Everyone is talking about mergers

…but is a merger right for my NFP?

A RESOURCE FOR NFP BOARDS CONSIDERING MERGERS AND OTHER FORMS OF COLLABORATION

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Executive Summary

Purpose of this resource

Close to a third of Australia's not-for-profit (NFP) Board directors have discussed a merger as a potential form of collaboration to improve their organisation's efficiency and achievement of strategic objectives.

Mergers are attractive because they provide economies of scale through greater organisational size. While mergers may work in certain circumstances, there are other NFP collaboration forms that may be more appropriate and should be considered by NFP Boards.

> *"32% of NFP directors reported that their Board had discussed a merger in the last 12 months."* - AICD 2015

Many factors are driving NFPs to consider mergers

Some of

- Increasing service delivery costs due to sector professionalisation
- Reducing Government budgets
- Perception that NFPs are inefficient
- Shift to market-based competition
- Greater client choice and purchasing power
- Increasing recognition of client need complexity

Other forms of collaboration which may assist organisations in achieving their mission

The key is to determine which collaboration form will provide the most effective service to your targeted end-users at the lowest cost. This guide will present five key types including introductory scenarios and factsheets covering advantages, disadvantages, lessons learned and key considerations for a NFP Board contemplating collaboration. The five collaboration types discussed in this resource include:

1. Merger
2. Subsidiary
3. Joint Venture
4. Memorandum of Understanding
5. Fee for Service

Why are NFPs talking about mergers?

Increasing costs

The cost of delivering community services has grown, in large part because of the professionalisation of what was traditionally a highly feminised, volunteer-based (and undervalued) NFP sector. This has resulted in demands for professional wages for staff. This is a challenge for NFP organisations which have traditionally been preferred by governments because of their lower cost service offerings.

Government cut backs

Governments are seeking to reduce their own expenditure on administrative functions in challenging budgetary conditions. As the management of every government contract has an administrative burden, there’s a preference for the awarding of fewer, but larger, contracts.

Perception of inefficiencies

There is a widely held view that NFP operations are inefficient compared with for-profits. While there is little evidence available demonstrating this view, the NFP sector has also not managed to effectively counter the perception, so it continues to support the assumption that there is room to reduce costs.

Shift to market-based competition

The perception that NFPs are inefficient has led governments to favour an approach to contracting which emphasises competition – believing that competition will improve services and reduce costs. NFPs have to address their ‘inefficiencies’ if they want to survive in the marketplace.

Greater client choice and purchasing power

The shift towards individualised funding models (i.e. in the aged care and disability sectors) is designed to provide clients with greater purchasing power, choice and control over the services and supports they access. Service providers are now required to compete for individual clients, rather than for government service contracts, which requires significant changes in NFP business model(s).

Increasing recognition of needs complexity

Community service organisations report that a larger proportion of their clients are presenting with multiple and complex needs. Complex needs are more difficult for organisations to meet, as government funding streams tend to focus on meeting only a narrow range of client needs.

Why are NFPs talking about mergers?

NFP mergers are happening

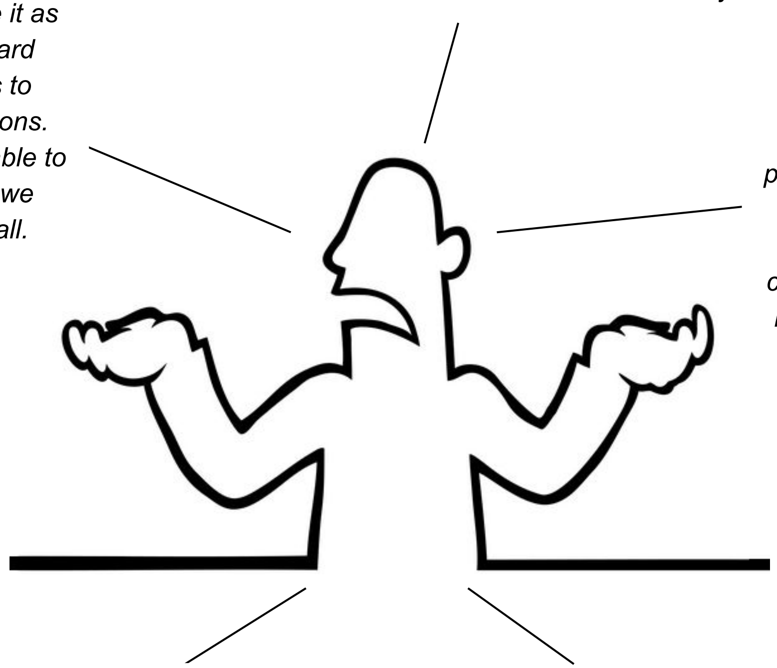
In the Australian Institute of Company Directors' 2015 NFP Governance and Performance Survey, 32 percent of NFP directors reported that their Board had discussed a merger in the last 12 months. 7 per cent also responded that they had completed a merger in 2015, and 7 percent reported that they were in the process of a merger.

Mergers are attractive because they provide economies of scale through greater organisational size.

The illustration on the right highlights a range of challenges facing NFPs that may lead them to consider undertaking a merger.

Is a merger right for my organisation?

While mergers may work in certain circumstances, there are other NFP collaboration forms that may be more appropriate and should be considered. It's more about finding the collaboration type(s) that will enable you to efficiently achieve your organisation's mission.



Forms of NFP Collaboration

There are many forms of NFP collaboration from two organisations informally working together to complete integration. Different forms of collaboration require different degrees of cooperation and each present unique challenges. Many organisations which start working together informally often increase their intensity of cooperation as greater trust develops between the parties, sometimes leading to a formal merger. The key is to determine which collaboration form will provide the most effective service to your targeted end-users at the lowest cost.

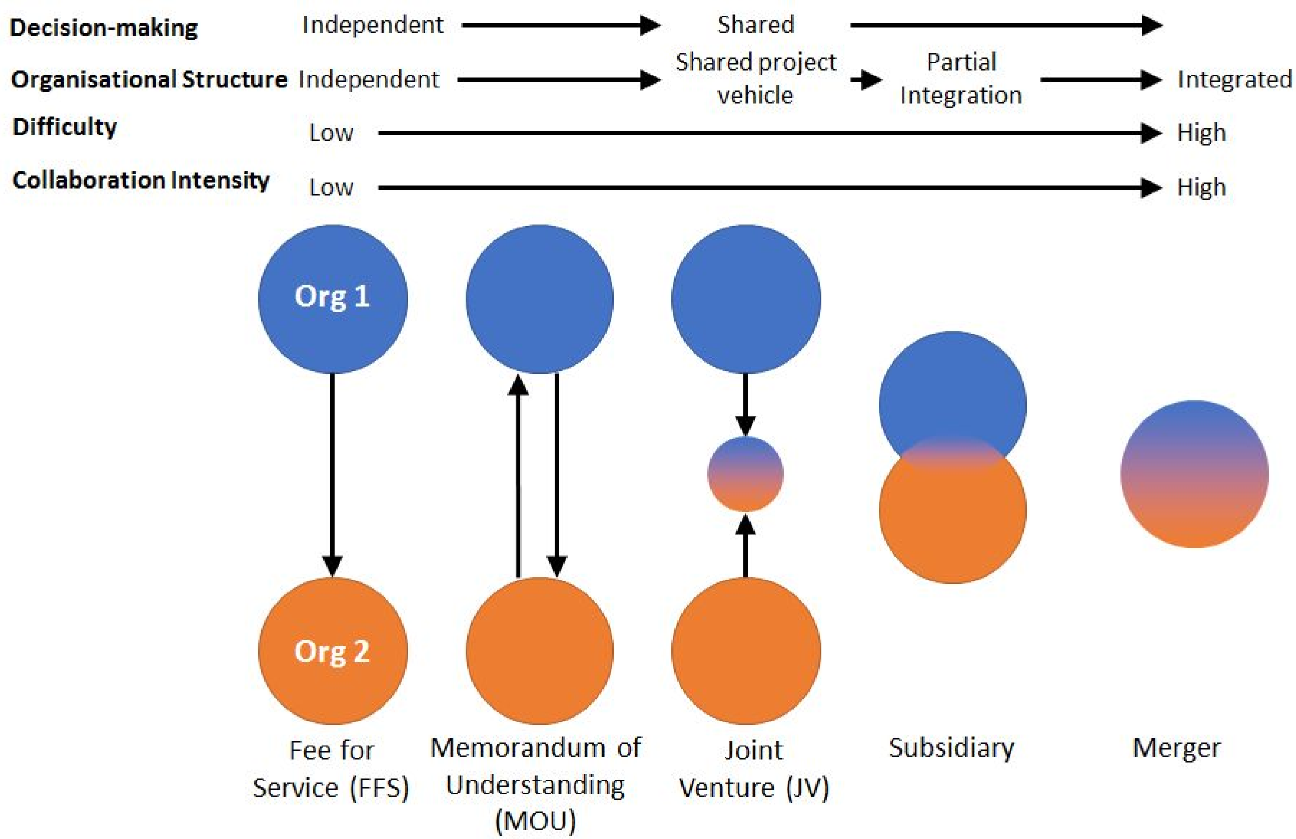
Collaboration options

This resource presents and compares five key forms of collaboration: Merger, Subsidiary, Joint Venture, Memorandum of Understanding, and Fee for Service.

Note: Collaboration forms not captured include Auspicing, Partnerships/ Alliances and Back-office integrations.

The diagram on the right compares the different collaboration types, based on characteristics including decision making, organisational strategy, difficulty and collaboration intensity.

Source: Diagram (right) developed based on the Nous Group's '<u>Options for working together with another organisation'.</u>



Additional resources can be found here:

- <u>Collaboration Blueprint</u> (http://www.nousgroup.com/images/news_attachments/Collaboration_blueprint.pdf)
- <u>Collaboration Framework</u> (http://www.nousgroup.com/images/news_attachments/One_page_collaboration_framework.pdf)
- <u>Collaboration Types</u> (http://mergers.nfpstrategy.com.au/understand-options-for-working-with-others/)

Comparing collaboration types: Traits to consider for a Board

Scenario: Organisation A has identified an emerging need to provide a transport service to clients. However, Organisation A does not own sufficient vehicles to deliver this service and does not have the capital/borrowing capacity available to invest in the number of cars required. Organisation A is looking at collaboration options with Organisation B which would allow it to meet this service need.

	Fee for Service (FFS)	Memorandum of Understanding (MOU)	Joint Venture	Subsidiary	Merger
Definition	An arrangement where an organisation provides an unbundled service to another for a price.	A formal, non-binding agreement between two or more parties expressing a common will between them that may lead to agreed actions.	A legally binding agreement between two or more organisations for a specific program or project. Often a separate legal entity is formed for the purpose.	Ownership/control of a smaller organisation (subsidiary) is transferred to a larger organisation (parent), while retaining its own separate activities and identity.	When two (or more) organisations unite to become fully integrated and operate as a single entity.
Traits	Decision making is independent of each Board. The impact is limited to what is agreed in the schedules.	Shared understanding between two Boards, however there is no legal requirement to fulfil the agreement.	Both Boards are bound and therefore both must be willing to hold each other accountable for agreement.	Partial integration of governance structures. Smaller organisation may lose control once transferred to parent.	Most difficult form of collaboration and complete integration. Previous Board structure may cease to exist in new merger.
Application	Organisation A has recognised that there are only a few clients who need a disability access car. The service is only occasionally needed, so Organisation A opts pay Organisation B to provide the service.	Organisation B sees value in working with Organisation A so wishes to become their preferred transport service provider. However, Organisation B is yet to understand the full financial impacts and so does not want to become legally bound and signs a MOU to provide access to their transport services.	Organisation B has forecast a growth in transport services and wishes to be locked into a formal contract as the only preferred supplier. Both Boards wish to maintain control over their respective Organisations and see this scenario as an opportunity to bid for a large Government tender and sign a Joint Venture.	Organisation B becomes the parent for Organisation A (the subsidiary). Organisation A is a strong existing brand, Organisation B sees value in keeping separate branding as clients for Organisation A are very loyal, however, there are opportunities to achieve economies of scale.	Organisation A and B decide to merge and re-brand as this will take them in a new direction with the same organisational strategy. Integration will expand and streamline services available to clients. The merger of operations will deliver economies of scale. Any improvement in cash reserves or asset base may improve the organisation's ability to borrow/fund future expansions.
Example	White Oak offers brokering services to with other aged care providers, hospitals and local communities. Instead of providing the in-house service White Oak charge a brokerage fee on top of the service for the client.	Rise Network signed a MOU with Technology Assisted Disability WA (TADWA) under which Rise is able to access and purchase equipment from TADWA.	The Passages Resource Centres in Perth - which delivers information, referrals and services to homeless young people - is a joint venture between Vinnies and the Rotary Club of Perth.	Food Rescue, a well established program in WA, became a subsidiary of UnitingCare West in 2013. Both brands have remained separate.	CommunityFirst, Volunteer Task Force & Care Options are to merge and become a new organisation (yet to be named). New organisation will have only one Board as a result of merge.

Fee for Service: A Factsheet for Boards

What is a Fee for Service?

An arrangement where an organisation provides an unbundled service to another for a price.

Advantages

- Allows an organisation to focus on its core capabilities and outsource non-core activities to more efficient providers.
- Enables NFPs to raise/diversify revenue by servicing other organisations by doing what they do best.
- Low administrative burden resulting from narrow form of collaboration.
- Potential for long-term relationships with key suppliers/customers.
- Enable NFPs to bid for larger government contracts by filling in capability gaps with FFS sub-contractor.
- Low risk and limited obligations due to short-term nature of the service.
- Both organisations can work together whilst maintaining autonomy.

Lessons Learned

- Not fully understanding the conditions attached to the organisation's funding (public and other), which may limit FFS activities.
- Forgetting to establish whether there is a market for your services.

Key Considerations

- While NFP should treat their FFS activity like a for-profit business, they should ensure there is a clear specific purpose for FFS activity which is related to your organisation's mission.
- Requirement to create a separate legal entity to provide the service (depends on materiality to NFP).
- Ensure there are appropriate risk management measures and procedures in place for contracts including due diligence, legal review of contract and delegations of authority for contract approvals.
- Track the performance of the FFS activity with strategic service providers / customers.

Disadvantages

- Organisational relationship limited to the services specified in the contract.
- Fee for service arrangements are transactional in nature, especially small, low-value contracts, so may limit collaboration.
- Client/funder reputational risk if sub-contractor fails to deliver a good quality service.
- Risks jeopardising your public funding.

Available Frameworks

Strengthening Non Profits (US) – Understanding Fee for Service Models

Written with individual clients in mind but translatable to organisational clients.
http://strengtheningnonprofits.org/resources/guidebooks/Understanding_Fee-for-service_Models.pdf

Justice Connect (AU) – Checklist: Issues to cover in a Sub-contract Agreement

Checklist of what should be covered in a sub-contract agreement.
https://www.nfplaw.org.au/sites/default/files/media/Checklist_-_Issues_to_cover_in_a_Sub-contract_Agreement_1.pdf

Know How Non Profit (US) – How to Subcontract: What you need to consider

Questions to consider when considering sub-contracts
https://knowhownonprofit.org/how-to/how-to-subcontract-what-you-need-to-consider

MOUs: A Factsheet for Boards

What is a Memorandum of Understanding?
A formal, non-binding agreement between two or more parties expressing a common will between them that may lead to agreed actions.

Advantages
- Formality of the agreement encourages collaboration between staff of each organisation.
- Not a legal contract thus allowing greater flexibility.
- Sharing of specialist skills or knowledge between organisations to achieve mutually beneficial ends.
- Demonstrates intent to stakeholders of intent to collaborate further with another organisation.

Disadvantages
- Generally, MOUs are written in a way that indicates they are not contractually binding, and are more a statement of intent or an 'agreement to agree'. This is because the courts will generally not recognise agreements to enter into contracts as binding contracts themselves.
- Not always appropriate for highly complex collaborations.
- Competitive funding model may discourage MOUs as NFPs may feel obliged to protect their intellectual property from potential competitors.

Lessons Learned
- Ambiguity exists regarding whether an MOU is legally binding or not. The legality of the agreement will be highly dependant on the terms of the MOU – legal advice recommended.
- In complex and or long term collaborations it is best to support the MOU with a briefing note that outlines the history of and reasons for the collaboration and a documented partnership agreement including a risk management plan.

Key Considerations
- An MOU will typically establish a framework for the collaboration between the organisations and express the common goals or vision of the parties to the MOU.
- In general, an MOU will not deal with the specific details of particular projects. An MOU is therefore usually more of a 'high level' agreement.
- As an MOU is normally not a legally binding document, it is not appropriate to use an MOU if your organisation wants to be able to enforce a part of the agreement. If you need to rely on the other organisation taking certain actions and/or if your organisation stands to lose money if the other party does not act – your organisation should seek to enter into a contractual arrangement.

Available Frameworks
Justice Connect (AU) – Memoranda of Understanding: Legal information for community organisations
Checklist of high level considerations when entering into an MOU
https://www.nfplaw.org.au/sites/default/files/media/Memordanda_of_understanding_0_0.pdf

Justice Connect (AU) – MOUs to mergers: Formal options for working with other NFPs
Legal analysis of MOU
https://www.justiceconnect.org.au/mous-mergers-formal-options-for-working-other-not-for-profits-vic

QCOSS/Community Door (AU) – Memorandum of understanding
Explains the different elements of an MOU
http://communitydoor.org.au/organisational-resources/collaboration/stage-2-formalising-your-collaboration/memorandum-of

Joint Ventures: A Factsheet for Boards

What is Joint Venture?

A legally binding agreement between two or more organisations for a specific program or project. Often a separate legal entity is formed for the purpose.

Advantages

- A vehicle for greater level of cooperation for specific programs such as fundraising, service delivery or advocacy
- Combine complementary capabilities and resources to deliver new or better services for end-users. Collaboration may also result in identification of other/future collaboration opportunities.
- Risk limited to the JV arrangement
- Organisations maintain their autonomy, and no changes are required to the organisations' existing governance and financial structures.
- Potentially stronger positioning for Government funding of specific program

Lessons Learned

- Harvard Business Review estimates that only 53% of JVs are successful. Key reasons for JV failure include strategic misalignment, incompatible JV partners and poor leadership.
- JVs tend to focus on the delivery of a project, but underestimate the cultural, people and communications required to facilitate JV success.

Key Considerations

- Compatibility of each organisation's strategic objectives. Ensure the specific purpose of the JV is (a) aligned with your organisation's mission and (b) clearly articulated and understood by all parties.
- Consider what both parties are contributing (capital, capability, people, knowledge or other resources).
- Requirement to create a separate legal entity for JV (determine what is fit-for-purpose).
- Setup of a governance system that promotes shared decision-making between parties and manages risks while not hindering the JV operational management.
- Provision of additional resources may be required for the management of JV planning and execution.
- Plan for the worst case scenario - determine possible exit scenarios and associated processes, and give consideration to how this should be reflected in your contractual arrangements.

Disadvantages

- Shared ownership of project/program means shared risks.
- Success of joint ventures relies heavily on strategic and cultural alignment, and the trust and relationships between staff involved.
- Uneven or inequitable demands/contributions can lead to conflict.
- Collaboration limited to the scope of project.
- Competitive funding models may discourage JVs as NFPs feel the need to protect their intellectual property from potential competitors.

Available Frameworks

Justice Connect (AU) – Joint Ventures: Legal information for community organisations

Justice Connect's NFP Law Guide - JV specific
https://www.nfplaw.org.au/sites/default/files/media/Joint_Ventures_0_0.pdf

Justice Connect (AU) – Working With Other Organisations

Summary of legal issues to consider when working with other NFP organistations
https://www.nfplaw.org.au/sites/default/files/media/Working_with_other_organisations_2.pdf

Charles Sturt University (AU) – Joint Venture Evaluation & Development Guidelines

Series of important questions which every NFP can ask themselves before entering a JV.
https://policy.csu.edu.au/view.current.php?id=00157

Subsidiaries: A Factsheet for Boards

What is a Subsidiary?

Ownership/control of a smaller organisation (subsidiary) is transferred to a larger organisation (parent), while retaining its own separate activities and identity.

Advantages

- Cost savings through economies of scale and back-office consolidation.
- Maintain separate operational activities including service delivery.
- Unlike a merger (with associated re-branding), maintaining existing branding can avoid loss of brand recognition.
- Improved collaboration between service streams of parent and subsidiary thanks to a common mission.
- Potential to undertake revenue generating (i.e. for-profit) activities while protecting the parent organisation's tax-exempt status.
- Subsidiary structure protects parent company if subsidiary is struggling financially or has a higher risk profile.

Disadvantages

- High financial cost of consulting fees (legal and financial due diligence fees).
- Potential loss of existing funding arrangements and tax concessions.
- Time and energy required to negotiate, and conduct proper due diligence, ahead of subsidiary formation.
- Readiness of organisation and resilience in people for cultural changes
- Potential loss of governance to parent organisation's board.
- Retained 'separateness' of operations may result in economies of scale not being achieved.

Lessons Learned

- Underestimating the complexity of the acquisition change journey and the associated facilitation and communications required.
- Underestimating the cash and in-kind costs associated with investigating and progressing a subsidiary collaboration, and potential short-term impacts to revenue generation.
- Need for clear understanding of future operating and governance model.

Available Frameworks

Mills Oakley (AU) – Merger Legal Toolkit

Legal guide for NFP mergers covers Subsidiary as a merger sub-option.
http://www.millsoakley.com.au/docs/MergerToolkit.pdf

Limited reference frameworks available.

Key Considerations

- Generally suitable for smaller organisations joining a larger parent.
- Need to ensure subsidiary's objectives are in alignment with parent organisation's strategic plan.
- Careful transfer of management and strategy to parent organisation (if required).
- Consider how the subsidiary's management will report to parent organisation's Board (e.g. separate to, or included within, the CEO report).
- Be clear on the Board's position on financial and non-financial non-negotiables early in the process. For example, *what is the absolute minimum level of surplus you must be able to achieve post-acquisition in order to proceed?*
- Conduct due diligence early to enable accurate and timely decision making.
- Ensuring an effective stakeholder communications strategy is established and maintained to outline how the acquisition will advance the organisation's mission.

Mergers: A Factsheet for Boards

What is a Merger?

When two (or more) organisations unite to become fully integrated and operate as a single entity.

Advantages

- Cost savings through economies of scale and consolidation of indirect costs.
- Opportunity to build organisational capabilities to improve ability to meet (more of your) clients' diverse needs "in house".
- Improved collaboration between service streams within merged organisation thanks to a common organisational mission and staff.
- Extend your organisation's networking strength by providing access to larger pools of funding and build relationships with new funders.
- Opportunity to reshape the Board and increase experience and organisational knowledge through changes in membership.

Lessons Learned

- Underestimating the complexity of the merger change journey and associated facilitation and communications required.
- Underestimating the cash and in-kind costs associated with investigating and progressing a merger, and short-term impacts to revenue generation through the merger.
- Need for a clear understanding of future operating and governance model.

Key Considerations

- Understand early who your change champions will be, those that will lead and drive the change (conduct stakeholder analysis).
- Be clear on the Board's position on financial and non-financial non-negotiables early in the process. For example, *what is the absolute minimum level of surplus you must be able to achieve post-merger in order to proceed?*
- Do any of your Board members have experience in undertaking mergers? If not, what knowledge/skills will you need to access, and how can you do this?
- Conducting due diligence early helps enable accurate and timely decision making.
- Ensuring an effective stakeholder communications strategy is established and maintained (with the clients, funders and staff from both organisations) is critical to the success of a merger. Be clear about how the merger will advance the organisation's mission and service delivery.

Disadvantages

- High financial cost of associated consulting fees (legal and financial due diligence fees)
- Potential loss of existing funding arrangements and tax concessions
- Time and energy required to negotiate, and conduct proper due diligence, ahead of merger being progressed.
- Readiness of organisation and resilience in people for cultural changes
- Potential loss of existing brand and reputation
- Potential organisational restructure of the Board (reduced # of members) and operations and loss of organisational knowledge (through attrition of staff)

Available Frameworks

Our Community (AU) – Thinking Big: Mergers Guide

An introduction into NFP Mergers
https://www.ourcommunity.com.au/mergersguide

Justice Connect (AU) – Merging with other organisations: Legal information for community organisations

Provides clarity on legal concepts and fiduciary obligations
https://www.nfplaw.org.au/sites/default/files/media/Merging_with_other_organisations_0.pdf

Nous Group (AU) – NFP Mergers

A detailed step by step framework for undertaking NFP Mergers in Australia http://www.nfpmergers.com.au/

Prospectus & Eastside (UK) – The Good Merger Guide: For charities and other civil society organisations

Lessons learned from Mergers in the UK (NHS Trust mergers)
https://ep-uk.org/wp-content/uploads/2014/07/The-Good-Merger-Guide-2014.pdf

Conclusion

This resource has been designed to provide an overview of five forms of collaboration, advantages/disadvantages of each and lessons from organisations who have put these forms of collaboration into practice. It is clear that there are several common areas boards should be considering before venturing into any type of collaboration:

- **Legal implications**
- **Administrative costs**
- **Cultural compatibility**
- **Brand impact**

This resource is intended to be a starting point for boards considering collaboration. More information on each collaboration type is available through the 'Available Frameworks' links in each factsheet.

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About the ELGP

This resource was developed as a part of the Emerging Leaders in Governance Program (ELGP). ELGP develops young professionals for Board leadership in the aged care and community sector. The Program uses action and experiential learning methods aimed at developing people's leadership and governance skills for a Board position within the aged care and community sector. The program is delivered by Alicia Curtis with Dr Nicky Howe.

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Sonia works for Nous Group as a Public Policy Consultant and previously worked in Canberra in political lobbying and in the parliamentary office of the Federal Shadow Minister for Justice. Sonia sees aged care as the biggest policy challenge of her generation. She is passionate about intergenerational inequity and increasing dialogue between young Australians and older Australians.

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Antoine has seven years' experience in the upstream oil and gas industry, having worked on various projects and studies in the UK, West Africa and Australia. He holds a Master of Engineering degree (First Class Honours) from The University of Manchester and has recently completed his MBA at UWA. His goal is to serve the community with his business and leadership skills. Antoine's interest lies in helping youths from disadvantaged backgrounds reach their potential.

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Sarah Mummé is a policy wonk, a politics nerd, a people person, a squash player and a sewist. She holds an MBA, Graduate Certificate in Project Management, and BA/BCom (First Class Honours). Sarah works as a senior analyst at the WA Department of Treasury, and has also worked in policy and advocacy roles for the WA Council of Social Service (WACOSS) and the Uniting Church in Australia. Sarah is driven by a passion for social justice, and has a history of involvement in community organising for local and national committees and movements.

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Tomy is a Management Consultant at EY specialising in Healthcare Advisory. He recently completed his MBA at UWA having won the Charles Harper Prize and the BHP Billiton Accelerated MBA Scholarship. Tomy has a strong history of volunteering and demonstrated experience in joining a local community to drive change and provide a positive impact. Tomy is a passionate and aspiring leader with ambitions to make a positive impact to the community. He is passionate about health care, mental health, aged care and youth advocacy.