Do mergers in the voluntary sector provide financial stability for the newly formed organisation?

Findings and Recommendations from Research

Introduction

The research question was "do mergers in the voluntary sector provide financial stability for the newly formed organisation?" In considering the answer it would appear that a number of factors have to be taken into account to give a merger in the sector the best possible chance of achieving post merger stability.

Research was undertaken on one particular advice organisation. Then an opportunity to interview another organisation in the third sector, but in a different field, enabled the researcher to compare and contrast the mergers both had undertaken. The research was carried out using a distributed survey and interviews.

1. Definition of a Merger

The Concise Oxford English Dictionary[1] definition of merger, "the combining of two commercial companies etc into one"; was considered to be an apt one for commercial companies but not for the voluntary sector, by respondents. The changes requested by respondents to the survey were to remove commercial and companies and then 80% felt it would be acceptable for the sector. However, it is worth noting that there were a number of respondents who commentated on the combining part of the definition. It was considered that many mergers are in fact takeovers by a dominant partner, in the voluntary sector as in the commercial sector. This would lead one to consider a definition of voluntary sector mergers to be "the combining or absorption of two organisations etc into one."

2. Financial Stability

From the primary research a number of issues were flagged up that could affect the financial stability after a merger. Financial instability can affect an organisation in the voluntary sector at any time through a number of issues both of an organisation's own making through lack of financial management to external factors such as the state of the economy. One of the respondents to the questionnaire considered that financial stability also required low inflation and low interest rates amongst other things. Currently the British economy is seeing a change in both inflation and interest rates but with the added pressure of the credit crunch which could be a cause for concern for the voluntary sector.

With a merger there appears to be an additional pressure to have financial stability, especially soon after the completion of the merger. Some mergers it would appear from the replies received regarding this research are sometimes for gaining or increasing financial stability. If the merger is judged to be a success it is measured in these terms if that was the goal at the start of the process. As Literature suggests the success or failure of mergers is often considered based on the reasons for entering into the merger.

[1] 1995 *The Concise Oxford English Dictionary*, Oxford University Press

The majority of the advice organisation interviewees felt that the merger did not bring financial security. A number of interviewees felt that by merging with another advice organisation that there should have been opportunities for increased and varied funding for the main advice centre because of the merger. This did appear to be the case, affecting the financial position.

Conversely the merger between the organisations from a different sector was felt, by the interviewee from the new organisation, to be a success and financial stability was a priority and that there was stability. This was felt had been achieved by having a stable financial base before the merger and the interviewee talked of a “comfort blanket”.

3. Definition of Financial Stability

Whilst all respondents agreed that financial stability is important after a merger over half of respondents did not agree with Deardoff’s[2] definition of financial stability as “the avoidance of financial crisis”. The view that came out of the research was that this was too negative a definition. However, many talked about achieving financial stability and having forward planning in a stable financial environment for not just present beneficiaries but future beneficiaries too. In the current downturn in the economic climate the researcher questions whether the responses would not be commenting on the negativity of the definition today.

The definition that was considered by the researcher to be most apt comes from a respondent who felt that the definition should read, “the ability to successfully ride financial crises over a period of time while continuing to fulfil the charitable objectives.” This perhaps is realistic especially for smaller charities or those with decreasing reserves as was the case of the advice organsiation in this research.

4. Recommendations for aiming for Financial Stability after a merger

The research highlighted that pre merger factors may be the influence on post merger financial stability.The recommendation is to consider pre merger the following factors to give the best opportunity for post merger success:

a. Reserves – Important for both organisations to have a comfort blanket to cover the initial period post merger is important. If this is not possible due to the financial situation of one of the partners this may require a consideration of borrowing in the short term.

[2] Deardorff, A. 2001, *Deardorff’s Glossary of International Economics*

b. Financial modelling - It would be beneficial to produce financial models of how the finances will look post merger. Again this may highlight any requirement for short term borrowing and also highlight any issues which may mean the merger should not proceed.

c. Consolidation before expansion – it would appear that time is needed for the new organisation to settle before the business is expanded.

d. To measure if have achieved financial stability after the merger it would appear that a benchmark for the sector could be growth in operations as in the non advice organsdiation’s case or stable accounting results. Unfortunately in the advice organsiation’s case the results deteriorated after the merger and showed signs of not being financially stable.

e. Diversify – Look to diversify income streams or asset bases to ensure less reliance on a single funder.

5. Non Financial Factors

Reflecting on the factors that can influence the success or otherwise of the merger it would appear issues that are not purely financial affect the financial stability of a newly formed organisation. In the advice organisation’s case the lack of experience of contract work and the contract compliance required to gain the maximum contract payments has put the finances of the new organisation in jeopardy.

One interviewee discussed the main advice organisation’s arrogance during the merger and another the working practices imposed on staff who were working on the contracts. The interviewee went on to state that “the contract defined how required to work and the advice organsiation ignored this. The contract was target driven and the organisation did not understand how to work to targets.” The targets had to be achieved to receive payments from the Community Legal Services and for the advice centre not be subject to repaying money paid in advance.

Another interviewee discussed the different ethos and that still has a legacy. This can have an adverse effect on morale, which again when target driven work is involved, can affect the finances of organisation with targets not being reached. If people are not all striving to achieve the same end conflict then resistance can halt or slow change, to put right this issue. As one interviewee considered that with change you “need to carry people while regrouping and then move forward and expand. “

The management structure of the original advice organisation remained largely intact after the merger. There was an assumption that this would continue. One interviewee posed the question “did the management have the right skills to run a larger organisation? The assumption was they did. The number one job goes to the bigger company." The interviewee felt that the organsiation did not have the right systems in place or the right people to manage the contracts. The unchanged management structure was not necessarily the correct one for the newly formed organisation and thus had an impact on financial stability. For example, no financial information was submitted to the Board on the full cost of the projects until the researcher joined the organisation in 2006. The management team did not include a Finance Manager at the time of the merger.

The two organisations concerned in the other merger complimented each other and were in the same area; but approached research from different angles. Keeping the combination of work; both in house research funding and grant funding of research has enabled growth in grant funding and a broader research portfolio for the organisation as a whole.

However, in the new organisation the interviewee talked of ripples still today after the merger. Ethos and dynamics are an issue to a lesser or greater extent in any merger. This may be more appropriate to consider further in another research project.

Due diligence was a factor in the mergers. In the advice organsiation's case the comments from interviewees indicated that they felt that the process had dragged and that although due diligence had been carried out that more was required than a paper exercise. In addition, more than one interviewee commented that "did not ask the right questions" during the process.

The reflection from the other organisation was to speed up the process of merging as this can be a factor in the success or failure of the merger.

With a variety of interested parties it is imperative that the voluntary sector encourages a management and governance style which ensures that all stakeholders are taken account of in setting the organisation goals and objectives. One of which must surely be financial stability. However, a question must arise that especially in the increasing contract culture whether a review of terms and conditions including performance pay would not ensure meeting contract targets and retaining staff. This must be built into financial modelling to monitor financial stability.

6. Recommendations for aiming for Financial Stability after a merger considering non Financial factors

The research highlighted that pre merger factors may be the influence on post merger financial stability.The recommendation is to consider pre merger the following factors to give the best opportunity for post merger success:

a. Due diligence process – this needs to be more than a paper exercise. There needs to be a more in depth view of each other's organisations and the work each undertakes. Members from each organisation spending time in the other's workplace to observe and discuss ideas and issues would be felt to be beneficial.

b. There should be a strong lead from a legal or finance professional during the merger process. In the other organisation the legal director took charge of the process and took responsibility for the process.

c. The management structure of the new organisation should be reviewed – while the researcher understands this may be difficult while going through the merger process it is important that the management structures are strengthened and in place at the end of the process, to operate an enlarged organisation.

d. Trustees – a skills audit should be undertaken on existing trustees to ensure that the new governing body has the range of experience required to govern the new organisation.

e. Contract/target driven work – Understand what is involved in any work the merging organisations do. Read the small print and talk to operatives and managers about the things that must be done to achieve targets or receive payments for the contracts. This is more than due diligence where the contracts are listed and funders asked if they are happy with the merger. Perhaps if one organisation has no experience of the work then a contract manager should be included in the management structure and given authority in the new organisation to ensure terms are followed.

f. Ethos/dynamics – This is always a factor and needs further research as how differing dynamics impacts on newly formed organisations but should be aware that the speed of the merger process may be a factor in lessening the impact of this area.

g. Consider the beneficiaries – In all this process the beneficiaries must not be affected and perhaps the most important success factor is a greater improved service for the current beneficiaries and future beneficiaries. This will require not only financial sustainability in both short and long term but a thorough review of what the new organisation can provide. This should include consultation with beneficiaries.

h. Consider the terms and condition of staff – are they appropriate for the area and will they be suitable both to retain and bring in quality staff. Consider performance pay for contract staff.

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