THINKING BIG

To merge or not to merge – that is the question

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This guide is the result of a collaboration between Our Community, Moores and Commonwealth Bank Not-for-Profit Sector Banking. We would like to acknowledge the individual contributions of Chris Borthwick and Kerryn Burgess (Our Community), Libby Klein (Moores), Philip McCabe (Commonwealth Bank), and not-for-profit sector stalwarts Gerard Reed, Jocelyn Bignold and Kaye McCulloch.

Thinking Big: To merge or not to merge – that is the question

Published by Our Community Pty Ltd

Melbourne Victoria Australia

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Email: service@ourconsumerplace.com.au

ISBN: 978-1-876976-52-1

Published: May 2015

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MERGERS
INTRODUCTION

This guide looks at mergers in the not-for-profit sector: the advantages, the disadvantages, the legal and financial issues to consider, and the nuts and bolts of how to merge.

Mergers are a hot topic, according to the community organisations we work with at Our Community, at Moores and at Commonwealth Bank Not-for-Profit Banking. State and federal governments have reined in budgets, and constraints on household spending have added to the perception that there's just not enough money to go around, and that something's got to give.

But financial considerations are not the only reason why mergers should be on your radar. And whether to merge is not something you can think about once, determine once and for all, then forget about. For many organisations, it's an issue that must be visited and revisited as circumstances change, as they frequently do.

The purpose of this guide is to help frame the thinking of not-for-profit organisations that are considering or being pushed towards a merger.

Denis Moriarty

Group Managing Director
Our Community

WHY MERGERS SHOULD BE **ON YOUR RADAR**

The public worries about not-for-profit inefficiencies, and especially about teeth-to-tail ratios – how much of their donation goes to paying your administration staff rather than directly to kiddies, koalas or cancer cures.

Major funders (usually state and federal government agencies) are also concerned with perceived not-for-profit inefficiencies, particularly so when their budgets are strained. Governments have been known to tell not-for-profit organisations that are similar to each other that funding is conditional on a merger. The underlying assumption here is that merging means becoming more efficient.

In the UK, this assumption is held so strongly in some quarters that a recent report by the Institute of Chartered Accountants in England and Wales recommended that the Charity Commission (the UK equivalent of the Australian Charities and Not-for-Profits Commission) should be enabled to refuse to register a new charity whose mission was already covered by an existing charity.

A Federal Government report published during the global financial crisis, *Impact of the Economic Downturn on Not-for-Profit Organisation Management* (June 2009), found that 15% of charities surveyed were considering a merger.

Little has changed since then. A 2015 Our Community - Commonwealth Bank survey produced largely the same result.

An Our Community survey the year before contained another interesting finding. While 29% of those surveyed were generally not in favour of mergers, 23% were generally in favour, and 48% responded, "It depends on the circumstances." That's a total of 71% prepared to consider a merger under the right circumstances.

So what are the right circumstances?

The reason you should be considering a merger is that it might enable you to fulfill your mission better – to rehabilitate more burnt koalas, to find permanent accommodation for more homeless women, to provide higher quality physiotherapy services in your rural town.

If you're mission focused, you should be centred on the cause, not your organisation's own fortunes (or at least not at the expense of the cause). If there's a chance that *anything* might enable you to fulfill your mission better, then you have a responsibility to consider it, and that could include merging.

THE 2015 NOT-FOR-PROFIT FINANCE SURVEY, AN INITIATIVE OF OUR COMMUNITY AND COMMONWEALTH BANK NOT-FOR-PROFIT SECTOR BANKING, REVEALED THE FOLLOWING:

Have you or do you plan to collaborate with another organisation to improve or increase programs or services offered?

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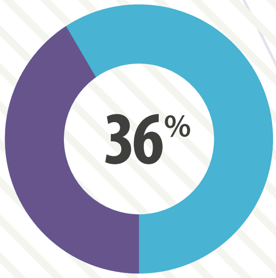

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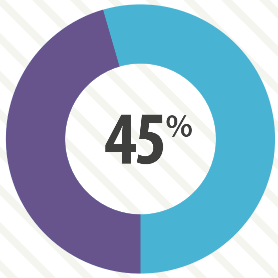

Have you or do you plan to collaborate with another organisation to reduce administrative expenses?

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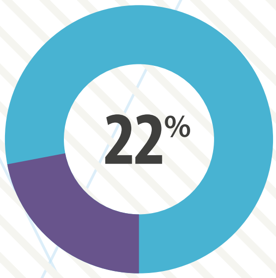

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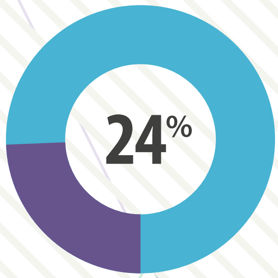

Have you or do you plan to merge with or acquire (or be acquired by) another organisation?

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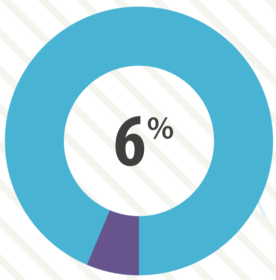

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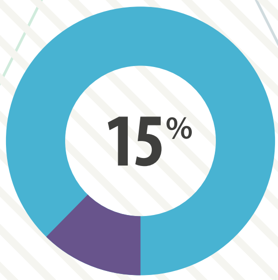

Have you or do you plan to undergo major organisational restructuring?

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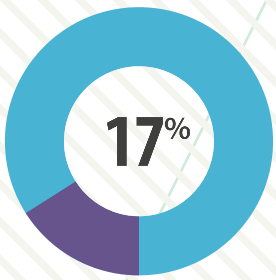

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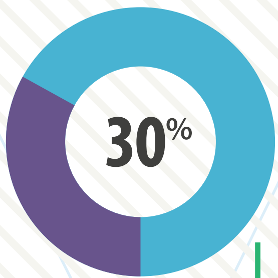


ADVANTAGES OF MERGING

STRENGTH IN SCALE

There certainly are advantages of scale for not-for-profits, as for almost any organisation.

For a start, it makes it much easier to get grants, both from government and from the private sector. Many grantmakers favour giving a few big grants to big organisations – from the grantmaker's point of view, that's much easier to administer. Grantmakers are also generally more comfortable with organisations with strong administrative systems and there's a general view (rightly or wrongly) that the larger you are the better your systems are likely to be.

Larger organisations may also have an advantage when it comes to advocacy in favour of their own fortunes and those of the causes they represent. Bigger groups tend to find it easier to gain the trust of the big end of town. If they stamp their feet, the media might hear them.

COST SAVINGS

In theory, if you're big it's easier to have an efficient office without starving the front-line service delivery end of the enterprise. One organisation needs one CEO, not two, and one IT system, not several. You'll need only one human resources team and one accounts team in the merged organisation. This means you can help more people for less money.

TWO HEADS ARE BETTER THAN ONE

Combining two organisations means combining contact lists, donor databases, brainpower and more.

REJUVENATION

A merger can bounce an organisation out of its rut, and can show you a way around founder's syndrome. That said, if it takes external pressure to make you change with the times, you might need something stronger than a merger.

DISADVANTAGES OF MERGING

The theory of mergers tends to be quite a long way from the practice. Mergers are very difficult to pull off and quite easy to stuff up. Even in the commercial world, where things are (arguably) a little more straightforward, not all mergers are commercially sound. Businesses aren't always businesslike."Study after study puts the failure rate of mergers and acquisitions somewhere between 70% and 90%," according to this article in *Harvard Business Review*: https://hbr.org/2011/03/the-big-idea-the-new-ma-playbook.

SAPPING TIME AND ENERGY

Mergers can harm organisations by taking a lot of time and effort and sucking up all the management. They can promote uncertainty, anxiety and rebelliousness among staff and lead to increases in absenteeism and job turnover.

SAPPING MONEY

One of the purposes of merging is to reduce the amount of resources you need – human resources included. But in many cases you have to spend money to save money. If you lay people off, it will cost you in redundancy payments.

Not-for-profit groups, in any case, tend to shy away from forced redundancies, so either way, it will cost you. Often, projected savings don't actually materialise.

Other possible financial costs include fees for merger or process advisers, lawyers, public relations and communications strategists, among others.

There's a risk of losing income too. If you cover much the same area as your merger partner, it's likely your donor lists will overlap. There's no guarantee that a donor who used to give $100 a month to you and $100 a month to your partner will now give $200 a month to the merged organisation. More likely it'll still be $100 a month, if they keep giving at all.

INCOMPATIBLE CULTURES

Corporate culture arguably constitutes a larger part of a not-for-profit than of a standard commercial enterprise. The real assets of any not-for-profit group aren't its property or bank deposits but its goodwill and volunteers, both of which are attached to the organisation as it stands now rather than to the hypothetical merged group. It's a lot easier to turn off goodwill and volunteers than to build them up. Changing your culture by merging with a culturally different organisation is a risk.

IN THE END, IT'S ABOUT THE MISSION. THE MISSION MUST BE ABSOLUTELY CENTRAL TO ANY DISCUSSIONS ABOUT MERGERS.

ASK YOURSELF: WHAT WAS YOUR GROUP SET UP TO ACHIEVE? WILL MERGING WITH ANOTHER ORGANISATION GET YOU CLOSER TO THAT GOAL?

MERGING – OR ANOTHER MODEL?

Not-for-profits tend not to consider merging unless they're in diabolical trouble. If a group can survive on its own, that's generally its preference. However, many organisations in the current climate would rather like to cut back on their costs. They would also like more resources, and would like to be able to apply for large grants. Can such groups cooperate with other groups to bring these good things about without metamorphosing into another entity entirely?

The report *Impact of the Economic Downturn on Not-for-Profit Organisation Management*, mentioned earlier, found that nearly half of all not-for-profits surveyed were "collaborating or rationalising" with peer organisations, as shown in the graph on page 13.

So what does "collaborating or rationalising" mean? There are several models you could adopt without entering into a fully fledged merger. If your problems aren't both absolute and urgent, it's probably sensible to test the potential of greater collaboration first through some other sharing arrangement, or even a program of joint working.

Even if this goes well at first, though, remember that the real test of a collaboration is what happens in the long term. Many partnerships either end abruptly or peter out as people lose interest.

Some of the more common models of collaboration are outlined below.

INFORMAL COOPERATION

Small associations with small needs – a room, a hall, a sportsground – can share with other groups without too much difficulty. Even here, however, it's necessary to consider the details. Insurance, in particular, can be a sticking-point, and arrangements for security need to be talked through.

Make sure you draw up a written agreement; it avoids bad feeling later. Our Community has some partnerships helpsheets that could be helpful in thinking through what your agreement might contain. See http://www.fundingcentre.com.au/sponsorship/help.

"BACK END" MERGERS

Sharing back-office functions – accounting, payroll, joint operations – can lead to cost savings. But organisations going down this route have to agree on joint funding, and have to negotiate – even haggle. Details need to be settled, in writing.

Your partner doesn't want to be out of pocket – if they'd wanted to subsidise your work, they could simply have made a donation. Check that you are in fact getting a better deal than you'd get if you simply went to a local bookkeeper and paid standard rates.

AUSPICING

A small new group may have trouble getting its bona fides accepted, and could certainly take a while to get any tax concessions, or to become eligible for deductible gift recipient (DGR) status, which is a pre-requisite for eligibility for certain grants. Such a group may seek a short-cut to respectability, tax breaks and DGR status by being taken under the wing of an established group. This is known as auspicing.

You can't go and ask just anyone to auspice you. It's important to find a group whose purpose overlaps with yours, and it's important that there's goodwill and trust between the two groups.

The auspicing body will probably charge a percentage to cover their own administrative costs (and to compensate them for the reputational risk of having you muck it up), but that's not the biggest challenge – the biggest challenge is finding a group that will do it at all.

Parramatta City Council has published an excellent guide to auspice agreements, available from www.ourcommunity.com.au/files/aigm/ParramattaCouncilGuideToAuspiceAgreement.pdf.

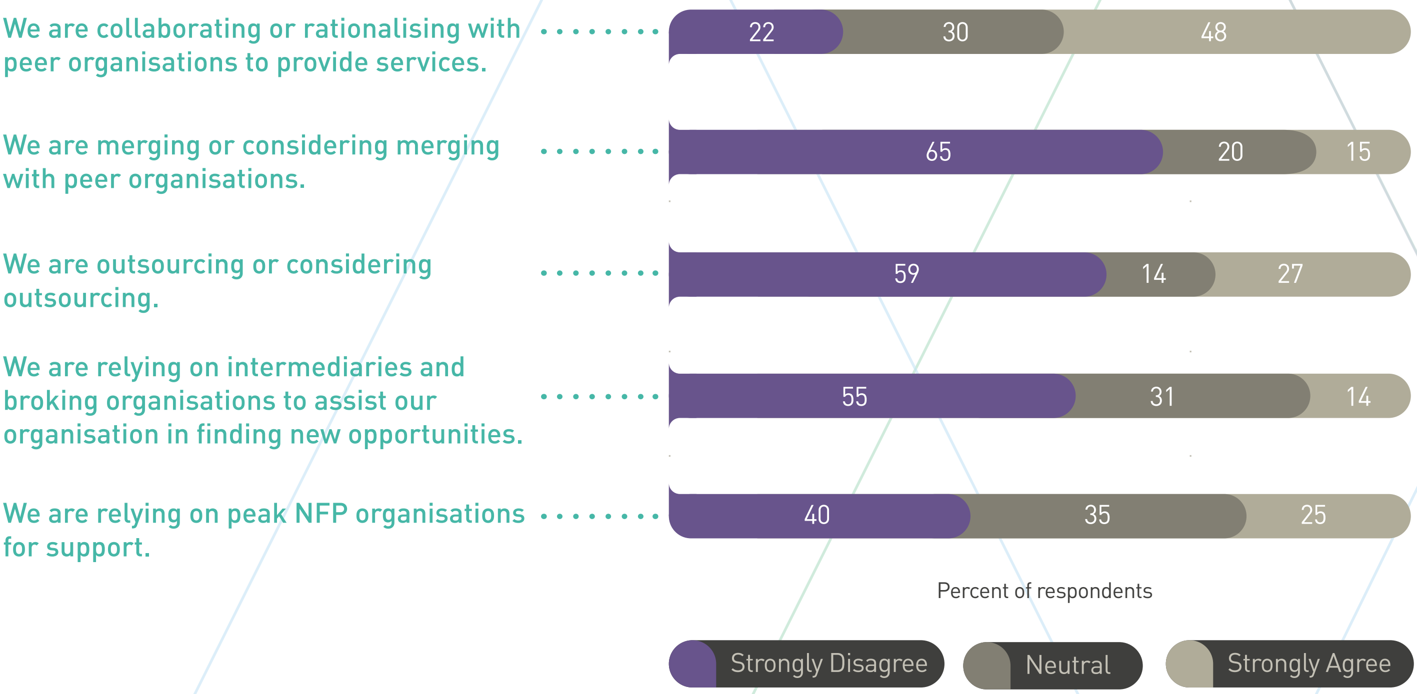
JOINT PROGRAMS AND PARTNERSHIPS

It's not uncommon in the not-for-profit sector for like-minded groups to come together over a particular project – the campaign to get the Federal Government on board for the National Disability Insurance Scheme is one example of a large-scale collaboration.

On a smaller scale, a number of groups established to help sick children – Camp Quality, CanTeen, Make-A-Wish Foundation, Redkite, Starlight Children's Foundation and Variety – come together regularly under the umbrella of Children's Charities Leadership Forum. This enables the groups to work together closely on common issues. You can read about this partnership model at www.redkite.org.au/sites/default/files/joint_charities_brochure.pdf.

Such collaborations can help reduce overlaps in service delivery and bring to bear for all members of the group some of the benefits being a bigger organisation can impart – a stronger voice, for example.

COLLABORATION



HOW TO MERGE: A 10-STEP GUIDE

In procedural terms, mergers are quite challenging to pull off. They have to be voted through by both organisations' boards, and then by one or both memberships at special general meetings. It's necessary to adopt a constitution for the merged association. Each stage provides opportunities for those opposed to the merger to derail the process.

Managing communication carefully right from the beginning is crucial, and extensive consultation is likely to pay off.

Your board will need to engage deeply with the merger process, and make key decisions along the way. Here's a 10-step guide to how the process typically proceeds:

1. Make an in-principle decision to seek a merger partner
2. Identify potential merger partners (note that sometimes steps one and two are inverted)
3. Agree to explore a merger
4. Develop or approve a communications strategy
5. Undertake due diligence
6. Decide on key features of the merger, including:

   (a) what will happen to employees

   (b) whether both organisations' names will continue to be used

   (c) the composition of the board of the merged organisation

   (d) how and when changes at board level will be implemented

   (e) legal structure
7. Decide to go ahead (or not)
8. Approve the communications plan
9. Call a meeting of members to seek approval for the merger
10. Implement the deal.

LEGAL MECHANISMS FOR MERGING: **THREE OPTIONS**

There are three main legal mechanisms for merging not-for-profit organisations, whether they are associations or companies limited by guarantee.

1. TRANSFER AND DEREGISTER

The simplest means of merging is to transfer assets and liabilities from one organisation to the other. Once this has occurred, the organisation that has transferred its assets can deregister.

An advantage of this method is that it is not necessary to appoint a liquidator. There is no need to go through a formal wind-up process. A disadvantage is the perception (or reality) that this constitutes not so much a merger as a takeover of one organisation by another. It doesn't give the expiring group much leverage, and it doesn't ensure the carrying forward of any of its particular concerns or strengths.

2. MAINTAIN PARALLEL ORGANISATIONS

In some cases, it makes sense to keep two legal entities in place. The organisations can be "merged" by replacing board members such that both organisations have the same board membership (sometimes called "mirror boards").

3. AMALGAMATE

In some cases, legislative provisions enabling two or more organisations to "amalgamate" into one can be used. Contracts and other legal relationships in place before the amalgamation are not disrupted by the merger. A wind-up process is not necessary, but formal approval by members of both organisations needs to be obtained.

If an association wishes to merge with a company limited by guarantee, different rules apply and the laws are mostly silent. If you are contemplating this, either your association will have to wink out of existence or it will have to become a company itself and then merge. You'll need a specialist lawyer.

DECIDING WHICH MECHANISM TO USE

When you're deciding which legal mechanism to use to facilitate your merger, don't just assume that maintaining the larger partner's existing entity is the way to go. There are a whole lot of factors to consider.

TAX STATUS

What type of tax concessions does each organisation have, and can the organisations merge without losing these? If the tax status of the organisations is different (e.g. if one is a public benevolent institution and the other is not), is there merit in keeping both organisations alive?

TYPE OF ENTITY

If the bigger organisation is an incorporated association, is it time to consider company status? If the smaller organisation is a company, it might make sense to transfer assets and liabilities to the smaller organisation. Alternatively, the big organisation could change its entity type. The attitudes of your regulators and funders might come into play here too. Some regulators prefer or require a company structure.

GOVERNING DOCUMENT

If one organisation's constitution is up to date and the other's is an historical mess, you might choose to use the organisation with the up-to-date constitution to avoid having to update the other one.

PERCEPTION

Would it be significantly easier to sell the proposal to members if one entity rather than the other (or a new one) were adopted as the formal legal vehicle? Is that the only reason for adopting a particular structure? If so, have you considered maintaining both entities in the short term, and moving to the optimum structure later? Or is it better to move to the optimum structure immediately rather than leave further work to be done later?

LICENCES

Does one of the entities have a licence of some sort that is best left in place rather than being lost via deregistration of the entity?

SKELETONS

If there are concerns about unknown liabilities arising in the future out of one of the entities, that could be a good one to deregister.

FUNDING

Is it important to keep a particular entity and its name alive for the sake of existing or future bequests or other funding agreements?

MANAGEMENT

Would the merged organisation be easier to manage as one or two entities?

CULTURE

Do the organisations have different cultures, and do you want to maintain the differences? Or is maintaining or achieving a unified culture part of the merger strategy?

RELEVANT LEGISLATION

Every state and territory except Western Australia and the Northern Territory has a provision in its Associations Act governing mergers between two incorporated associations:

- ACT Associations Incorporation Act 1991, Division 3.3, Section 26, Amalgamation of incorporated associations
- NSW Associations Incorporation Act 2009, Section 6, Application for registration
- Queensland Associations Incorporation Act 1981, Part 9, Division 2, Amalgamation of incorporated associations
- South Australia Associations Incorporation Act 1985, Section 22, Amalgamation
- Tasmania Associations Incorporation Act 1964, Section 25, Amalgamation of associations
- Victoria Associations Incorporation Reform Act 2012, Part 2, Division 3, Amalgamation of incorporated associations.

TOP TIPS FOR SUCCESSFUL **MERGERS**

1. KNOW YOUR POSITION

Before you find yourself caught up in the thick of merger discussions, figure out whether you want to proactively seek a merger. If you were approached by another party, what criteria would you use to assess whether or not to go ahead? Why would you want to enter into a merger? Why not?

2. CONSIDER OPTIONS OTHER THAN MERGING

Is a full-blown merger the best option, or might you be better off starting with a less radical arrangement? You could jointly provide services or work collaboratively on a project without merging.

3. LOOK BEFORE YOU LEAP

Get some due diligence done on the other organisation so that you go into the deal with open eyes. You want to know their financial position and whether there are any legal skeletons hidden in their cupboard. At the same time, due diligence is not a magic bullet. It won't and can't tell you whether the new organisation will be successful. Don't waste time and money looking for guarantees that can't exist. The success of the new organisation will rely on good governance from the new board and good management from the new CEO and executive team.

4. CONSIDER YOUR CULTURE

Cultural alignment is critical. It is essential that organisations come together with shared values and a shared sense of purpose. But culture is more than values and purpose; it's "the way things are done around here".

5. DON'T MAKE ASSUMPTIONS ABOUT LEGAL STRUCTURE

You don't necessarily need to adopt the bigger organisation's legal entity as the vehicle for the merged organisation. There may be good reasons to continue with more than one entity, or to change entity type (eg from an incorporated association to a company). Protect your tax concessions – the last thing you want to do is inadvertently lose them.

6. TAKE COMMUNICATION SERIOUSLY

Avoid angst by having a carefully thought through communications strategy. Who will you communicate with and when? What issues will you consult over and what issues will you just announce?

7. CLARIFY EXPECTATIONS WITH THE OTHER PARTY

Ideally, clarify your expectations in writing, in a binding or non-binding memorandum of understanding, updated at every milestone stage in the discussions. Remember to cover confidentiality, communication channels, dispute resolution and protocols for making announcements. You might start with a verbal agreement, then sign an agreement setting out the intentions of both parties, and then progress – if the merger proceeds – to the final documentation to implement the deal. Build in some opportunities for bailing out along the way (eg if the due diligence process identifies some show-stoppers).

8. ESTABLISH HOW YOU WILL MEASURE THE SUCCESS OF THE MERGER

Before the merger, set financial and other key performance indicators (KPIs). After the merger, track outcomes against those KPIs. This leaves you well placed to correct your course if you need to, and to celebrate successes. It also helps to ensure the transparency of the financial and mission-focussed aspects of the merger process.

9. BE RESILIENT

Once you've decided to merge, you will be vilified for your decision. You will be called the "c" word – a corporatiser. You will be accused of selling out to economic rationalists, trashing the legacy of the organisation, failing in your governance duties and insulting the CEO of 36 years. Acknowledge real grief and loss. Then get on with it.

10. BE HONEST

Make these two three-word phrases your best friends: "I don't know" and "I hope so." Use them constantly.

RECOMMENDED READING **AND VIEWING**

What Place for Mergers Between Charities?, New Philanthropy Capital, 2009

http://www.thinknpc.org/publications/what-place-for-mergers-between-charities

Collaborative Working and Mergers, Charity Commission, 2003

http://www.charity-commission.gov.uk/publications/rs4a.asp

Key Findings on Voluntary Sector Mergers, Centre for Voluntary Action Research, 2003

http://193.61.20.148/documents/MergerKeyFindings.pdf

The Good Merger Index, Eastside Primetimers, 2014

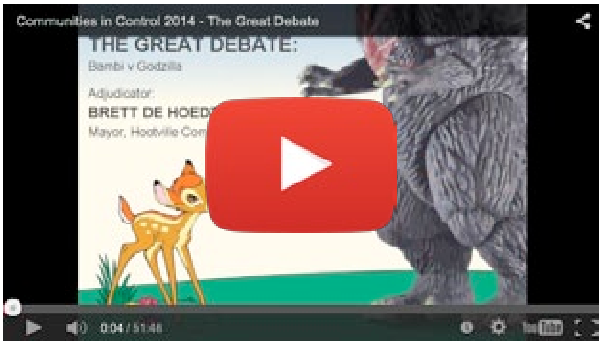
http://www.civilsociety.co.uk/docs/the_good_merger_report_-_final.pdf

The Guardian, "What to Consider When Thinking about Starting a Merger", 2012

http://www.theguardian.com/voluntary-sector-network/2012/nov/13/merger-considerations-charity-organisations

The Great Debate: Bambi versus Godzilla (video), Communities in Control conference, 2014

http://www.ourcommunity.com.au/control/control_article.jsp?articleid=5901



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Where not-for-profits go for help

The Our Community Group provides advice, connections, training, and easy to use tech tools for people and organisations working to build stronger communities.

Our partners in that work are grantmakers (government and philanthropic), donors, enlightened businesses, community builders, and - of course - not-for-profit organisations themselves.

A Certified B Corporation and multi-award-winning social enterprise, Our Community's offerings include OurCommunity.com.au (where not-for-profits go for help), FundingCentre.com.au, GiveNow.com.au, the Australian Institute of Grants Management, SmartyGrants, the Australian Institute for Corporate Responsibility, and The Innovation Lab - the engine room for seeding ideas to drive social change by doing old things better or new things first.

Our Community is a Certified B Corporation.

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A mid-sized law firm, Moores is one of only a few legal practices with a team dedicated exclusively to not-for-profits. For many years now we have been giving strategic advice on governance, structure, tax and compliance for charities, social enterprises, community housing and disability organisations, and educational institutions across the country. Our lawyers advise on the opportunities and challenges that not-for-profits encounter and are focused on enabling these organisations to function efficiently and make the best use of their resources. All this at a pre-agreed price. No estimates. No ranges. No hourly rates.

CommonwealthBank

At Commonwealth Bank, communities are at the core of our vision: to excel at securing and enhancing the financial wellbeing of people, businesses and communities. For more than 100 years, Commonwealth Bank has supported Australian communities, including the not-for-profit organisations that help to sustain and strengthen them. And today we are making our banking solutions and service for our not-for-profit customers deeper and better than ever before.

Your banking is in good hands thanks to our accredited not-for-profit sector bankers, our not-for-profit investment team, our specialist transaction bankers, our 24/7 on-shore service centre, and our dedicated switching team.

NOTES

THE LAST WORD:

“What’s with all the bloody-mindedness to force not-for-profits to merge? When was the last time you heard a bureaucrat or a politician telling small businesses to merge? Do your research, weigh the costs and benefits, give it a good hearing, but if it’s not right for your group – for your mission – don’t do it.”

Denis Moriarty,
Group Managing Director
Our Community