

A review of not-for-profit mergers
for 2016/17

THE

GOOD
MERGER

INDEX



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1. FOREWORD

I am proud to introduce this fourth Good Merger Index, Eastside Primetimers' annual exploration of merger activity in the not-for-profit sector.

We seek to provide the most comprehensive picture possible of how many charity mergers there are, what forms they take, and where and why they are sought. Moreover, we have selected three areas for deeper analysis - federated charities, supported housing and mental health, which are 'hotspots' that together accounted for 36% of all mergers this year. We shine a light on many stories of struggles and innovations as CEOs and Boards strive to best serve their beneficiaries under often-challenging circumstances.

Our core finding however remains consistent with past years, with only about 70 mergers occurring in the context of a sector with 167,000 registered charities. Analysis of the financial health of merging charities also shows that many are in weak positions and making losses.



On the whole, we are left with an impression of a charity sector not yet able to grasp the nettle and explore the need for greater consolidation, or do so in a timely and strategic manner. This is despite continuing competition for constrained resources, a degree of duplication in services and the duty of charity managers and trustees to consider the best means to meet their charitable objectives in this environment.

I see reason for optimism, though, both from following many of the exciting charity mergers which feature in this report and from wider initiatives being undertaken. In the past year the new Charity Governance Code has gone a long way towards clarifying the obligations of trustees around considering merger. We have also been assisting a group of funders to make real strides on pooling their money into a common fund to support charities undertaking merger. The jury remains out on whether we will see these initiatives take-off in 2018, but I hope they will, because making the environment easier for charities to explore and undertake mergers is crucial for a strong and effective charity sector.

A handwritten signature in black ink, reading "R. Litchfield". The signature is written in a cursive, flowing style.

Richard Litchfield
CEO, Eastside Primetimers

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2. EXECUTIVE SUMMARY

This is now the fourth edition of our annual Good Merger Index, with data centring on charity mergers in the year of 2016/17. Producing this report continues to give us a good overview of merger activity in the not-for-profit sector, including both constraints on consolidation and examples of change. Towards our conclusion, we provide an update on some of the recommendations made last year about how the sector might seek to facilitate more mergers.

Key Findings – 2016/17 merger activity

By our definition 70 charity mergers took place in the year of 2016/17, representing a small but perceptible increase from the last two years. However, this figure remains very small proportional to the 167,000 registered charities in the sector, many tens of thousands of which are active organisations with a physical presence.

These deals involved 142 organisations with a cumulative income of £974.9m. Approximately £175m of income was transferred to a new organisation, which we use as a proxy for the size of merger arrangements, though 89% of this 'value' is concentrated in the 20 largest deals. This is in the context of a charity sector much like a pyramid, with a proliferation of small organisations that are at times potentially duplicating services or competing for finite pots of funding.

68% of charities making acquisitions (transferees) were in financial surplus in the most recent available accounting year, consistent with previous years. In a partial break from past years, 56% of those being taken over or merging with a similar-sized organisation (transferors) were also in surplus when they sought merger. However, 44% of transferors being in deficit still points to financial distress as a clear driver of many mergers.

In a majority of cases (56%), a larger organisation wholly took over another charity, resulting in a loss of identity or structural autonomy for the smaller organisation. However, this is slightly lower than in the previous year (61%) and 8% of 2016/17 deals did see experimentation with subsidiaries or group structures. Mergers of relative equals represented 29% of cases, up from 23% in 2015/16, and we also note a number of asset or service swaps that occurred in this most recent year.¹

¹ Our in-house definitions of merger types are explained in section 4.3

Hotspots of activity

In Chapter 5, we take an in-depth look at specific types of organisations that saw concentrations of merger activity. We explore some of the factors behind these mergers, as demonstrated by charities' press releases, their most recent available accounts and through interviews.

13% of mergers involved separately-registered local branches of national federated charities. We found that complexities within the federation model were partly responsible for this. This came in addition to other pressures that weigh on federated charities at different scales, such as local authority cuts for small charities or pressures within the supported housing sector for medium-sized YMCAs with housing stock.

19% of mergers involved at least one organisation in the supported housing space, with housing providers either merging

together or taking over smaller charities with complementary services to expand their service provision. Mergers amongst registered housing providers were often driven by Homes and Communities Agency regulatory mandates, constraints on local authority spending, welfare reforms, rent cuts or by initial government plans for a cap at Local Housing Allowance rates.

Mental health services or advocacy were included in at least 13% of total deals. Although heightened awareness has led to high-profile announcements about funding, constraints remain on NHS and particularly local authority resources available to fund mental health services in the charitable sector. Health commissioning continues to bundle together contracts and encourages intense competition, which rewards larger-scale, better-resourced or multi-specialism providers.

Barriers to merger and potential solutions - updates

In response to the overall static picture on merger in the sector, in our previous 2016 Index we had explored eight common barriers to merger, and made a set of recommendations around how to improve the overall environment for consolidation. Our findings this year and our experiences in the sector continue to suggest most of the same barriers are present, but we have seen two developments in the past year relevant to our recommendations to improve the environment for consolidation.

One is the Charity Governance Code, which has backing from sector bodies and the Charity Commission, and encourages charities to evaluate their approach against their objectives and consider whether merger may be an option. However, there are questions as to how effective the code can be as a voluntary measure. The second is that at time of writing, Eastside Primetimers is collaborating with the Social Investment Business and a group of sector funders to explore the feasibility of a 'Merger Turnaround Fund', as a potential means to provide funding and support for small and medium charities that want to benefit from merger.

CONSOLIDATION SNAPSHOT – 2016/17

These charity deals involved the transfer of **£174.5m** of income – the top 20 largest deals represented 89% of this amount

The combined income for these 142 organisations was **£974.9m**

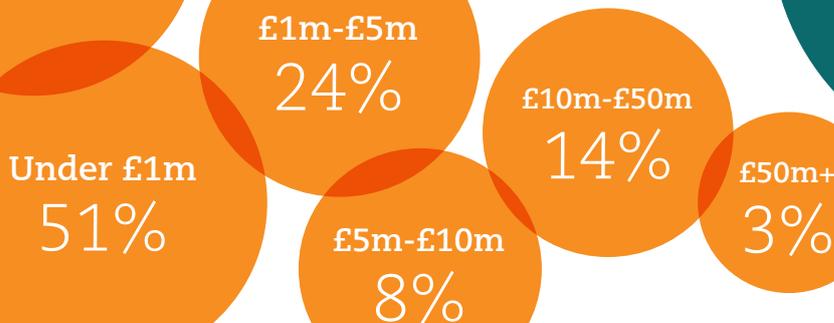
The single largest change featured the formal merger of Action for Blind People into the Royal National Institute for the Blind, following on from previous partner/subsidiary status

The largest completely new merger was the merger of the Chapter 1 Charity into the Salvation Army Housing Association

13% of mergers were between local federated organisations (e.g. YMCAs, Minds, Citizens Advice)

19% of mergers involved supported housing and 13% involved mental health services

SIZE BY INCOME OF ORGANISATIONS



2016/17 saw a net increase of **1,692** entities registered with the Charity Commission

CONSOLIDATION SNAPSHOT – TRENDS

2014/15
61
mergers
involving 129
organisations

2015/16
54
mergers
involving 116
organisations

2016/17
70
mergers involving
142 organisations

MERGER TYPES IN 2016/17:

'Mergers of
equals'
29%
(24% in 2015/16)

Takeovers
56%
(61% in 2015/16)

Subsidiary
deals
7%
(11% in 2015/16)

Asset/
service swap
7%
(We recorded no asset/
service swaps in
2015/16)

Group
Structure
1%
(4% in 2015/16)

3. METHODOLOGY

- ▶ This analysis follows on from the previous three years of this Index - our research objective was to identify and collect data on mergers that occurred in the year 2016/2017
- ▶ As many mergers are announced in early April, we use a 12-month period for this study running from May 1st 2016 to April 30th 2017. This is consistent with previous editions
- ▶ We have tried to count 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 2017
- ▶ Our geographic focus is England and Wales. Most organisations were registered charities and Companies Limited by Guarantee, but our data can include Community Benefit Societies, Registered Providers and Community Interest Companies where relevant. We do not generally include pure housing association mergers, except when one party is a registered charity (e.g. Chapter 1 Charity joining the Salvation Army Housing Association)
- ▶ A key challenge is to identify mergers, as not all mergers require immediate registration. We use two main sources:
 - **Public registries.** The Charity Commission maintains a register of mergers, but this only covers situations where one organisation is dissolved. From a list of 178 registered within the 12 months (by asset transfer, comparable to 154 in the previous year), we removed cases where deals happened in the past but were only now being registered, internal reorganisations and tiny organisations with little publicly available information. This excludes some community groups, churches and benevolent funds
 - **Media and organisation websites.** We reviewed the charity and housing sector press to find deals at the point of announcement and also drew on local and specialist publications, social media and charity websites. Many of these transactions had not yet been recorded on the Charity Commission register
- ▶ For each deal we collected financial and non-financial information by referring to the Charity Commission website, Companies House, press releases, organisation websites and Eastside Primetimers' own records. Figures were the most up to date available at time of writing
- ▶ We use a non-legal framework to classify different types of merger (elaborated in section 4.3). This framework is based on Richard Gutch's work in the 2012 Good Merger Guide and then was adapted through peer-review
- ▶ 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 sector. For the sake of this report, we use 'merger' or 'deal' in two ways: firstly, in a general sense to describe any strategic change that involves the exchange of assets and liabilities, and secondly, in a specific way to describe a genuine 'merger of equals' that is defined in detail in our framework

4.2016/17 MERGER TRENDS

4

4.1 TOP 20 DEALS

We explore here the largest 20 charity mergers by income transferred in 2016/17.²

As we have observed in previous editions, this reveals that as with the structure of the charity sector as a whole, the approximate financial (and potentially social) value of merger activity is 'top heavy'. 89% of the 'value' of mergers is concentrated in these top 20 deals - in 2015/16 this figure was similar at 92%. The top five are all over £10m in size.

Ten of these mergers feature two charities of similar sizes that joined forces to create a new organisation, and four involve the creation of a truly autonomous subsidiary. Merger types are discussed in greater depth in chapter 4.3.

The largest merger in 2016/17 saw Action for Blind People fully merge into the Royal National Institute for the Blind (RNIB), which was an evolution from a seven year long collaboration. RNIB cited rising demand for sight-loss services and confusion about the two brands among their service users as the basis for a need to fully integrate the teams, operations and eventually brands of the two organisations under the RNIB name. In 2009 the organisations had merged their frontlines in an "association model", including Action taking over RNIB's regional service delivery, followed by back office integration in 2014 and some staff transfers in 2015. Former RNIB chief executive Lesley-Anne Alexander had been outspoken about the risks of duplication and competition in the charity sector, and the potential benefits of mergers where appropriate.

Health and social services charities accounted for 47% of all charities participating in merger, and also around 15 of these top 20 deals. We have observed in the past that funding and commissioning shifts often drive these mergers, and that trend continues to be evident. For example national addiction charities Cranstoun and Swanswell came together in the fifth largest merger of 2016/17, citing "an increasingly demanding political and economic environment, together with the growing and more complex needs of service users" and the need for a consolidated operation that would afford the combined organisation greater sustainability and ability to retain existing contracts and win new business, "in order to better deliver high-quality services to individuals and communities".³

We also see several federation deals (chapter 5.1), including two sets of local Minds and a set of YMCAs. Evolve and Grenfell, Transform and Cherchefelle, SAHA and Chapter 1 and the two London YMCAs are the most prominent examples of merger activity in the supported housing sector (chapter 5.2), while at least 4 of the top 20 mergers involve the mental health sector (chapter 5.3).

² For 'mergers of equals', income figures combine both organisations transferring into the new entity. For takeovers, subsidiaries and groups, the figure refers to the income of a single transferor organisation. For any asset/service transfers, the figure is the value of the specific assets/services transferred if available

³ 'Cranstoun and Swanswell merger', 16 December 2016, Swanswell <https://www.swanswell.org/news/cranstoun-and-swanswell-merger.aspx>

Top 20 Mergers Ranking

	Organisation 1	Organisation(s) 2	Type of deal	Size by income transferred ⁴
1	Royal National Institute for the Blind	Action for Blind People	(2) Takeover	£27,938,000
2	Salvation Army Housing Association	Chapter 1 Charity	(2) Takeover	£18,507,000
3	Teaching Leaders	The Future Leaders Trust	(1) Merger	£16,994,656
4	YMCA London South West	YMCA East London	(1) Merger	£16,387,539
5	Cranstoun	Swanswell	(3) Subsidiary Model	£11,403,324
6	Livability	Prospects	(2) Takeover	£9,822,468
7	Transform Housing and Support	Cherchefelle Housing Association	(1) Merger	£9,349,000
8	Hafal	Crossroads Mid and West Wales	(1) Merger	£6,876,710
9	The Royal London Society for Blind People	Royal Society for Blind Children	(1) Merger	£5,708,752
10	Unlocking Potential	2nd Chance Education	(1) Merger	£4,782,799
11	Catch22	Community Links	(2) Takeover	£4,613,276
12	Great Ormond Street Hospital Children's Charity	Sparks	(3) Subsidiary Model	£4,127,759
13	The Prince's Foundation for Building Community	The Prince's Regeneration Trust	(3) Subsidiary Model	£3,437,163
14	Medway Youth Trust	Young Kent	(1) Merger	£3,081,711
15	Hft	The Edward Lloyd Trust	(2) Takeover	£2,653,306
16	Avenues Group	Welmede	(4) Group Structure	£2,574,939
17	Evolve Housing + Support	Grenfell Housing and Training	(2) Takeover	£2,075,221
18	Mind in Cambridgeshire	Peterborough and Fenland Mind	(1) Merger	£1,921,609
19	Colchester Mind	Mid Essex Mind	(1) Merger	£1,834,972
20	Alcohol Research UK	Alcohol Concern	(1) Merger	£1,614,338

⁴ 'Amount of income transferred' figures are the most recent available annual figures for the transferor organisation(s) in the deal. For 'mergers of equals', we have combined the income figures of both/all organisations to reflect that a new organisation is being formed

4.2 FINANCIAL DRIVERS

We provide here an overview of the top-line financial position of charities engaging in merger, looking at whether they were in surplus or deficit in the most recent available financial year before the merger. For the purposes of this section, ‘transferee’ organisations are organisations making acquisitions, while ‘transferors’ are those either joining a larger structure or merging sideways with an equivalently-sized organisation in a ‘merger of equals’.

Our figures this year represent a subtle shift from the past. We have tended to find that the majority of transferee organisations are in financial surplus, which continues to be the case this year - 68% were for 2016/17, similar to the 2015/16 year when 65% were in surplus. But previously, we found that organisations being taken over or merging sideways tended to be in deficit, corroborating the sense that transferors - generally the smaller organisations - are often in a tougher financial position and are seeking merger as a form of ‘rescue’. However, this year’s figures show even a majority of the transferors (56%) are in some degree of financial surplus.

It should still be noted that this is a relatively crude measure of financial performance, and nevertheless shows that a considerable number of merging charities are in deficit. Moreover, if we calculate the surplus/deficit of organisations as a percentage of their turnover, the average profit

margin of transferee organisations was 4%, while for the average transferor this was -14%. Financial drivers therefore remain a very important factor motivating merger, and we found numerous organisations that were saved from significant hardship through timely takeovers, such as Age Concern Poole’s takeover by Dorset care provider Prama in June 2016 and disability charity Livability’s takeover of Prospects in May 2016.

However, we are pleased to see some examples of strategic mergers as well. For instance, the children’s medical research charity Sparks, who even after running a surplus equivalent to 20% of their £4.1m turnover approached the Great Ormond Street Hospital Children’s Charity (GOSHCC) for a merger in the summer of 2016. They believed this would boost their profile and fundraising, while GOSHCC agreed the merger would strengthen funding for paediatric research, making the deal a “no brainer”. GOSHCC allowed Sparks to retain its own brand identity within the GOSHCC “family”, an example of how well-positioned smaller charities can negotiate better arrangements for themselves. GOSHCC chief executive Tim Johnson noted that the move was also consistent with the Charity Commission’s recent guidelines on trustees’ responsibilities to explore mergers where they made sense: “We often hear there are too many charities out there, so where people can join forces to deliver more for beneficiaries you’ve got to think that that’s a sensible thing to happen”.⁶

GMI4 2016/2017	Transferees	Transferors
Surplus	68%	56%
Losses	32%	44%

Sample Size: 128 organisations⁵

⁵ Relevant figures were publicly available for 128 out of 142 organisations involved in mergers. Categories manually adjusted so that for merger deals both organisations are counted as transferors – 63% of all organisations are therefore transferors for these purposes

⁶ ‘Sparks will become part of Great Ormond Street charity from February’, Third Sector, 23 January 2017

4.3 TYPES OF MERGER

Here we break down the 70 deals in 2016/17 by our framework of merger types (see pages 14-15).

'True mergers' of relative equals accounted for 29% in 2016/17, up from 2015/16 (24%) and 2014/15 (18%), but nevertheless not far off the normal range we have seen over the years.

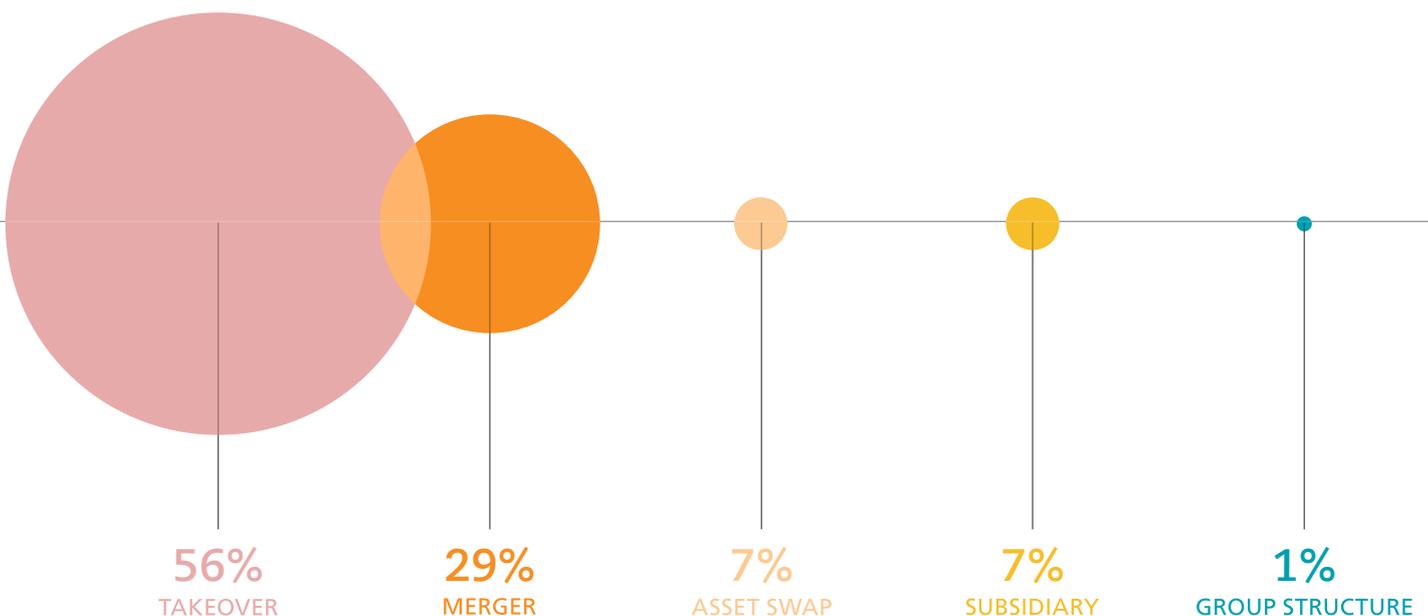
Full takeovers where a smaller organisation loses its separate structure or identity continue to be more common and are the sector's default merger type, though charity press releases still tend towards describing takeovers as "mergers" to manage sensitivities. They represented 56% of deals in 2016/17, though this was down from 61% in 2015/16.

Only 8% of deals featured either the creation of a subsidiary attached to a charity (7%) or the incorporation of a further subsidiary into a more developed group structure already retaining several subsidiaries (1%). This is down from a combined 15% in 2015/16 and 20% in 2014/15. It should be said that press releases for some mergers state clearly that a temporary subsidiary will be used as an interim step towards integration, but we have generally classified these as full takeovers, reserving the 'subsidiary'

and 'group' classifications for arrangements that appear intended to be ongoing operational models in their own right.

The use of operational subsidiaries can be a compromise for managing concerns about local operational autonomy and identity, on the one hand, with effective coordination and economies of scale on the other. Their continuing rarity suggests the sector still needs to learn about the variety of merger types available short of full merger or outright takeover, as they could be a means to cut through sector anxieties around the more absolutist models of merger and increase the overall level of consolidation. The housing association sector, where operational subsidiaries and mature groups are more common, is a model for further study.

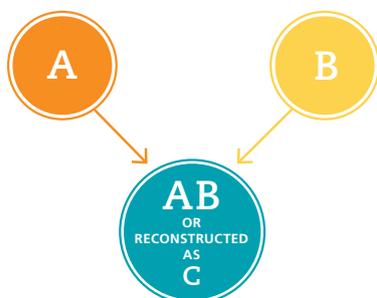
An example of the addition of an organisation to an established group is Welmede Housing Association's decision in November 2016 to become an operating subsidiary of the Avenues Group, a disabilities provider with subsidiary arms in the East of England, London, the South East and West Midlands. Operating Surrey-wide, Welmede adds its person-centred housing and support in learning disabilities to Avenues' offer.



Sample size: 70 deals

Types of Merger Explained

1 Merger



SUMMARY

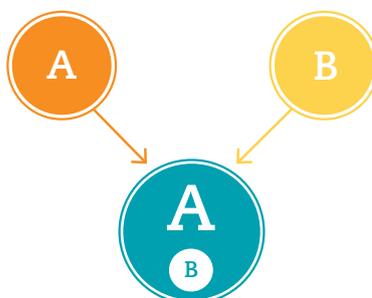
Two or more organisations join to form a new organisation either through:

- 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 or become dormant (or for housing associations, continuing trading as subsidiaries as part of a group structure)

KEY FEATURES

- ▶ Often acknowledgement in the new brand identity of two organisations coming together, or a completely neutral new brand is created;
- ▶ Evidence that the top executive team for the newly enlarged organisation has a balanced representation from the legacy organisations;
- ▶ Governance of the new organisation must be representative of the two merging organisations

2 Takeover



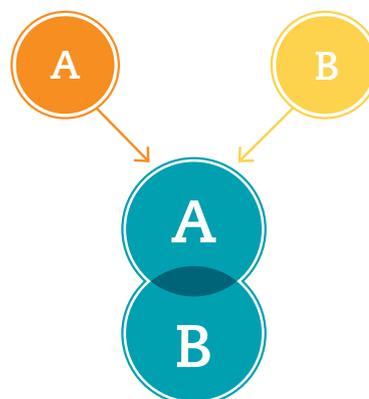
SUMMARY

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

KEY FEATURES

- ▶ 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

3 Subsidiary Model



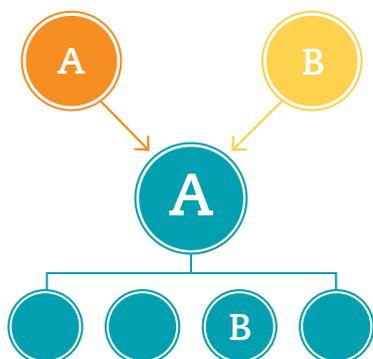
SUMMARY

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

KEY FEATURES

- ▶ The transferring organisation retains a separate Board and identity within a group-wide strategy or business plan;
- ▶ 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

4 Group Structure



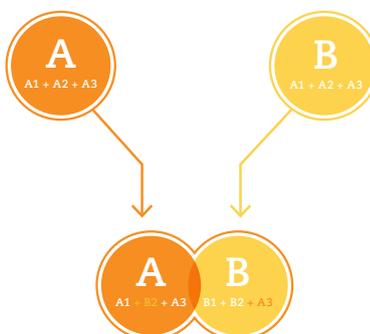
SUMMARY

Two 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.

KEY FEATURES

- ▶ 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;

5 Swapping services or assets



SUMMARY

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.

KEY FEATURES

- ▶ 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

Asset and service swaps case study

CHANGING LIVES

A rarer and subtler form of deal in the sector are asset or service swaps – these made up 7% of consolidation activity in 2016/17. A good example is North East supported housing provider Changing Lives' acquisition of services from Thirteen Group's Care and Support arm.

Changing Lives had worked in an informal partnership with Norcare for many years, as they were both large providers of supported accommodation in the North East. Norcare had merged with a large housing association based in the Tees Valley which had become Thirteen Group, with Norcare rebranding as Thirteen Care and Support. In 2014 Newcastle City Council retendered its homelessness services, and merged over 40 contracts into 8 across the city and across different client groups. Changing Lives led a partnership with Thirteen Care and Support and two other smaller providers, which helped them secure an £876k annual contract delivering supported accommodation in the city. At the same time, Thirteen Care and Support won a Floating Support Contract with Changing Lives as a partner.

In early 2016, Thirteen approached Changing Lives to discuss the future of their supported accommodation services. Thirteen had taken a strategic decision to consolidate services in the Tees Valley and were looking for options

for its supported accommodation services in the north of the region. They were keen to find a solution which would secure the services and look after their staff, and their history of close working made Changing Lives an obvious choice. The two partners held meetings to discuss principles and how they might proceed, before agreeing to commence due diligence.

Due diligence assessed the risks of the transfer, including contracts, delivery, finance, buildings and staffing. Gaining permission to novate (transfer) the Floating Support contract from Newcastle City Council and agreeing on repairs to the buildings were critical to the transfer, and once this had been achieved Thirteen and Changing Lives were able to negotiate an agreement to transfer in December 2016.

The total annual value of services transferred was around £600k, and benefited both organisations. For Thirteen the arrangement secured the future of the services and staff in the north of the North East, and for Changing Lives it increased the critical mass of accommodation services in Newcastle and Gateshead, which in turn helps them help more people and creates efficiencies in managing and developing services.

**CHANGING
LIVES**

5. IN FOCUS: SECTOR HOTSPOTS

The UK's charity sector is incredibly diverse, featuring organisations with all kinds of different structures, responsibilities and service roles. In a new feature this year, we look in-depth at three examples of sectors that have seen notable levels of merger activity, and at some of the specific drivers that have led organisations in these spaces to join forces for greater impact.

These three sectors are federations, supported housing and mental health.



5.1 FEDERATIONS: IS THERE A NEW MODEL FOR FEDERATIONS?

Federated charities are structures with independently registered and autonomous local branches, alongside a national charity of which the local branches are affiliated members. The high-profile examples of this are major charity ‘brands’ like Mind, Age UK, YMCA, Mencap, Citizens Advice, Relate and the Wildlife Trusts. There are also federated organisations in the care sector such as Home-Start, Carers Trust/Crossroads and the Abbeyfield Society.

The model provides a way of benefiting from local rooting - and the familiarity and responsiveness to needs associated with it - and national coordination, economies of scale and combined strength. National umbrella charities can also draw on local experiences and bring wider attention to them, and disseminate best practice across their entire network of member charities.

Mergers involving sets of local branches coming together to form larger branches accounted for nine deals, or 13% of the overall total of merger activity in 2016/17. This comes in light of observations which sector thought leaders have made about challenges to the federated model and how competition, funding difficulties and governance problems have forced some weaker branches towards merger or closure. NPC research found funders of branches often recommended merger, and that local branches weren't always able to justify the benefits of separation - this led a chief executive of City and Hackney Mind to suggest that geographic remits should be revised to reduce duplication within relatively confined geographies through partnerships or mergers, where necessary.⁷ PwC have outlined how the federated model can also encumber coordinated change, especially as procedures and information gathering across the federation will vary and better-performing branches can be resistant to subsidising weaker ones.⁸

In addition to local deals between previously separate branches, there are also instances of mergers between national centres and regional players, and of local branches leaving their federations entirely. In April 2017 Crossroads Mid and West Wales joined Welsh mental health charity Hafal and became branded as a 'Crossroads Hafal' service within it. CMWW had been a local branch of the national charity Carers Trust, itself formed from a national merger of the Princess Royal Trust for Carers and Crossroads Care in 2012. Likewise, in Dorset Prama's takeover of Age Concern Poole removed the latter from parent federation Age UK, which had been formed nationally from Age Concern and Help the Aged in 2009.

It is noteworthy that in both the Crossroads Mid and West Wales and Age Concern Poole cases, the now-exited and dissolved local branch had not actually been using the updated name of their national federation years after a rebrand, something which continues to be somewhat common at a local level across Age UKs, where for example we continue to see the usage of 'Age Concern' in parts of the country. This demonstrates how difficult securing uniformity across a loose federation can be.

7 'Federated charities: a briefing paper for charities, their trustees and funders', 28 July 2014, Alex Van Vliet & Rachel Wharton, NPC

8 'Is the federated model for national charities now under threat?', 7 January 2016, Ian Oakley-Smith & James Bowman, PwC

Local federated charity mergers 2016/17

	Organisation 1	Organisation(s) 2	Type of deal	Size by income transferred ⁹
1	YMCA London South West	YMCA East London	(1) Merger	£16,387,539
2	Mind in Cambridgeshire	Peterborough and Fenland Mind	(1) Merger	£1,921,609
3	Colchester Mind	Mid Essex Mind	(1) Merger	£1,834,972
4	Chelmsford YMCA	Colchester YMCA	(1) Merger	£1,441,495
5	Home-Start Richmond Upon Thames	Home-Start Hounslow	(1) Merger	£495,888
6	Hyndburn Citizens Advice Bureau	Rosendale Citizens Advice Bureau	(1) Merger	£484,921
7	The Abbeyfield Kent Society	The Abbeyfield (Beckenham) Society	(2) Takeover	£434,959
8	Hull and East Yorkshire Mind	Grimsby, Cleethorpes and District Mind	(2) Takeover	£59,605
9	Age UK North East Lincolnshire	Age Concern Cleethorpes	(2) Takeover	£5,833

⁹ 'Amount of income transferred' figures are the most recent available annual figures for the transferor organisation(s) in the deal. For 'mergers of equals', we have combined the income figures of both/all organisations involved in a deal.

Federations case study

YMCAS IN LONDON

In March 2017 two of the largest Associations of the national federated YMCA charity, YMCA London South West and YMCA East London, finalised a merger. YMCA London South West had a pre-merger income of £10.2m and YMCA East London of £6.2m, and between the two of them they have 750 beds in an approximate 50/50 split. The merger created the largest YMCA in the UK and was a step towards creating a large and local YMCA across the region, which they believe will be better placed to harness the best of both organisations and take a strategic view of the many community services that the YMCA delivers, especially to the young, vulnerable and homeless across London. In support of this vision, at the time of writing YMCA London South West and East London are also set to take on YMCA Slough and amalgamate with YMCA West London by March 2018.

REASONS

The merger was originally prompted by the Homes and Communities Agency (HCA) regulator asking YMCA East London to seek a merger partner from a list of YMCAs and housing associations. The regulator's concerns were due to poor past performance and the threat to supported housing from potential Local Housing Allowance caps. After a competitive process, YMCA London South West was selected as the "preferred partner" for YMCA East London, due to the cultural fit and substantial amount of crossover in services between the two organisations, including supported housing, health and wellbeing, community outreach and children and families services. During the merger negotiations, YMCA East London successfully brought in interim management and with some encouraging developments about the LHA cap, at the point of merger the deal was not felt to be as urgent as it was at the outset of discussions. However, both parties nevertheless feel that the combined organisation is more resilient and impactful from coming together than they were apart.

PROCESS

The merger cost around £500,000 - this included legal work, due diligence, external consultancy and restructuring costs. An attempt was made to seek grant funding to cover some of these costs, but this proved not to be successful. A business case and then a more detailed business plan were developed, the latter being stress-tested through a range of both positive and negative scenarios. A meeting with the regulator confirmed that concerns had been alleviated and consent to merge was granted.

A skills-based approach was used to appoint a single combined board with trustees from both predecessor organisations. Following this, the CEO of London South West was interviewed and confirmed as CEO of the merged group. A new regional staffing structure was developed with further mergers and amalgamations in mind – as a result, two senior staff posts came from London South West, two from East London and three were recruited externally.

Though the formal merger process finished at the end of the financial year 2016/17, group chief executive Richard James said that the process of cultural and operational integration was ongoing, not least due to the integration of YMCA Slough and subsequent amalgamation with YMCA West London. The result of this is that the Association will be the first to have over 1,000 units of accommodation over 16 London boroughs.

Having gone through a more traditional merger, the Association is now approaching the amalgamation with YMCA West London "backwards" - working on policies, shared services and service alignment first, before proceeding with full legal and structural integration by the year end. Experiences, knowledge and resources developed during the negotiations with YMCA East London are also helping smooth the process with both West London and Slough.

OUTCOMES

Cost efficiencies of at least £1.2m from the four mergers are expected to be realised by the third year (representing a 5% reduction in expenditure - this is partly due to a 40% reduction in pre-merger senior management costs). Efficiencies are being reinvested in the Association's Y Cube (affordable housing) scheme, with up to 200 new units expected across London, and expansion of the Association's nursery provision. By taking the best from each, a fresh focus is going on achieving excellence across the service areas as well as governance.

Investment in growth has also been made possible by combining the basket of lenders that the different Associations had into one combined funding package, which was subsequently agreed with Metro Bank and Charity Bank. This new offer came at a lower coupon, required less reporting and by pooling security, assets were freed for future investment when required. It represented the largest single funding offer ever made to a YMCA.

The merger is having a positive social impact by allowing the group to focus on developing a common homeless pathway, with performance measures across the Association's housing projects. Investment in schemes such as Y Cube can then be released to help address gaps in the pathways and enable residents to move on from living in a YMCA 3 to 6 months sooner than before (saving between £3,600-£7,500 of support costs for each young person or resident). At the same time, investment and research is being undertaken to develop stronger data on how ex-residents have progressed since leaving the YMCA, the learning from which will be fed back into the pathway.

FUTURE TRENDS

Richard James reported that the merger/ amalgamation of some of the largest YMCAs in the country had triggered "ripples" across the wider YMCA federation. There are now several other mergers and collaborations underway in the East of England and the North West. The profile and prominence of the mergers in London has since prompted other YMCAs to approach Richard James and the new grouping in London to learn more about their experiences. This is against a backdrop in which YMCA England is promoting innovation and collaboration, making it seem likely that this activity will increase, though the type of collaborations occurring among local YMCAs varies. Medium-to-large YMCAs with housing in the moulds of YMCA London South West and YMCA East London face more pressure to merge due to the general factors in the supported housing sector, while smaller YMCAs with fewer housing assets are tending to stay separate or partner in looser formations than full merger.

Identity is a common issue for charities of all types exploring merger, including those in federation. The selection of a name for this new grouping of London YMCAs that is both concise and respectful of other YMCAs in London has been a challenge for the fledgling organisation, for example, and at time of writing this work was ongoing. However, beneficiaries generally identify with the national brand and find the distinction between local branches either irrelevant or in some cases confusing, something which YMCAs and members of other similar federations contemplating merger may do well to remember.

The YMCA logo is displayed in a bold, black, sans-serif font. The letters are thick and blocky, with a slightly irregular, hand-drawn appearance. The 'Y' and 'M' are particularly prominent, with the 'Y' having a wide base and the 'M' having a deep, rounded valley. The 'C' and 'A' are also thick and blocky, with the 'A' having a slightly irregular top edge. The overall impression is one of strength and stability.

5.2 SUPPORTED HOUSING: ARE PRESSURES ON SUPPORTED HOUSING INSTIGATING MERGERS?

Supported housing schemes combine housing, support and in some cases care services and access to work and training, in order to enable residents to live independently. Some are long-term, while others are short-term with an aim to enable people to move on into mainstream accommodation, and they can be associated with a wide range of needs including mental health, addiction, benefits and debt support. At any one time, over 600,000 people rely on supported housing.¹⁰

13 mergers in the 2016/17 year involved at least one organisation in the supported housing space, comprising 19% of all merger deals.

This comes against a backdrop of funding reductions, welfare reforms and specific government reforms that have impacted upon the supported housing sector, notably rent cuts and the plans announced in September 2016 to apply the Local Housing Allowance caps to supported housing. Political shifts in 2017 have led to some changes in government policy, but overall many supported housing providers remain nervous and some of the mergers that were seen in the 2016/17 period covered by this report were responses to this environment.

An additional factor is that the Homes and Communities Agency (HCA) regulator is also very active in advising registered housing providers of their options when they face financial and governance difficulties. The second largest merger of the 2016/17 period saw the Chapter 1 Charity join leading homelessness provider Salvation Army Housing Association, initially as a subsidiary in November 2016 as a precursor to full takeover in October 2017. This underpinned hopes to expand their combined support services for young people, domestic abuse victims and people with mental health conditions, and SAHA has claimed it has already made improvements to IT systems, repairs services and back offices.

Both organisations shared a strong Christian ethos, creating a cultural alignment in this case. However, while a registered charity, Chapter 1 was also a Registered Provider and had been warned by the HCA that its financial position was “not sustainable” after governance failures. Further, the HCA also served as an initial instigator for YMCA East London’s decision to merge with YMCA London South West. This is a reminder of the regulatory clout of the HCA as compared to the Charity Commission, a model we recommended that the charity sector could learn from in the conclusions of our 2016 Good Merger Index.

Commissioning changes are another driver of merger activity in this sector, impacting upon smaller organisations that provide very specialist types of housing. In Yorkshire, YACRO’s merger into regional housing and support services provider Changing Lives was prompted by a reduction in available tenders for offender-based housing services, due to shifts in York towards more generic services. This led YACRO to explore diversification, but more generally they were also at a crossroads, with a change in leadership imminent and a view emerging within their board that despite a strong balance sheet and some innovative projects, at under £1m the organisation might struggle in the current climate. This led them to approach Changing Lives, already a commissioning partner of theirs on homelessness services in York, and the two organisations established that they had shared values and compatible cultures and so preceded with due diligence. YACRO’s status as a registered provider (RP) meant that relevant assets needed to be transferred to Changing Lives’ own subsidiary RP, TCUK Homes, but the transfer of assets and liabilities was finalised in December 2016 and YACRO’s trustees plan to dissolve the charity.

¹⁰ Statistic from Homeless Link <http://www.homeless.org.uk/supported-housing-alliance>

¹¹ ‘Troubled association to merge’, 7 November 2016, Inside Housing

Other supported housing providers have strengthened their service provision by taking on small charities with associated services, harnessing local strengths. During 2016 Depaul UK (the national branch of Depaul, an international homelessness charity with a Catholic heritage), took on two youth homelessness organisations, SAFE@LAST in Yorkshire and Alone in London.

In both cases, Depaul found the local reputation and relationships of these charities to be an asset and has sought to maintain these ties, retaining their names as services within Depaul. Alone in London had been a service within housing organisation EPIC Trust following a 2005 merger, so the 2016 deal was therefore a service transfer, but Depaul were able to use a similar due diligence process to the one they undertook with SAFE@LAST.

Mergers involving supported housing charities 2016/17

	Organisation 1	Organisation(s) 2	Type of deal	Size by income transferred ¹²
1	Salvation Army Housing Association	Chapter 1 Charity	(2) Takeover	£18,507,000
2	YMCA London South West	YMCA East London	(1) Merger	£16,387,539
3	Transform Housing and Support	Cherchefelle Housing Association	(1) Merger	£9,349,000
4	Catch22	Community Links	(2) Takeover	£4,613,276
5	Avenues Group	Welmede	(4) Group Structure	£2,574,939
6	Evolve Housing + Support	Grenfell Housing and Training	(2) Takeover	£2,075,221
7	Chelmsford YMCA	Colchester YMCA	(1) Merger	£1,441,495
8	Centrepoint	The Young People's Support Foundation	(2) Takeover	£940,954
9	Changing Lives	YACRO	(2) Takeover	£915,599
10	Changing Lives	Thirteen Care and Support	(5) Asset/service Swap	£600,000
11	Depaul UK	Safe@Last	(2) Takeover	£321,929
12	Cornerstone Supported Housing and Counselling	Willington Community Action	(2) Takeover	£69,645
13	Depaul UK	Alone in London	(5) Asset/service Swap	Not available

¹² 'Amount of income transferred' figures are the most recent available annual figures for the transferor organisation(s) in the deal. For 'mergers of equals', we have combined the income figures of both/all organisations involved in a deal.

Supported housing merger case study

EVOLVE AND GRENFELL HOUSING

In April 2017, Grenfell Housing and Training successfully merged into Evolve Housing + Support. With a combined turnover of £12.8m and working in eight local authorities, the combined organisation is now the third largest provider of accommodation for homeless people in London. Eastside Primetimers carried out the initial introduction between the two organisations, helping them take the first step to forging this new partnership.

REASONS

The timing of the merger was opportune for both sides. Evolve had rebranded in 2015, having previously been South London YMCA, with a fresh vision and a desire to proactively expand their reach and impact in neighbouring boroughs. They were also strong financially and had some existing merger experience, including from a 2013 merger with Earls Court YMCA.

Grenfell Housing and Training meanwhile had services that aligned well with Evolve's, but were struggling to grow and were seeking a partner to put them on a stronger footing for the future – previous discussions with two other potential suitors had fallen through. Grenfell also had an office building in Wimbledon and Evolve's lease on their office space in Croydon was due to run out, so Evolve's headquarters will relocate to Wimbledon in early 2018 – this had the added benefit of emphasising Evolve's new wider geographic profile, beyond their original home borough in Croydon.

PROCESS

Due diligence identified risk areas and allowed them to be addressed, such as areas where Grenfell's business was weaker and cost reductions were required. Commissioners and funders, including the Social Investment Business which held a loan to Grenfell for their headquarters, were broadly supportive of the merger. A joint merger working group was established between the two organisations to drive the process forward.

The first step towards merger was Grenfell becoming a wholly-owned subsidiary in April 2017, followed by fuller integration from October 2017. Evolve chief executive Jeremy Gray described this second stage as the start of the real work of seeing through the merger, to ensure that one unified staff team with common practices comes to exist. A shift in planning also came over summer 2017, when a decision was taken to move to full brand integration around the Evolve name in light of the tragic (though completely unrelated) Grenfell tower block fire in Kensington in June of 2017.

OUTCOMES

The protection of Grenfell's services for the future, an increase in profitable turnover for reinvestment in services, an increase in the number of beneficiaries supported and an expansion of Evolve's geographic footprint across London boroughs were the main outcomes set for the merger. Grenfell's three boroughs were contiguous with Evolve's existing five, so this represented a neat fit, and by joining together, the new organisation will have increased financial strength and will be able to achieve even better outcomes for many more people, serving 2,000 people and with a base for expanding community services and building more affordable homes for homeless people. Evolve report that though staff team and cultural integration are ongoing, a new support model for work with customers is being embraced.

THE FUTURE

Jeremy Gray commented that after seven years of relative austerity, the future arrangements for supported housing funding are still uncertain. Local authority funding remains on a downward trend and government proposals around short-term services entail significant risks, which still

need to be resolved. Evolve will be keeping additional collaborations and partnerships on the table as means of expanding their impact further - this represents a strong model of a dynamic response to factors in the sector, and it seems likely that further consolidation of this kind will be seen elsewhere in the supported housing sector.



5.3 MENTAL HEALTH: CAN CHARITY CONSOLIDATION STRENGTHEN MENTAL HEALTH PROVISION?

The mental health sector has approximately 1,500 registered charities, providing direct services and conducting awareness-raising campaigns for a wide range of mental health conditions and in localities across the UK.¹³

In 2016/17, at least nine mergers took place involving charities with mental health services, or 13% of total deal activity. This includes deals between pure mental health specialists and three examples of local Minds coming together, but also some examples of broader health and wellbeing organisations that emphasise mental health as a key part of their provision mix. For example, the merger of Positive Parenting and Children (PPC) into LGBT charity METRO was described as an opportunity to develop “an integrated offer within METRO’s HIV domain and across our Sexual & Reproductive Health, Community, Mental Health, and Youth domains”.¹⁴

Mental health charities have faced an historical lack of funding, and though heightened awareness and political salience has led to NHS England notionally requiring ‘parity of esteem’ and the government announcing £600m for mental health and £1.25bn for children and young people’s mental health services, this continues to be a challenge. Mental health still only receives 13% of the NHS budget, despite a larger proportional disease burden, and just 55% of Mental Health Trusts received a real-term increase in their 2015/16 budgets. Only a quarter of NHS providers expect CCGs to increase the value of mental health contracts.¹⁵ Moreover, some local mental health charities are in practice reliant on local authority rather than NHS funding, and it is here that services have seen severe cuts.

Additionally, mental health is subject to the same commissioning trends as the health sector, wherein services are increasingly being bundled into larger, more multidisciplinary contracts that tend to favour providers with deeper resources, more diverse expertise and wider geographies.

It is primarily against this backdrop that we continue to see examples of mergers among charities engaged in provision and advocacy around mental health. Community Ignite, a small charity providing help with mental wellbeing and other community services in south Gloucestershire, cited “financial pressures” as their rationale for seeking merger with their partner Southern Brooks Community Partnerships, and argued that “economies of scale will mean that more funding can be used to deliver services rather than managerial and financial overheads”.¹⁶

In Surrey, Eikon and Windle Valley Youth Project (WVYP) came together, emphasising that “delivering as a larger charity enables greater influence and geographical reach, the potential to accelerate the strategic aims of both organisations, and the reduction of unnecessary competition for a diminishing pool of, in particular, statutory funding”. Eikon further cited their success at securing Child and Adolescent Mental Health Services (CAHMS) projects with the local Surrey and Borders Partnership NHS Foundation Trust as an example of the benefits of collaboration.¹⁷ In Wales, the merger of Crossroads Care Mid and West Wales into Wales-wide mental health provider Hafal was similarly linked to an aim to “complement rather than duplicate each other”.¹⁸

13 1,576 with “mental” and “health” in their name or activities on Charity Commission (4,811 if also including objects) 192 with “mental” and “illness” in their name or activities on Charity Commission (870 if also including objects)

14 ‘A STRONGER FUTURE TOGETHER’, 4 May 2016, METRO Charity, <https://www.metrocentreonline.org/news/2016/may/04/stronger-future-together>

15 ‘FUNDING MENTAL HEALTH AT LOCAL LEVEL: UNPICKING THE VARIATION’, May 2016, NHS Providers <http://nhsproviders.org/resource-library/reports/funding-mental-health-at-local-level-unpicking-the-variation>

16 ‘Community Ignite have merged with Southern Brooks’, April 2017, Community Ignite <http://www.communityignite.org.uk/news/community-ignite-have-merged-southern-brooks>

17 ‘Merger of Eikon and WVYP’, 1 July 2016, Eikon <http://eikon.org.uk/2016/07/01/merger-of-eikon-and-wvyp/>

18 ‘Hafal to merge with Crossroads Care Mid & West Wales’, 23 August 2016, Hafal <http://www.hafal.org/2016/08/hafal-to-merge-with-crossroads-care-mid-west-wales/>

Mergers involving mental health charities 2016/17

	Organisation 1	Organisation(s) 2	Type of deal	Size by income transferred ¹⁹
1	Salvation Army Housing Association	Chapter 1 Charity	(2) Takeover	£18,507,000
2	Hafal	Crossroads Mid and West Wales	(1) Merger	£6,876,710
3	Mind in Cambridgeshire	Peterborough and Fenland Mind	(1) Merger	£1,921,609
4	Colchester Mind	Mid Essex Mind	(1) Merger	£1,834,972
5	Mind	Depression Alliance	(2) Takeover	£737,924
6	METRO Charity	Positive Parenting and Children	(2) Takeover	£442,232
7	Southern Brooks Community Partnerships	Community Ignite	(2) Takeover	£82,229
8	Hull and East Yorkshire Mind	Grimsby, Cleethorpes and District Mind	(2) Takeover	£59,605
9	The Eikon Charity	Windle Valley Youth Project	(2) Takeover	Not available

¹⁹ Amount of income transferred' figures are the most recent available annual figures for the transferor organisation(s) in the deal. For 'mergers of equals', we have combined the income figures of both/all organisations involved in a deal.

Mental health charities case study

MIND

In August 2016 the mental health charity Depression Alliance (DA) was merged fully into its larger counterpart Mind. DA had had an income of £737,924 and 17 staff and its role was to be the leading national charity for people in England with depression, which affects 1 in 5 people at some point in their life. DA's role included providing up to date information on depression and services accessible to all sections of the community, in order to help people take control of their condition and maintain recovery. Mind is one of the UK's largest mental health charities, with a 2016 income of £39.9m, and operates as a federation with 135 branches helping over 513,000 people across England and Wales. Their services include supported housing, crisis helplines, drop-in centres, employment and training schemes, counselling and befriending.

REASONS

Though its income had increased slightly between 2015 and 2016, DA faced deficits (-£33,956 in March 2016) and lacked the “critical mass” needed in terms of size and stability to continue combatting depression effectively. This led DA to approach Mind for a discussion about support or a looser partnership, but Mind recognised DA as having clearly complementary services and aims and these initial conversations soon evolved into a discussion about full merger.

PROCESS

Full staff meetings were held with DA and Mind representatives as a way of building trust between the two organisations, and a steering group featuring three DA trustees and two Mind officers was formed to carry the merger forward. A due diligence exercise was conducted looking at financial, reputational, strategic and beneficiary risks, later followed by drawing up of Heads of Terms. Change-management costs from the merger totalled around £100k and were covered fully by Mind.

OUTCOMES

Goals set for the merger were essentially threefold: to not lose DA's funders, to increase the number of beneficiaries supported and to avoid the closure of any DA services. The Chief Operating Officer of Mind, Paul Ward, reported that all three of these metrics were met through the merger, and that continuing to preserve DA's services and valuable contribution to supporting those with depression was the overriding success of the move. Contracts DA had held that had been due to expire were successfully renewed, after some uncertainty.

All of DA's staff were also retained. Five moved into Mind's head offices in Stratford, under the larger organisation's community services directorate, while another twelve joined local branches of Mind to continue providing community services directly – DA's areas of operations spanned around five local Mind areas. The overall DA name was discontinued as part of full integration into Mind, but DA's Friends in Need online community did retain its own identity and the DA name is still sometimes used for peer support services.

FUTURE TRENDS

Paul Ward commented that mental health service provision faces something of a dichotomy, with the high profile of the cause and recent political attention juxtaposed against continuing acute funding pressures. The latter is a particularly big issue for small charities that are heavily reliant on public funding or otherwise on narrow funding streams. Moreover, competition continues to increase as heightened profile leads to the creation of more mental health charities. This could mean that there is untapped potential for mergers, to enable mental health organisations to maximise their vital social impact and do more with less.

As a national federated organisation, Mind is also examining its own approach in this environment, including a major financial review of sustainability with their local networks. Where some local Minds have decided to look at merger as an option, Mind's national position is generally to encourage them if it will lead to a more sustainable, economical or impactful combined local organisation. Peterborough and Fenland Mind's merger with Mind in Cambridgeshire and the unification of the Colchester and Mid Essex Minds represented two examples of this in 2016/17.



6. DEVELOPMENTS IN THE ENVIRONMENT FOR CONSOLIDATION

We concluded our previous edition of this Index with an analysis of common barriers to merger and with a set of recommendations about how to improve the environment for charity sector mergers. Here we look at developments in the past year or so on these fronts.



6.1. BARRIERS

Barriers to merger can be both attitudinal and practical. We previously identified eight such barriers, which we believe have continued to be a sector-wide challenge in the past year.

8 MAIN BARRIERS TO MERGER

1. Institutional inertia and attitudinal barriers:

Merger is an unknown to many in the sector and for many managers, institutional preservation often instinctively takes precedence

2. Trustee role:

Immediate issues at board meetings relate to organisational sustainability, rather than proactive challenge to whether independence is still the best way to meet stated aims and obligations to beneficiaries

3. Relative prioritisation:

The relevance of merger as an option should rightly vary from organisation to organisation, but often it does not make it onto the agenda

4. Communication of the benefits:

It can be a challenge to measure the benefits of mergers and demonstrate that they will outweigh the time, effort, risk and cost taken to implement them

5. Finding partners and managing relationships:

Some organisations also struggle to find partners in the first place, due to a lack of resource or expertise in how best to identify or approach a good partner

6. Finance and costs:

Dedicated funding is not widely available for mergers and costs involve those associated with procuring external support, with internal restructuring and with lost income during implementation. Merger costs are often relatively fixed regardless of the size of the organisation

7. Pensions:

Pension liabilities in a potential partner organisation are quite often a red line for charities evaluating the case for merger with another

8. Complexity:

Mergers can be an intensive process and can take many forms, which puts off many trustees and senior management teams, especially when their resources are already stretched

PENSIONS

In our 2015/16 Good Merger Index we discussed how pension liabilities can often thwart mergers, in some cases leaving stricken charities with no recourse but to close, and noted the impact of a change in accounting treatment of defined-benefit pension schemes in the revised charities Statement of Recommended Practice (SORP), FRS102. These changes were binding on

charities by March 2016 and have now begun to show up in their publicly-available accounts, making the size of any pension gap and how they manage and report on it more visible. This potentially opens up charities to more bad publicity and makes struggling charities of less interest to potential partners, something managers and boards must now take firmly into account in their planning for the future.

6.2. RECOMMENDATIONS

In the 2015/16 Index we also made a set of recommendations about how to potentially improve the merger environment.

7 IDEAS FOR HOW TO IMPROVE THE ENVIRONMENT FOR CHARITY MERGERS

1. Attitudinal change:

charities should take a proactive attitude and make exploration of collaboration a routine duty of CEOs, actively encouraged by boards

2. Charity Commission guidance:

guidelines could be strengthened and merger activity could be shaped and tracked more comprehensively - the role the Homes and Communities Agency (HCA) plays with housing associations is a potential model

3. Voluntary merger code:

the charity sector should introduce something similar to the National Housing Federation's merger code to help them assess potential mergers, to be sponsored by sector bodies like Acevo and NCVO and voluntarily adopted by charity boards

4. Social impact measurement:

wider take-up of impact measurement would focus charities on outcomes for beneficiaries and clarify the case for merger

5. Tools and resources:

more guidance, diagnostic tools, workshops and grants should be available for charities exploring merger and pioneering new collaborations. The Collaboration Prize in the US is a potential model to follow

6. Research programme:

a research programme to follow the mergers and transparently report the findings could produce data which would be invaluable for others setting about the task

7. A mergers and acquisitions fund:

sources of merger funding are currently patchy – a fund of some kind could provide both capital and expertise to support potentially impactful mergers, unlock savings and strengthen charities in the commissioning market

GOVERNANCE CODE

In July 2017 the Charity Governance Code was published, following a consultation between November 2016 and February 2017. It was drawn up by a steering group chaired by independent consultant Rosie Chapman and comprising the Association of Chairs, Acevo, the governance institute ICSA, the National Council for Voluntary Organisations, the Small Charities Coalition and the Wales Council for Voluntary Action. The code will also replace the Charity Commission's Hallmarks of an Effective Charity guidance, in a mark of recognition from the regulator of the new Governance Code.²⁰

The very first principle of the code is about organisational purpose, stating explicitly that it is important that “the board has a shared understanding of and commitment to the charity's purposes and can articulate these clearly” and “can demonstrate that the charity is effective in achieving its charitable purposes and agreed outcomes”. This includes a duty to analyse both the external environment and the sustainability of the organisation's income sources and business model, and their impact on the organisation's ability to

²⁰ Charity Governance Code: <https://www.charitygovernancecode.org/en>

meet its charitable purposes. In line with this, it is advised that “trustees consider the benefits and risks of partnership working, merger or dissolution if other organisations are fulfilling similar charitable purposes more effectively and/or if the charity’s viability is uncertain” and that that the board must recognise “its broader responsibilities towards communities, stakeholders, wider society and the environment”. This is clearly worded and welcome guidance.

Further, on general board governance and effectiveness, the Code advises that if a trustee has served for more than nine years, the charity is advised to demonstrate that their reappointment is “subject to a particularly rigorous review and takes into account the need for progressive refreshing of the board”. This could well sharpen and professionalise boards if adhered to, making it perhaps more likely that more of the recommendations made in the Code will be implemented by charities as a matter of routine.

However, if these new guidelines do not lead to a step-change in consolidation activity and improvements in governance generally, there may be a case to go further and back these proposals with a stronger regulatory mandate from the Charity Commission. This would make improvements in board composition and evaluation of the most effective means of serving beneficiaries a formal fiduciary duty.

Charities have grown, evolved and diversified greatly in recent decades, and thought has to be given to whether regulation and governance have kept pace with these shifts and the weight of the demands they now place on the sector. Funding methods and expectations have evolved, with many charities having become service providers operating on contract on behalf of the state. This means the sector is now routinely challenged to demonstrate simultaneously that it is ‘professional’ enough to manage complex and high-risk services and still ‘voluntary’ enough to convey value for money and firm rooting in the needs of their beneficiaries – lapses on either side of this

balancing act threaten to undermine confidence in the sector. Failure to adequately explore collaboration and consolidation as an option can lead to duplication and unnecessary competition for its own sake, in an environment where public funding remains constrained. In extreme cases, it can also lead to the outright loss of services and damage to confidence in sector governance when an organisation goes into liquidation without having found a suitable partner.

A ‘MERGER TURNAROUND FUND’

Building on the suggestion we made in 2016 for some type of fund providing both capital and expertise to support mergers, Eastside Primitimers has been working with the Social Investment Business, social investors, grant funders and charities to assess the feasibility of a ‘Merger Turnaround Fund’.

This feasibility work was still ongoing at time of writing, but the tentative case would be for a fund that connects small, troubled charities to both the funding and expertise required to see through mergers, ensuring that vital services are preserved. Two sources of funding would be used for different stages of this process. First, grant funding would be provided for the exploration, planning and due diligence for mergers and the procurement of relevant support in relation to these. Then, repayable loan finance will be used to fund integration, refinancing and growth, based on expected returns.

For the feasibility work around this model, chief executives of small and medium-sized charities that have considered or gone through merger have been interviewed about their attitudes and experiences around it. This was in order to ascertain what kind of support and finance would best suit their needs and make the most impact. And crucially, social investors and grant funders have also been brought together for what we believe is the first time for a serious discussion about the case for a dedicated fund to support potential mergers.

7. CONCLUSIONS



CONCLUSIONS

CHARITY CONSOLIDATION REMAINS RELATIVELY LOW AND NOT STRATEGIC ENOUGH

After four years of this Index, we have made a consistent finding that charity mergers remain surprisingly rare, with 50-70 mergers occurring each year. This is in a sector with tens of thousands of active charities and 167,000 registered in total. 2016/17 continues this trend with around 70 mergers, which while an increase from 54 in 2015/16 is ultimately still small in context. Further, the sector saw a net increase of 1,692 charities registered with the Charity Commission.

Moreover, the quality of the mergers we do see is another issue, in terms of their timing, rationale and the resulting form they take. In 2014/15 and 2015/16 we observed that a majority of merging charities were in deficit. Though this situation improved somewhat in 2016/17, we still found that 44% of 'transferor' organisations were in deficit and that the average operating margin of transferor charities as a percentage of their turnover was -14%. This shows that mergers are still very often sought as a form of 'rescue' from a position of financial and strategic weakness. These mergers may not necessarily aim for productive value beyond the survival of existing services and they can entail unnecessary risk, even if the organisation's services are in the end saved. The continuing dominance of takeover as the default type of merger in the sector may be linked to the prevalence of distress mergers, which can involve a loss of autonomy for the smaller partner due to their reduced negotiating power in these situations.

SOME SUB-SECTORS EXHIBIT 'HOTSPOTS' OF ACTIVITY, HOWEVER

However, while the overall impression is still of a charity sector where merger activity is static, there is more beneath the surface when we look at sub-sectors such as federated charities, supported housing and mental health. In these areas, we find more charities ready to innovate and partner for greater impact.

13% of all mergers involved local branches of federated charities. This model aims to strike a balance between national and local, but competition, funding difficulties and governance challenges have led some hyper-local branches towards either merger or closure.

19% of mergers involved organisations in supported housing, with housing providers either merging together or taking over smaller charities with complementary services to boost their community provision. Mergers amongst providers in particular can be linked to the political and regulatory environment, including constraints on local authority spending, welfare reforms, rent cuts and the presence of the Homes and Communities Agency as a proactive regulator.

Organisations providing mental health services made up at least 13% of total deal activity. This reflects that although high-profile campaigns have raised awareness about mental health and brought with them promises of funding and recognition, funding is not yet reaching frontline organisations. Constraints can be particularly severe for small charities dependent on local authority rather than NHS funding, and for those relying on contracts in a commissioning market defined by greater bundling and competition. This is incentivising charities to think about efficiencies, scale and impact through new partnerships.

DEVELOPMENTS IN THE ENVIRONMENT FOR CONSOLIDATION

We concluded our previous edition of this Index with an analysis of barriers to merger and with recommendations about how to improve the environment for charity mergers. The static picture of merger activity in 2016/17 again underscores that the same barriers remain stubbornly intact, but we have seen two promising developments; the new Charity Governance Code and the start of work towards a potential Merger Turnaround Fund. It will be crucial in 2018 to see whether either of these measures make a much-needed impact.

THE GOOD MERGER INDEX

This annual survey has been prepared to understand more about the consolidation activity that charities and social enterprises undertake. A framework is included which describes five different types of not-for-profit deal: Mergers, Takeovers, Subsidiary Models, Group Structures and Asset or Service Swaps. We report on top deals for 2016/17 and give our impressions of an emerging charity merger market based on the four years of data we now have.

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, social impact, business planning, board recruitment and good governance.

Through our Foundation we support senior professionals who are seeking to work with the voluntary 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 not-for-profits 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.

Find out more at: www.ep-uk.org

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