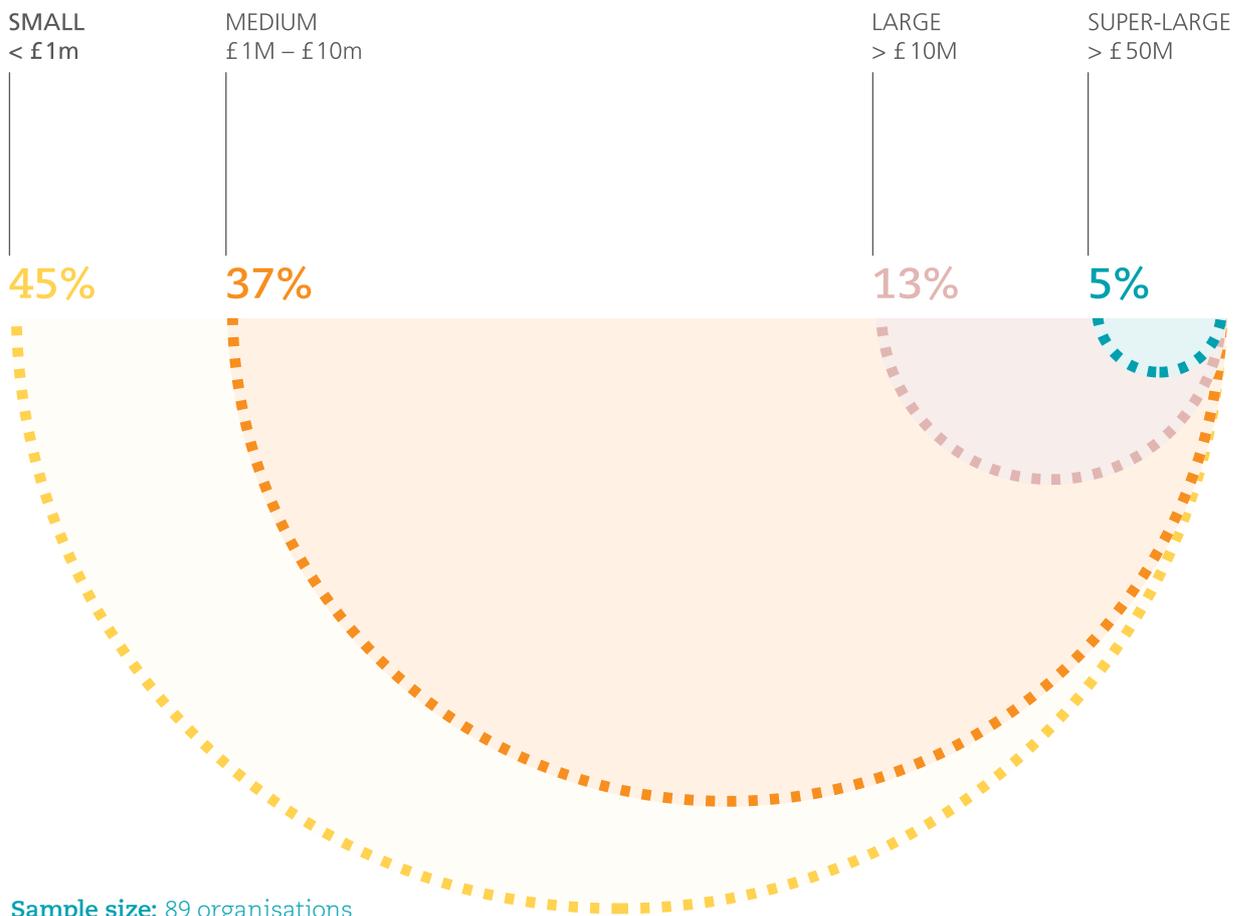
5.3 SIZE AND DISTRIBUTION

We present here the income size of organisations that engaged in mergers in 2014/5.

While we know from the top 20 ranking that the largest few deals represent the majority of the value of charity mergers, the smallest charities account for most of the actual activity. Small charities (those under £1m) made up 45% of merger partners, with medium-sized organisations (£1-10m in our classification) representing 37%.

This means that the centre of gravity for consolidation activity in the sector has shifted downward slightly since 2013/4, with smaller charities now replacing medium-sized charities as the most likely to be involved in mergers.

In 2014/5 there was again a few large (£10m+) and super large (£50m+) organisations involved in mergers, including organisations like GLL, Addaction, the Shaw Trust and Centrepont. The proportion was fairly consistent with 2013/4 and reflects the overall 'pyramid' shape of the not-for-profit sector, which tends to feature many small or local organisations and progressively smaller numbers of larger organisations. Combined with the share of income that the top few mergers represents, this continues to tell a story of a small number of large transformative mergers and a comparatively long tail of small local mergers.



5.4 TYPES OF DEAL

Based on the framework described in chapter 4, straight takeovers where one organisation is fully integrated into another represented 62% of all the mergers in 2014/5 (up from 43% in 2013/4). Takeovers using a subsidiary model represented a further 13% and takeovers using a group structure 7%. Together, takeovers of all types rose to 82% (compared to 73% previously).

Straight takeovers are therefore the most common model for merger, due to the fall in the number of identifiable cases where the smaller partner had retained status as a subsidiary. This may have been due to the fact that many smaller organisations in financial distress sought a safe haven and did not have the negotiating power to enforce a subsidiary model. However, some small organisations did still retain a level of autonomy and identity, whether that was within an established group or as a subsidiary.

Equal mergers accounted for 18% of all deals - similar to the 23% share in the last Index - while there were no clear cases of asset or service swaps in 2014/5. As in 2013/4, genuine mergers appear to be rare, although mergers represent 4 of the 10 largest deals.

These findings continue to demonstrate that a wide range of structural options are available to charities considering merger, even if they are small or in distress. Some of the details of particular mergers we looked at led to significant discussion on our team about how best to classify them, which is a reminder that charities have the capacity to negotiate deals that best serve their particular circumstances and priorities – no two mergers are exactly alike. Once charities have given thought to what those priorities are, the right structure can invariably be found.

Sample size: 45 deals

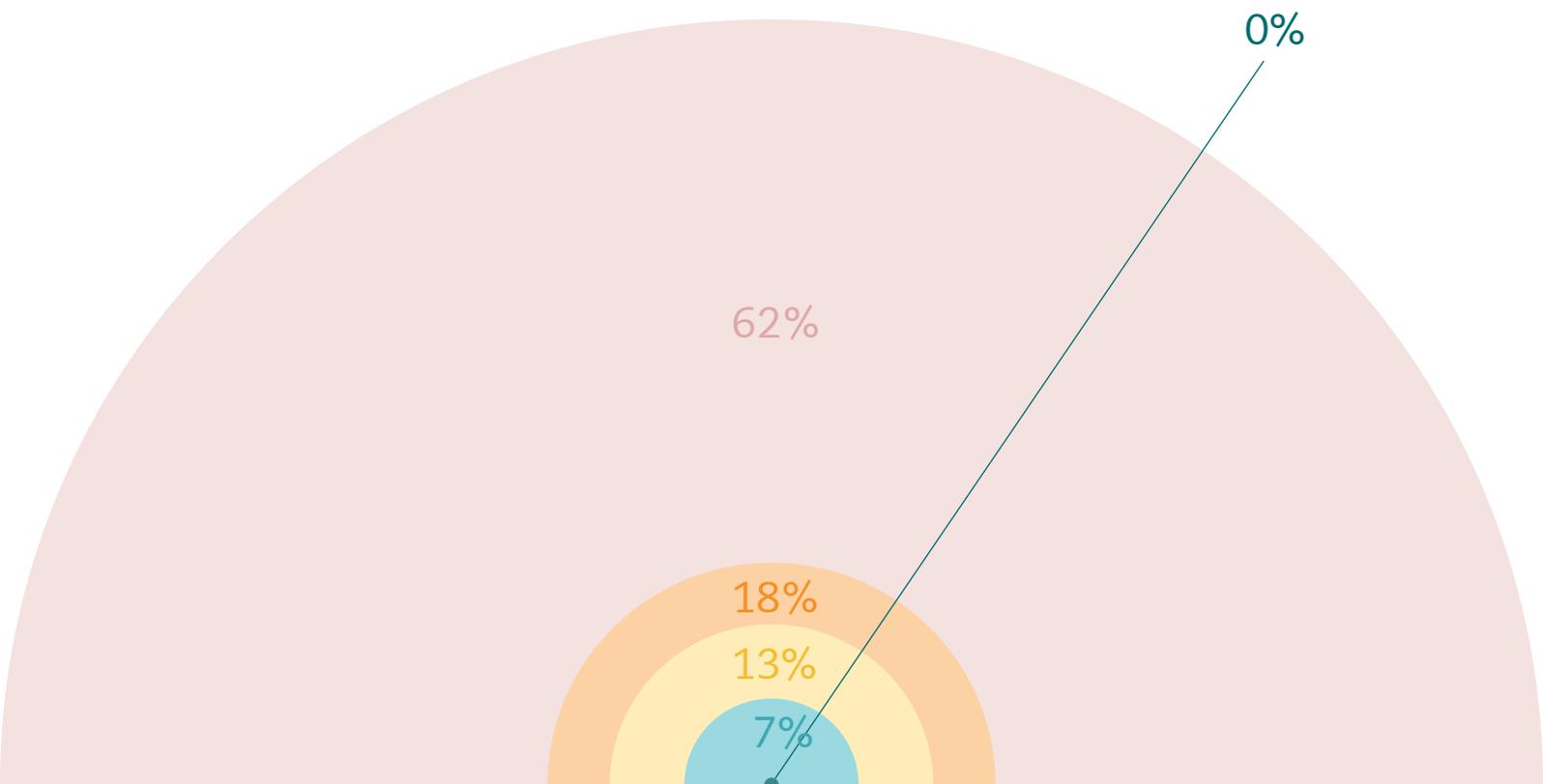
TAKEOVER

MERGER

SUBSIDIARY

GROUP STRUCTURE

ASSET SWAP



Types of Deal

The development of group structures

We have tracked the development of group structures, which are a relatively new innovation in the UK charity and social enterprise sector, but more common among housing associations.

Groups allow a range of services to be brought under one central company, achieving scale and cost reductions whilst allowing for the retention of brand, management and board at the subsidiary level (albeit with some new members and governance controls). Central services are delivered by the group company, which enables subsidiaries to focus on front line delivery, where subsidiaries often have interest and expertise. In a pure model, the central organisation is like a holding company and will not deliver frontline/customer services. There are cases though where group companies continue to handle delivery, and we regard these as 'emerging' groups.

GLL is notable here for two mergers which it completed using a group structure. Likewise, Richmond Fellowship added the Midlands-based substance abuse charity Aquarius as a further subsidiary into its group following the takeovers of MyTime CIC, Croftlands Trust and County of Northampton Action on Addiction as subsidiaries in 2013/4.

In the housing sector, there is a lively debate about the merits of group structures. It was only the Accord Housing Group's takeover of Heatun Housing that we regard as a fully established group structure. City South Manchester/Eastlands and Golden Gates Housing Trust/Helena Housing are both examples of emerging groups.

In an environment where cash is not changing hands, group structures are an attractive way for smaller not-for-profits to accept a takeover. More autonomy is retained by the transferring organisation including brand identity and a Board. That said the Parent still has ultimate control and all participating organisations do need to be aware that governance and reporting lines can be more complex going forward.

5.5 SECTOR HOTSPOTS

We assess here ‘hotspots’ of consolidation. As in 2013/4 health and social care was the area of greatest activity, with these types of services accounting for 43% of those changing hands. This was followed by intermediaries - which provide various kinds of infrastructure or representation for frontline charities - at 16%.

Intermediary mergers include deals involving both national organisations and local CVSs, the latter of which are under particular financial strain at the moment. NCVO conducted two mergers, one of which built on its recent volunteering focus (Monitoring and Befriending Service) and the other on its general support role for the sector (Charities Evaluation Service). We also saw the Social Impact Analysts Association and SROI Network come together demonstrating the rise of impact measurement and social value as themes in the sector.

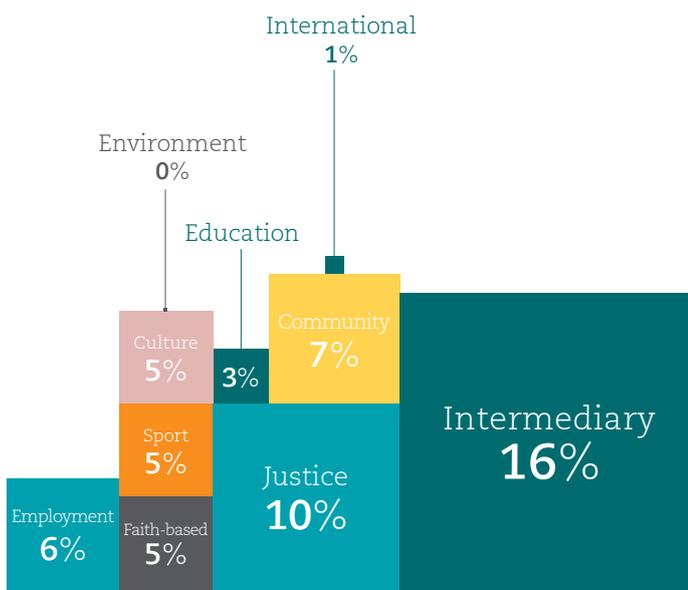
In terms of local CVS organisations, we saw mergers in Norfolk, the Vale of Glamorgan in Wales and the London borough of Merton. Reduced local authority budgets are a key driver of these mergers, as CVSs try to adapt and find new ways to fund themselves. This is a continuation of a trend we saw in 2013/4, when there were a further four mergers involving local CVS organisations. Over two years this means that 20 local CVS organisations have

merged. It is worth noting that NCVO chief executive Stuart Etherington recently called for more infrastructure mergers in an October 2015 speech, arguing that the level of duplication in the 800-strong sector is not sustainable with a tougher funding environment.

Other areas of high activity included the justice sector (including domestic violence, ex-offenders and animal welfare in our broad categorisation), community organisations such as local hubs and clubs, leisure trusts and employment and training providers.

In sports and leisure sector, 5 leisure trusts completed mergers in the 2014/5 period. In the context of a sector containing about 100 organisations, this is noteworthy. This has mainly been due to local authorities scaling back funding for formerly council-run local trusts and retendering contracts. The press release for GLL’s takeover of Carlisle Leisure alluded to these financial drivers, stating that “[Carlisle’s] directors believe that the economies of scale and savings in procurement that merger will bring maximise the chances of retaining the Carlisle and Allerdale contracts, due for renewal”. As local authorities seek to retender contracts for leisure services with more stringent terms, then scale and efficiency become ever more important for leisure providers.

Sample size: 129 organisations
(some organisations overlapped sectors)



Health & Social Care
43%

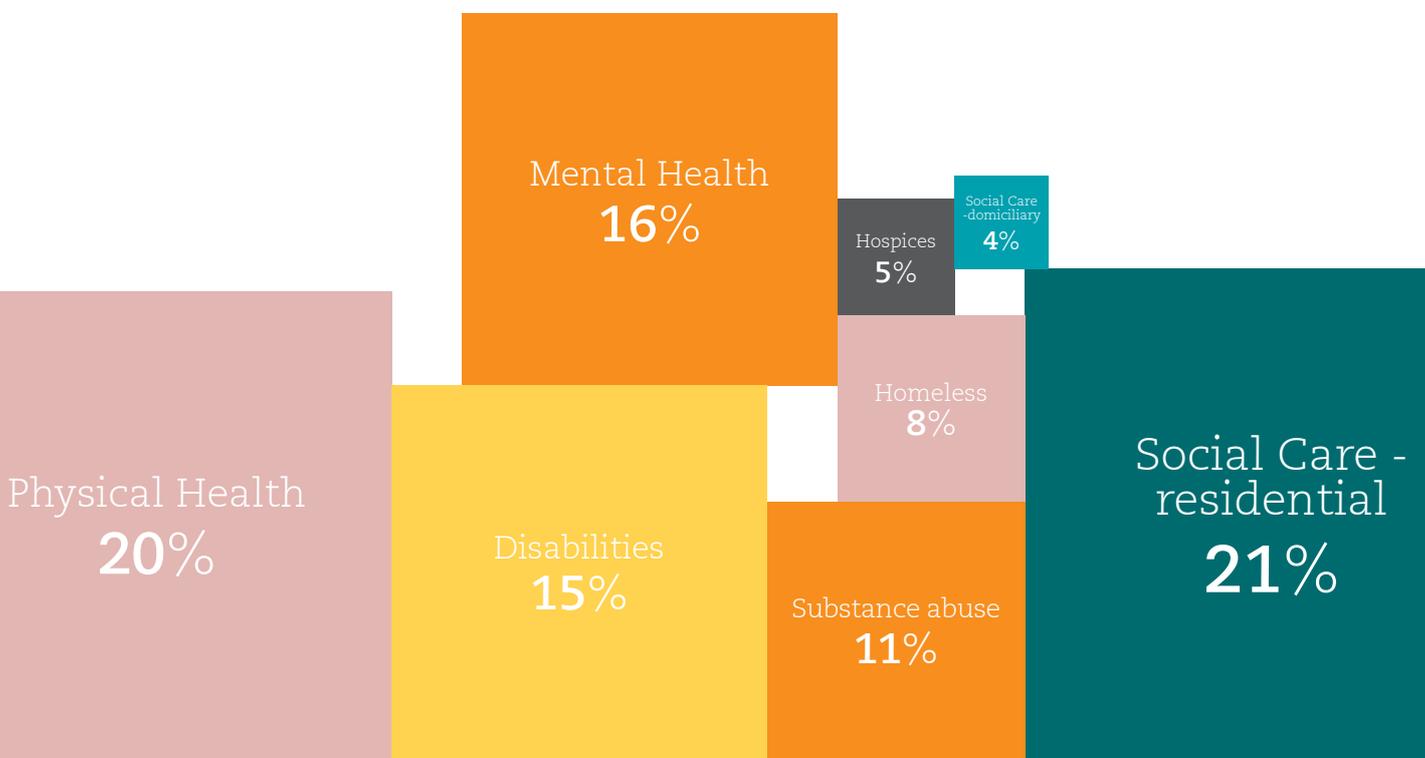
Consolidation trends for health and social care

Within the health and social care sector, charities delivering residential care (21%) and physical health (20%) participated in the most mergers. Residential care included a merger between federated Crossroads organisations in Kent and Age Concern Hampshire taking over a local day care centre. Physical health includes the formation of Breast Cancer Now, the single largest merger in 2014/5, as well as the Stroke Association's takeover of Speakability. More local examples include St Loye's Foundation in Devon making the Community Care Trust a subsidiary.

Mental health and substance abuse were also notable areas of merger activity, influenced by commissioner-led demands for cross-disciplinary provision. Substance abuse charity Addaction acquired KCA in order to strengthen its mental health services (following on from their acquisition of City and Hackney Alcohol Service in the 2014 Index), while mental health charity Richmond Fellowship continued its growth strategy by acquiring substance abuse charity

Aquarius (making 4 deals in the last two years). The desire to scale up and compete for complex, bundled health and social services contracts was a driver behind these mergers.

A complex merger between four charities covering mental health and disabilities was also seen when Advocacy Support, Leeds Advocacy and Advocacy for Mental Health & Dementia combined and merged into a consortia, Advonet. Advonet had originally been founded to provide a single point of access for service users, who previously faced a choice of advocacy organisations with complementary specialisms. Advonet also runs Leeds Independent Health Complaints Advocacy and one of the merging organisations owned a company, Articulate Advocacy. This is an interesting example of innovation and collaboration in the sector and an example of how joint efforts between separate organisations can provide a stepping stone towards full merger at a later stage.



5.6 LANGUAGE AND BRANDING

How mergers in the sector are explained, reported and branded is often a point of great sensitivity when deals are being negotiated. Charity managers are faced with a difficult balancing act – they must reassure staff, funders and beneficiaries as organisations go through substantial change, but they must also be clear about what everyone can expect from the new arrangements.

Language

In news announcements of deals, “merger” was the most common description (56%), even though the number of genuine mergers was far lower at 18% of all deals. This was very consistent with what we found in the 2013/4 Index (58% were branded “mergers”, against 23% of deals) and continues to reflect discomfort in the sector with acknowledging the prevalence of takeovers. Terms denoting takeovers were used in 27% of new releases this year, against 62% of actual deals. Further, one deal that was effectively a takeover stressed language around a “transfer of services”.

Softer language enables smaller organisations taking part in deals to feel reassured, but it calls into question whether organisations are doing enough to ensure that clear expectations are set. In the cases where mergers do struggle or fail we are often told it is due to false expectations, with staff facing greater operational changes than they had anticipated.

Finally, in the case of group structures we find that there is a much closer correlation between how they are reported and what is actually happening. Executives find it easier to speak plainly when adopting these models because they do give more autonomy to the organisation being taken over.

Branding

Charities have a number of different options to brand their new merger. As a report by nfp Synergy on charity branding noted, “sometimes the dominant brand wins out, sometimes a whole new name is created, and sometimes the two names are just bolted together like a crude piece of welding”.¹¹ We also track a fourth possibility, which is the transferor charity retaining its own brand as either a subsidiary or as a distinct service within their new parent body.

Most organisations involved in merger in fact chose this last option and agreed that a transferring organisation should retain its brand in some form, occurring in 51% of cases. This was much the same as last year, when the figure was 48%.

Among the other three options, what is immediately notable is that there were few, if any, clear examples of names simply being amalgamated. In 36% of cases, transferor charities were more clearly incorporated under the brand of a larger charity, with the resulting loss of their former brand. Rebrands with new names represented 13% - examples included Breast Cancer Now (from the merger of Breast Cancer Campaign

& Breakthrough Breast Cancer), Support Our Paras (formerly Parachute Regiment Charity & Parachute Regiment Afghanistan Trust) and Social Value International/UK (previously Social Impact Analysts Association & the SROI Network).

This points towards merged organisations being clearer in their branding this year and taking the opportunity of merger to refresh their brand or strengthen an existing one.

However, brand and identity were put in context by two charities in Surrey, Leatherhead Youth Project and Liquid Connection. When they announced their intention to come together after several years of close collaboration, they explained their decision simply by saying that “we began to realise that the young people couldn’t tell that we were two different organisations as we complemented each other so well”.¹² This is a reminder that for beneficiaries, the presence and quality of vital services is more important than the brands they are delivered under, and this is something trustees and managers would do well to keep in mind when considering merger.

¹¹ <http://nfpsynergy.net/free-report/whats-name-key-issues-when-charity-wants-change-their-name>

¹² <http://www.dorkingandleatherheadadvertiser.co.uk/Leatherhead-youth-charities-merge-unify-services/story-26194937-detail/story.html>

Housing Association Deals

6

HOUSING ASSOCIATION DEALS

We provide here a report on mergers in the Social Housing Sector.

Our analysis focuses upon 8 deals completed between April 30th 2014 and May 1st 2015 for which there is a reasonable amount of financial information available in the public domain. We have arrived at this figure starting with a HCA list of amalgamations, transfers of engagements and mergers which was cross referenced against media reports from Inside Housing¹³ and then adjusted to exclude internal restructurings and small deals for which little reliable information was available.

We also noted that several organisations had announced they were actively working

Headlines

We found the 16 organisations involved in these 8 mergers were turning over collectively £765m (compared to £811m for charities), with the transferring organisations accounting for £360m of this (compared to £110m for charities). It is worth noting that as in the charity sector, this means total merger activity is very small in the context of the HA sector, which contains 1,700 organisations.¹⁴

These deals involved asset transfers of £1.6 billion, based on the most recent information we had available. This means that housing sector deals involved about 3.5 times as much income changing hands than those done in the charity sector and were 33 times larger on a net asset basis.

The single largest deal - a merger between Jephson and Raglan to form Stonewater - saw the organisations bring together £153m of income (over 40% of the total in 2014/5), along

towards merger in 2014/5, only for them to call off the process in a further announcement. This highlights a difference between the way that charities and housing providers undertake mergers. In the charity sector, public announcements are frequently made when mergers are very likely to go ahead. In the housing sector, the greater scale and complexity means that the merger process is accompanied by multiple public announcements and news stories at various junctures, and it is not uncommon to see previously-signalled mergers abandoned as due diligence is carried out or regulatory judgements are issued. The level of rigour in due diligence is significantly higher for housing associations.

with £933m of assets (57%). Both of these housing providers were also categorised as 'super-large' for stock size (with more than 10,000 units apiece) and Stonewater is now reported to manage around 31,000 homes across England.

Jephson/Raglan was the only merger where full integration occurred, with both abandoning their previous brands. Four deals were structured as takeovers of some variety – either completely, or with one becoming the subsidiary of another. Three more involved the formation or expansion of a group structure.

Three organisations chose the option to rebrand under new names (Stonewater, One Manchester and Torus), while there were three cases where a subsidiary kept their name and two smaller housing association brands were lost through an outright takeover.

¹³ Inside Housing has reported that 89 mergers, amalgamations or transfers of engagements (where a transferring body ceases to exist) occurred in the period of 2011-2014. Another 90 occurred between 2007-2011, establishing a benchmark of approx 26 mergers and takeovers per year in the sector. However, we have found the figure to be much smaller if internal restructurings are excluded and if we only consider deals where there is available financial information in the public domain.

¹⁴ http://www.amaresearch.co.uk/Housing_Assoc_14s.html

	Transferee	Transferor(s)	Type of Deal	Size by income transferred	Size by Net Assets transferred	Stock sizes
1	Stonewater	1) Jephson Housing 2) Raglan Housing	Merger	£152,574,000	£933,061,000	Super Large (over 10,000) - Super Large (over 10,000)
2	Torus	1) Helena Housing 2) Golden Gates Housing Trust	Group Structure	£102,233,469	£270,803,000	Super Large (over 10,000) - Large (2,500-9,999)
3	One Manchester	1) Eastlands Homes 2) City South Manchester Housing Trust	Group Structure	£62,367,000	£302,456,000	Large (2,500-9,999) - Large (2,500-9,999)
4	Isos Housing	Cestria Community	Takeover	£16,569,888	£30,759,377	Super Large (over 10,000) - Large (2,500-9,999)
5	Accord Group	Heantun Housing Association	Group Structure	£13,879,000	£39,868,000	Super Large (over 10,000) - Medium (1,000-2,499)
6	DCH	West Devon Homes	Takeover	£6,805,000	£10,076,000	Super Large (over 10,000) - Medium (1,000-2,499)
7	Incommunities	Sadeh Lok	Takeover	£5,226,000	£32,679,000	Super Large (over 10,000) - Medium (1,000-2,499)
8	Origin Housing	Lee Housing Association	Takeover	Not available	£7,000,000	Large (2,500-9,999) - Small (under 1000)

Stock sizes

The amount of housing stock held by individual housing associations gives a sense of the types of mergers which were taking place in 2014/5. The figures show that 7 of the 16 associations were 'super-large' with stock sizes over 10,000. A further 5 were large (2,500-9,999 stock) and 3 were medium (1,000-2,499). Just one, the Enfield-based Lee Housing Association, was a small organisation with fewer than 1,000 units.

Group structures

Across this spectrum we found that 3 of the 8 deals were constructed as part of group structures. The West Midlands-based Accord Group, which took over Heantun Housing Association in Wolverhampton, was an expansion of an existing group. Accord already contained a number of subsidiaries with their own identities and governance structures (Ashrammoseley, bchs, Caldmoreaccord, Direct Health, Fry Housing Trust and Redditch Co-operative Homes). The group is notable in that it contains health and social care providers among its subsidiaries, as well as affordable housing – it runs 13,000 homes and helps 80,000 people a year. As part of this deal, Heantun is taking over the management of 500 more Accord homes and Accord will also “support Heantun to develop new homes, including low carbon timber houses, in Wolverhampton and provide a cash injection and efficiency savings worth £420,000 a year”.¹⁵

By contrast, we saw two examples of newly emerging groups this year – the formation of Torus in the North West (created from a merger of Golden Gates Housing Trust and Helena Housing) and One Manchester (from City South Manchester Housing and Eastlands Homes). For One Manchester, the two predecessor organisations have now become subsidiaries under a new entity. This appears to be the first step towards a traditional group structure, with central management separated from subsidiaries that handle provision.

The debate about the merits of group structures is nevertheless contested. As far back as 2008,

This paints a picture of a sector where two types of consolidation occurred: either large similar sized organisations came together in transformational deals or bolt-on takeovers of associations in financial distress occurred.

Yorkshire Housing collapsed its structure by merging its five constituent members into one charitable organisation, Yorkshire Housing Ltd. Plus Dane Housing Group in Merseyside and Amicus Group have also considered simplification. In May 2015, the Peabody Trust announced a plan to collapse both of its subsidiaries into its main asset-holding body, with a single board. Peabody stated this was to provide stronger overall governance and to bring about savings, a potential saving of £5m over nine years on pensions. However, the proposal to fold up Peabody's CBHA subsidiary in Waltham Forest has proved controversial – there have been complaints that the move could reduce tenant control, and a local charter has been drawn up by Peabody and local residents to ensure the protection of local services.¹⁶

We believe that group structures will remain an important option for not-for-profits seeking to consolidate and merge. Central administration costs are spread across a much larger revenue base. Further, autonomous subsidiaries with their own identities and specialisms are also able to remain rooted in their local communities, or even within specialist sectors in the case of non-housing subsidiaries – both of these are observable in the case of Accord, for example. There are occasions when group structures can become unwieldy and generate new administrative burdens, but there is no one-size-fits-all approach - parents and subsidiaries have the flexibility to choose for themselves the governance structures which most successfully balance accountability and efficiency.

¹⁵ <http://www.heantun.org/?p=1433>

¹⁶ <http://www.insidehousing.co.uk/peabody-to-collapse-group-structure/7009594.article>

Regulatory Environment

The Homes & Communities Agency (HCA) plays a more active role than the Charity Commission in encouraging, sanctioning or vetoing mergers. The HCA has more of a regulatory mandate to shape and rationalise the sector it oversees and we expect them to be more explicit about using this mandate in the future. One analysis in Social Housing magazine this year noted that the role of the HCA tends to be “permissive”, but that this still includes powers to “probe and challenge” and the time it can take to obtain consent has lengthened as the HCA has widened the scope of the scrutiny it subjects mergers to.¹⁷

Whereas charities don’t need to notify the Charity Commission of a merger in many cases, housing associations need to both inform the HCA and then produce a fully-costed, risk assessed business case which the HCA scrutinises and approves before a merger can be completed. Stakeholder engagement in the form of consultations with residents has also become a requirement for housing associations seeking merger. Although charities do on occasion go through voluntary consultations before mergers, this is not a requirement and therefore does not appear to be routine.

In the past year we have seen senior figures from the HCA seek out large, stable landlords able to take over smaller associations in a difficult financial position. This has involved

active discussions with large providers, demonstrating the direct role the HCA is playing in rationalising the sector.¹⁸ At the time of writing, it is also being speculated that the rent cut announced by the government in July 2015, due to take effect in April 2016, will push more HAs towards merger. The NHF has estimated the cut will cost £3.9 billion to the sector over the next four years and the HCA is giving guidance that small associations must explore merger if they wish to seek an exemption from the rent cap.¹⁹

In May 2015, the chair of the HCA’s regulation committee Julian Ashby asked associations to adopt a ‘merger code’ to govern takeovers and mergers, drawing on the Code on Takeovers and Mergers used in the City of London.²⁰ Ashby further said that while some mergers are “done for the right reasons and achieve real value”, others “seem to be driven more by retirement dates than by commercial or social logic”.²¹ It is worth noting that this is often characteristic of mergers in the charity sector as well, but the Charity Commission lacks powers to address the problem. Ashby also cited welfare reform and the government’s Right to Buy policy as potential drivers of merger.²²

Based on these factors, we expect to see the number of housing associations undertaking mergers rise in the coming years, as the policy and financial pressures we have outlined above bite and the HCA takes action.

17 <http://www.socialhousing.co.uk/is-a-merger-of-equals-a-thing-of-the-past-in-the-ha-sector/7009611.article>

18 <http://www.insidehousing.co.uk/business/regulation/hca-seeks-big-players-to-rescue-strugglers/7011168.article>

19 <http://www.insidehousing.co.uk/business/finance/merger-proviso-for-rent-cut-exemptions/7011836.article>

20 <http://www.socialhousing.co.uk/sector-should-consider-takeover-code-says-regulator/7009909.article>

21 <http://www.insidehousing.co.uk/ashby-housing-associations-should-adopt-merger-code/7009884.article>

22 <http://www.socialhousing.co.uk/sector-should-consider-takeover-code-says-regulator/7009909.article>

Concluding remarks



CONCLUDING REMARKS

By producing this second edition of the Good Merger Index, we have built on the baseline data observed in the previous 2014 Index, while also refining our approach and adding new features that add greater context to the data we already had.

With over two years of data, we have been able to start drawing conclusions about the state of the sector. For charities and social enterprises, we have not noted any increase in the rate at which mergers are occurring – instead it appears to be reasonably static (though this requires some accounting for the differing timeframe we have measured). Excluding two large deals in the 2013/4 Index, it is also observable that the average size of a deal in the charity sector was relatively static where measured by income transferred.

By investigating the financial surplus/deficit position of charities this year, we have also been able to observe that a key driver for mergers that do occur is poor financial position - over half of charities transferring their resources are in deficit. This tells us that even when smaller charities are opting for merger, they often do not do so strategically from a position of strength, which in turn may explain why we saw many straight takeovers and fewer deals involving subsidiary status. Both the quality and quantity of mergers we see in the charity and social enterprise sector are lacking, according to our findings.

The introduction of the housing sector to our analysis this year, confined to its own chapter to reflect its vastly different scale and regulatory realities, has put all this in further context. Two clear comparisons can be made. One is that the HCA plays a more proactive role both in encouraging and scrutinising mergers – this probably helps to address the quality problems

that might otherwise arise, something the Charity Commission could learn from for its sector. The other is that group structures and subsidiaries are far more of a fact of life for housing associations, while charities are far less experienced in how to strike a balance between consolidation and autonomy, leading to either inertia (when charities choose to fear the unknown and avoid merger altogether) or outright takeover (when they act too late and can only keep their services by agreeing to be subsumed).

Our findings on the housing association sector also suggest that the overall amount of merger activity is small – we have looked at 8 mergers involving 16 organisations that we were able to find substantial information on, out of a sector of 1,700. Given the current financial and policy pressures faced by associations, especially the majority with small stock sizes, we expect more will need to look at merger.

The external funding and policy environments for charities, social enterprises and housing associations alike are not going to get any easier in the years ahead, meaning much more clear-eyed analysis and discussion of these realities is required. We hope these findings may help contribute to that.

THE GOOD MERGER INDEX

This study has been prepared in order to understand more about the consolidation activity that charities, social enterprises and housing associations undertake. A framework is included which describes five different types of not-for-profit deal: Merger, Takeover, Subsidiary Model, Group Structure and Exchange of Services. We report on top deals for 2014/5 and give our impressions of the merger market based on the 2 years of data we now have. We aim to continue developing The Good Merger Index as a useful resource and publish regular updates on merger trends.

ABOUT EASTSIDE PRIMETIMERS

Eastside Primetimers is a management consultancy working exclusively for charities and social enterprises. We advise on: mergers, acquisitions, partnerships, investment, contract readiness, business planning, board recruitment and good governance.

Through our Foundation we support senior professionals who are seeking to work with the not-for-profit sector. We carefully select individuals for their commercial know-how and their passion to make a difference. We call them our 'members' because they are committed to supporting the sector as consultants, interim managers or Board members.

Our mission is to help charities and social enterprises play an even greater role in society. We have a particular interest in mergers and strategic partnerships because we think they could be more widely used by organisations to preserve and grow what they are doing.

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