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Foreword

Merger is currently a hot topic in the voluntary sector. Concern over the number of organisations operating in similar areas and duplicating services has seen a drive for charities to merge their operations where appropriate. The successful high profile merger of Cancer Research Campaign and Imperial Cancer Research Fund into Cancer Research UK has also shown what can be achieved. The government's response to the Strategy Unit report, *Charities and Not-for-Profits: A Modern Legal Framework*, recommended that the Charity Commission should provide specific advice to facilitate mergers, possibly by creating a dedicated internal unit, and that a package of legal measures should be introduced to facilitate mergers and, more generally, the administrative running of the charity.

Of course its not all about formal merger, but collaborative working as well, through partnerships, shared services and buying groups. Such collaboration is driven by the need for charities to achieve greater efficiency as well as being able to provide better services to beneficiaries and share knowledge.

Mergers and collaborations are not to be undertaken lightly. As well as numerous legal and financial aspects, there are considerations around culture and the effect on staff and trustees. Planning and professional advice is essential. This is why the original research presented on the following pages is invaluable. It demonstrates the growth in recognition of shared working in the sector as a viable and realistic way forward, and identifies the key drivers and barriers to formal merger, and the effectiveness of collaboration. We are pleased to present the findings obtained by collaboration between PricewaterhouseCoopers and Nabarro Nathanson and hope the results will inform the sector's thinking on this important issue.

Ian Allsop
Editor
Charity Finance

Executive summary

Mergers and collaborations - what do charities think?

Are mergers between charities actually happening, or being actively considered?
Are charities actually obtaining the benefits of working in collaboration with other organisations?

In general, the answer to both these questions is a positive and resounding yes.

- 25 per cent of respondents have considered a merger in the past five years.
- Out of that 25 per cent, as many as 66 per cent have either actually merged or believe that their discussions will lead to merger.
- 67 per cent of respondents have been involved in at least one collaborative working project.

These results will be encouraging to the Strategy Unit, which considered mergers within its remit. Its proposals will be included in the draft Charities Bill.

What about those who have merged? Have the mergers been successful? What are the benefits?

Again, a very positive response:

- As many as two thirds of respondents reported that the mergers they have completed have satisfied their goals and objectives.
- A further 29 per cent responded that the merger has satisfied some of their goals and objectives.

The main benefits achieved are:

- better services to beneficiaries;
- economies of scale;
- reduction of confusion and duplication; and
- knowledge sharing.

Are collaborations perceived to be effective?

Only 4 per cent of respondents saw no benefits at all in collaborations. The main perceived benefits are:

- better services to beneficiaries;
- financial savings;
- knowledge sharing; and
- access to expertise.

We noted that 80 per cent of all respondents considered that there would be financial benefits from membership of a buying group while only 13 per cent participated in one.

On mergers, what are the specific areas where charities obtain advice and are the key areas of risk covered by that advice?

A key response was that, while charities tend to obtain advice in the fairly obvious (and certainly important) areas such as financial and legal due diligence prior to mergers, relatively few organisations seek advice in areas such as change management. This is particularly concerning given that the survey shows that culture clashes and staff dissatisfaction have been the main problem areas for charities which have merged, suggesting that more advice and emphasis could usefully be put on the people agenda rather than on purely financial and legal issues.

Where do charities obtain advice on mergers and collaborations?

We were surprised that only two-thirds of respondents took advice from the Charity Commission on proposed mergers since we believe that in every case an early check with the Charity Commission, if only a check to ensure that they see no difficulties in the proposals is essential. The Charity Commission will have been heartened to see the high level of support - as much as 89 per cent of respondents - for the Strategy Unit's proposals that it should provide specific advice aimed at facilitating mergers. It comments on this on page 15.

On collaborations, approximately 40 per cent of our respondents seem to have taken external advice, whether from lawyers, accountants or the Charity Commission. Of those involved in partnerships only one in three had a legally binding document. To mitigate the risk of these arrangements, we believe that it is vital to document the roles and responsibilities of each party and would be concerned if this is not happening.

Do charities recognise that the public is concerned about the risk of confusion between charities working in the same field? If so, how should this be addressed?

As many as 90 per cent of respondents thought that the public are confused, or may be confused, by the large number of charities currently working in the same sector. There is very strong support for the view that the promoters of proposed new charities should be encouraged, where possible, to work with an existing charity in the same field.

We believe that the responses showing a high level of interest in mergers, coupled with an even higher level of participation in collaborative working arrangements demonstrates that charities are responding to the public's concern by ensuring that resources are not duplicated. We believe that this trend is bound to continue.

What are the key messages for trustees?

• Be alive to the potential benefits of mergers and collaborative working as ways to enhance further the effectiveness and efficiency of your charity.
• If you are considering a merger, take advice from the Charity Commission at an early stage.
• On mergers, don't ignore the need to take advice on legal and financial aspects, but do also focus on the 'softer', people issues, which is where most of the real difficulties occur.
• In the area of collaborative working, address the associated risks or concerns to ensure that the full benefits are realised.

What was the research sample?

The survey was sent to a wide-range of UK charities and 224 responses were received.

Mergers

A popular theme

The survey supports the general view that charities are interested in and support the idea of mergers, and that many have already given active consideration to it.

The survey also revealed that up to a quarter of charities have considered a merger in the last five years. Of these charities 38 per cent merged, 26 per cent believe that their discussions are likely to lead to a merger with the remaining 36 per cent deciding not to merge. This confirms the trend we have noticed, demonstrating a high degree of interest in mergers within the sector, and a high success rate from those interested organisations.

It is interesting to break down these figures by size of contributors to the survey. 46 per cent of the largest charities, with a balance sheet total in excess of £100 million, have considered a merger, with the next most active category being charities with a balance sheet total of between £1m and £5m, where 34 per cent have considered merging. These figures are significantly in excess of the overall average of 25 per cent. In the case of the larger charities, this suggests an acquisitive nature, and, in the case of the smaller category, points towards a wish to expand and secure the benefits of being part of a larger organisation.

Based on the survey results the highest success rates for mergers falls among the small charities (those with funds on the balance sheet of between £100,001 and £1 million) with 60 per cent succeeding in their merger, against the average of 38 per cent. We wonder whether this reflects a lower degree of concern over issues which more typically characterise larger charity mergers, such as branding and loss of independence.

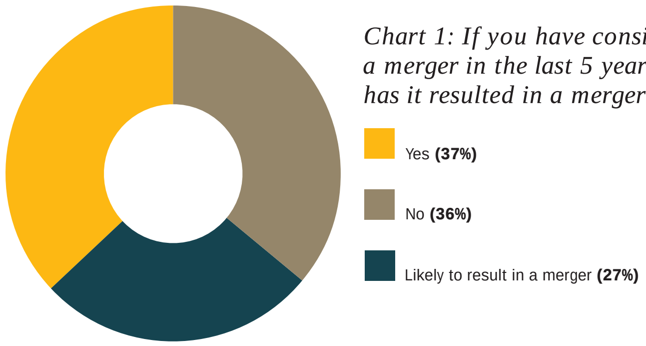


Chart 1: If you have considered a merger in the last 5 years, has it resulted in a merger?

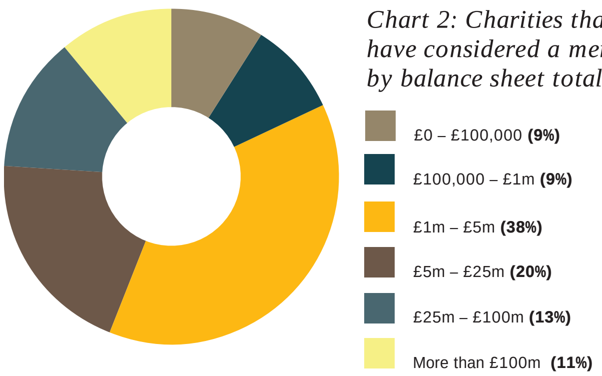


Chart 2: Charities that have considered a merger, by balance sheet totals

What of the 36 per cent that decided not to merge? The most common reasons given by them were internal politics, an inability to agree terms and reluctance from the other charity. The least cited reasons included loss of independence, differences in governance and membership disapproval.

It is interesting to note that loss of independence was not more frequently cited as a barrier. As we will see later on, this is often perceived to be a real barrier to merger. The fact that in the survey this reason was not considered significant would tend to indicate a sense of realism on the part of charities, in that they fully understand right from the outset that any merger will inevitably lead to some loss of independence.

Key drivers to merger

While much has been said of the benefits of charity mergers, we were interested in exploring the reasons behind them, and to identify whether practical experience bears out the theory.

Among charities that have merged, the survey showed that the main benefits were:

- improvement of services to beneficiaries;
- economies of scale;
- reduction of confusion and duplication for supporters; and
- knowledge sharing.

Similar potential benefits were identified by all respondents to the survey, including all those who have not actually been through a merger. However, 5 per cent of all respondents did not see any benefits at all in a merger.

Sometimes, of course, mergers are carried out for defensive reasons caused by financial frailty and/or changes in society. We had wondered whether financial pressures would be one of the most important reasons given. However, only 12 per cent of our respondents indicated that changes to the levels of their income, expenditure and reserves in the last 5 years would make them more likely to consider a merger.

Breaking down the results by size of charity, it is interesting to note that financial pressures made 22 per cent of charities whose balance sheets total between £1 million and £5 million more likely to consider a merger. It is possible that these medium-sized charities lack the critical mass necessary to ensure sustainability and that they are accordingly looking to secure the financial benefits of a larger charity. One thinks, for instance, of the area of smaller, independent schools as being one where significant rationalisation occurred in recent years.

Two thirds of respondents reported that the mergers they have completed

Case study - Cancer Research UK

Some two years after the successful and high-profile merger of the Cancer Research Campaign and Imperial Cancer Research Fund, involving the creation of the new charity Cancer Research UK, how is that merger perceived?

The merger has been very successful. The major benefits are the financial effects (both in terms of the significant rise in public donations and cost efficiencies from streamlined systems), synergies on the scientific and research side, an enhancement of its advocacy role as the major voice within its field and increased brand recognition.

As with most mergers, the two former organisations had different cultures and infrastructures. The planning for the merger placed great emphasis on the integration both of trustees and staff in order to reduce the risk of potential problems arising from a ‘culture clash’. The new board contained eight representatives from each of the old charities together with four new trustees. It was important to retain the expertise of the former trustees while introducing new members who could help bring the experience of both groups together. The charity emphasised the need for planning to be made throughout the organisation, from trustee level to senior management to volunteers. One area where Cancer Research UK has been very pleased is with its retention of volunteers post-merger.

In general, Cancer Research UK is satisfied that the merger has achieved its immediate goals and objectives but stressed that charities should not under-estimate how long it takes for all the benefits to emerge from such a process.

The charity stressed that what you need in such a process is to have people who are truly committed to it to help drive through change without, critically, any loss of momentum on the vital day-to-day work of the merging organisations. Mergers have the potential to create uncertainty, doubt and disruption to staff. That process needs to be very carefully managed and the flow of information maintained to staff in order to try to set at rest all those fears and uncertainties.

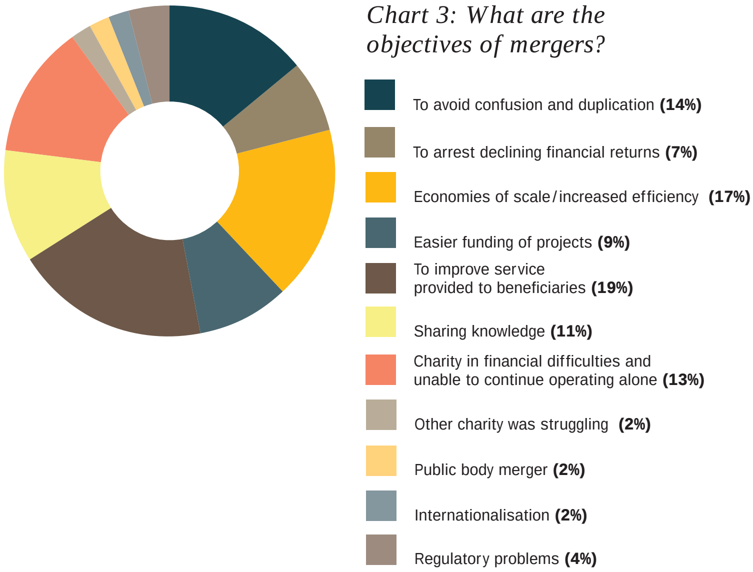
have satisfied their goals and objectives and a further 29 per cent responded that the merger has satisfied some of their goals and objectives. Only 5 per cent of respondents reported that their goals and objectives for merger have not been met, although that in itself is concerning.

There is a widely-publicised view that there are far too many, similar, charities competing amongst themselves. As a result, existing charities should be encouraged to merge and the promoters of proposed new charities should instead be encouraged to work with existing charities. Has this survey confirmed that view?

Broadly, there is very strong support for the view that the promoters of new charities should be encouraged instead to work with an existing charity in the same field. Three quarters of all respondents supported this view, largely on the grounds of minimising the duplication of effort, preventing confusion or lowering costs.

As many as 90 per cent of respondents thought that the public are confused, or may be confused, by the large number of charities currently working in the same sector. Not surprisingly, the greatest area for confusion was reported to be in the field of cancer research. However, we believe that responses on this matter should be treated with caution since it is one thing to encourage a reduction in the number of charities working in the same field, and quite another thing to be able to show that such a reduction would in practice actually achieve a better overall impact.

Chart 3: What are the objectives of mergers?



Key barriers to merger

Any organisational change can present significant practical problems. A merger is one of the most challenging of changes. We were interested to see the difference between perceived barriers and actual ones in practice.

Out of those charities that have merged, the most common barrier was considered to be culture clash, experienced in the case of 52 per cent of respondents. Interestingly, this problem is not anticipated by charities that have not merged, where only 12 per cent considered this to be the greatest barrier. It is surprising that there is such a mismatch between perception and reality in this case, and the figures do beg the question as to whether charities could and should have taken steps earlier in the merger process to deal with this concern. As one of our respondents, Martin Green, chief executive of Counsel and Care for the Elderly said: 'The effort needs to go into selecting a proposed partner, fusing issues, cultures and personnel. All the advice tends to focus on legal and structural issues – these are the relatively easy bits.' We beg to differ on the last sentence, but the point is well taken.

Linked to this, from those charities that have merged 33 per cent noted staff dissatisfaction as a problem. This was also recognised to be a problem among those which have not merged or are thinking of merger where 52 per cent cited this as an issue.

Another interesting statistic is the concern about loss of identity. Among charities which have not (or not yet) merged, this was considered to be the greatest barrier to merger by 70 per cent of respondents. However, among charities which have actually merged, it was not viewed as being such an important matter, with only 29 per cent citing this as being a barrier.

There is significant evidence in our survey that perception does not always accord with reality. Charities that may have previously rejected the idea of merger because of the loss of identity should take heart that, in practice, this has not proved to be such an issue. The example of the Cancer Research UK merger, and the successful re-branding exercise which took place upon merger, should give encouragement to those concerned about this issue.

What are the processes which mergers involve and who advises charities?

The survey showed an overall willingness by charities to seek advice, whether from lawyers, accountants or the Charity Commission. However, it also suggested that charities could make more use of other advisers to ensure not only a successful merger legally and financially, but also structurally.

Chart 4: Has the merger satisfied your goals and objectives?

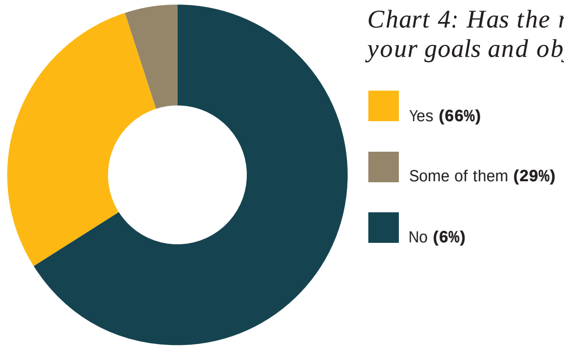
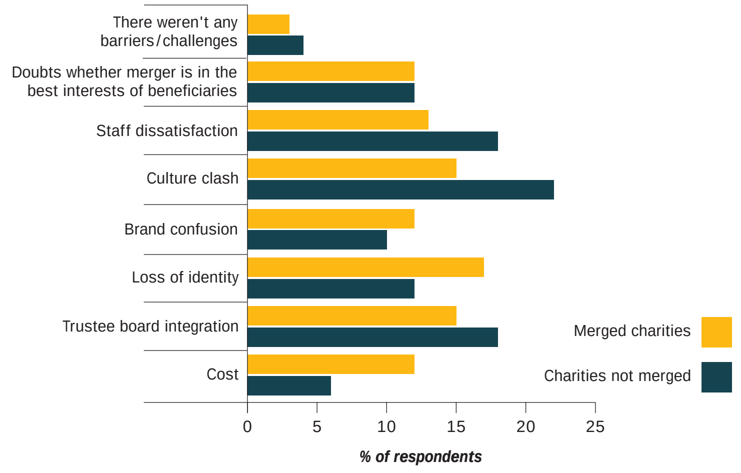


Chart 5: Key barriers to merging



Merged structures

We would have expected the process for the majority of charity mergers to have involved one organisation, probably the smaller one, transferring all its assets and undertaking into another, larger organisation. Indeed, the results showed that 76 per cent of those charities responding had merged with smaller charities. However, given that response, it is a little surprising that in 33 per cent of the reported mergers, the process involved the creation of a new charity to take the place of the two merging charities – clearly a more expensive route than that of simply one charity merging into another, with employment and property transfers applying to two charities rather than just one. However, there are clear advantages involved in creating a new charity for the merged organisation such as improved perception of what the charity is to do, loss of historical baggage, and a fresh start.

Perhaps starting with a brand new charity could also provide the opportunity on merger to adopt a more modern constitution. However, in that connection, we found it intriguing to see that 41 per cent of the reporting charities are still not established as limited liability companies which, to us, confirms the significant potential for use of the new Charitable Incorporated Organisation legal structure which is to be proposed in the forthcoming Charities Bill. There has clearly already been a significant move towards use of corporate structures, with 14 per cent of respondents having incorporated within the last three years – a trend borne out by our own working experience.

Taking advice

Advice on mergers is clearly mainly taken from lawyers (76 per cent) and accountants (62 per cent). In fact, we find it surprising that as many as 19 per cent of respondents, in each case, did not take advice on their mergers from their lawyers or from their accountants – perhaps these were the smaller charities being subsumed by larger organisations. Statistics are always capable of being interpreted in different ways – should one be encouraged by the fact that 67 per cent of respondents took advice from the Charity Commission or dismayed

Hints and tips: change management

A decision to merge has the potential to impact on every area of an organisation – systems, processes and most importantly, people. The results of the survey, as shown in chart 5, indicated that change management issues such as culture clash, staff dissatisfaction and trustee board integration were the key barriers for those that merged.

It is interesting to compare this to the commercial sector. A global survey of over 500 organisations was run in conjunction with MORI during the late 1990s. It discovered that nine out of the ten top barriers to change are people related. For example, limited change management skills, poor communications and employee opposition were all cited, so we can see that charities are right to focus on this area.

Business change is complex because of the interdependencies between the business environment, the organisation, its people and supporting technologies; any change in one aspect will affect one or more of the others. Experience of major change programmes shows that organisations must address the whole business change in an integrated way, not just focusing attention on the 'hard' components such as IT and process change. For example, the 'softer' aspects of business change, such as changing behaviours, gaining buy-in of the staff and providing training at the right time, are critical success factors for maximising the business benefit of any project and yet are rarely viewed as top priority by organisations, which prefer to focus on the more tangible 'harder' (and therefore easier) components.

There are key processes that organisations should adopt to facilitate change:

- a plan/vision for the change needs to be developed;
- stakeholders need to be engaged to build commitment for the change;
- review the existing organisational structures and bear these in mind when designing the structure and culture going forward;
- align existing practices and ensure staff are trained and communicated to effectively.

Although our survey revealed that only 15 per cent of charities that have merged took advice on change management, a closer look at the results shows that for those charities with over 500 staff this percentage was up to 67 per cent.

that only two-thirds of respondents took such advice?

Most advice was therefore obtained on financial (50 per cent) and legal (80 per cent) due diligence prior to merger. There were relatively low levels of advice obtained on areas such as change management (15 per cent). As discussed above, this is concerning given the importance to the success of mergers of the blending together of people at all levels, both trustees and employees. The role to be taken by the Charity Commission in respect of charity mergers is clearly an important one and is dealt with by the commission in its comments (see page 15).

We were interested to explore the average costs of merger. The pure financial expense of mergers (excluding management time) seem reasonable for such important, one-off events. Our survey showed that the reported costs fell within the £0-£25,000 (62 per cent) or the £25,000-£50,000 (24 per cent) brackets. Only one respondent reported costs exceeding £250,000. n

Hints and tips: due diligence

The results of our survey indicated that, of charities entering into mergers and acquisitions, 62 per cent took advice from accountants, and all of that advice was for financial due diligence. However, for more informal collaboration agreements, only 24 per cent sought advice from accountants. In many ways this is to be expected as the perceived risk being taken on is usually smaller, although it may be that the charity is considered to have a sufficient degree of financial knowledge internally to perform the financial risk assessment.

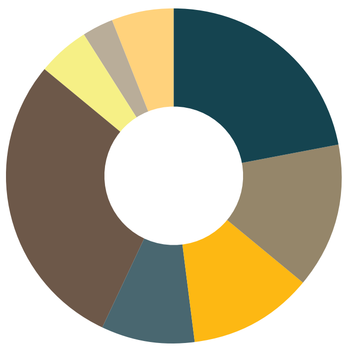
We strongly recommend that a charity should still perform a due diligence exercise, including a financial risk assessment, for each new venture that it enters into, whether this is for a complete merger with another charity, the acquisition of another entity or a collaborative working arrangement. The amount of resources invested in this assessment, and whether this is done internally or externally, will depend to a large extent on the charity's perception of the risk presented by the proposals.

Most charities will be aware of the need to consider the financial position of the charity with which they are proposing to merge. Some of the general questions to be asked include:

- Are the financial assets and liabilities of the other entity fairly stated? It is important to remember that the merger may see a charity receiving not only the assets but also the liabilities (some of which can be hidden)
- Are there potential pension scheme liabilities arising from an existing defined benefit scheme?
- Has the entity any outstanding litigation?
- Has the entity entered into any, onerous or otherwise, commitments, which it could be legally or morally obliged to stand by?
- Has the entity a good history with the Inland Revenue and, if relevant, Customs and Excise? When was the entity last inspected by these bodies?
- Is any of the charity's income considered to be potentially repayable (this can be particularly relevant where charities have received grant funding)?
- Have all restrictions on funds been identified?
- What is the assessment of the financial future of the entity? For example, what is the charity's business plan for future years, including future forecasts from both a surplus and cash flow position, and is the charity currently operating at a deficit?

This list is certainly not exhaustive but gives a flavour of some of the issues that should be raised when considering merger.

Collaborations



Collaborative working

Two-thirds of charities that replied to the survey are involved in at least one collaborative working project*. These projects took a wide variety of different forms, including shared advocacy, outsourcing and co-productions. However the three most popular types, representing 82 per cent of all the projects, were partnerships, shared services and buying groups. The next sections of this report look at each in more detail. The following paragraphs consider some of the more general issues applying to all types of collaborative working.

A wider variety of benefits have been derived from these projects, including knowledge sharing, access to expertise and sharing risk. The respondents consider that the main benefit of, and driver for, collaborative working is providing better services to their beneficiaries, with the financial benefits coming a close second.

All organisations involved in a collaborative project felt that they were deriving some benefit from it. Many commented that it gave them the opportunity to work closely with another organisation without committing themselves to a merger. This gives them better flexibility and avoids some of the perceived concerns associated with mergers, for instance, loss of identity and independence.

By considering the risks and concerns of collaborative projects up front, charities are able to minimise their impact by ensuring that these areas are addressed in initial agreements. From our respondents' replies, the main perceived concerns were the quality standards of the partner and a loss of control over parts of the charity's activities. Concerns were also expressed about loss of flexibility and uncertainty regarding the governance arrangements of the other organisations.

Only 4 per cent of the whole sample did not perceive any benefits from collaborative working. Overall our respondents felt there are more benefits than disadvantages from collaborative working.

*We have used a broader definition of collaborative working than that used by the Charity Commission in their recent publication *Mergers and Collaborative Working*, as we have included not just working with other charities but also public sector bodies and private sector organisations.

Hints and tips: risk assessment

Even when entering into collaborative working arrangements, which are obviously less all-encompassing than a merger, there are risks which need to be considered. These include:

- How are the costs of the venture to be shared? Has this been agreed in writing?
- Are there potential reputational risks to the charity if the venture fails? How can these be managed?
- Have checks been undertaken on the partner?
- What are the experiences of other charities working with that partner?
- How long has the partner company been established?
- Has the true identity of the partner been verified? Group arrangements may hide the true identity of a partner.

Partnerships

46 per cent of all respondents are involved in a partnership with another organisation. Our survey showed that the majority of partnerships are with another charity, however 39 per cent of the partnerships identified were with government bodies or a private sector company. In this case, it is the larger charities that were more likely to be working in partnership with a non-charitable body.

The partnerships established are generally of an informal nature with only one in three having a legally binding written contract. Due to the seemingly more straightforward nature of partnerships compared to mergers, the need to consult external advisers was considered to be lower; 29 per cent consulted solicitors, 25 per cent consulted accountants and 11 per cent consulted the Charity Commission prior to embarking on the partnership.

As noted by the Charity Commission, it is not the expectation that there will be a formal agreement in place for all collaborative working. Yet it is important to ensure that appropriate arrangements are made for each particular project. It is important to identify at the outset of any collaborative working relationship the respective obligations of both parties, and to scope these fully to minimise the risk of problems later on. It is also important to bear in mind what should happen upon termination; what if there are jointly developed assets remaining after the partnership – for example,

Case study – WaterAid

WaterAid has numerous collaborations and alliances with other not-for-profit organisations around the world. Some are formal in structure and some less formal, depending on the nature of the alliance. What is common to all the alliances is that they are based on a high level of trust and mutual understanding together with a common set of values and principles. Below are two examples of these projects.
WaterAid share a joint programme office in Mali with Protos, a Belgium NGO. This has three principle advantages:

- Firstly WaterAid has found this to be a cost-effective mechanism for the development of a new programme;
- Secondly, it acknowledges and builds on the complementary skills of the two organisations; namely Protos' experience in integrated water resource management and WaterAid's experience in sanitation and hygiene promotion; and
- Thirdly, it allows the two organisations to submit joint funding proposals to donors, thus sharing the administrative burden of preparing the documentation and using the complementary skills of the two organisations to best effect.

Due to the nature of this alliance, there is a clear and formal agreement in place. An example of a less formal alliance is WaterAid's collaboration with the International Trachoma Institute (ITI), whose mission is the elimination of blinding trachoma, the largest cause of preventable blindness in the world. WaterAid's input to the alliance is related to the face washing programme to reduce disease transmission and the environmental changes required to increase access to clean water and improved sanitation to eliminate the disease altogether. A formal agreement was not deemed necessary in this instance because of the absence of any legal obligation on either party.

Hints and tips: project management

While introducing shared services is seen as a great way to save costs, without careful planning and a thorough specification of the business case for shared services, organisations may fail to achieve the expected benefits and can on occasions suffer a reduced level of service. Time needs to be taken to think through what the project is trying to achieve and what the charity expects the benefits to be. Secondly, the scope of what is to be included in the shared service and what is to be done outside the shared service needs to be clearly defined.

Managing the implementation of a shared service can be difficult but it is a project like any other project. Many charities have good experience of managing projects, while others will need more support during this project stage. However, the initial saving should not be the full benefit, but many organisations fail to manage the shared service centre effectively and the year one savings quickly disappear. As a result organisations can find themselves managing a more costly and less efficient and effective service.

Yet for those charities that can plan, implement and monitor their shared services effectively, the benefits are there for the taking.

trademarks – who should own these following termination? Much heartache can be avoided by attempting to negotiate these matters at the outset. Based on the survey, 15 per cent of charity partnerships are with private sector companies. It is therefore important to have considered the corporation tax and VAT aspects of the arrangement.

Shared services

35 per cent of respondents working collaboratively were involved in sharing services. The most popular areas were management and administration, payroll services and IT provision. Other areas include property management, treasury services and catering.

Cost reduction is often seen as the key benefit for sharing services, but there are also benefits from a risk management point of view. These arrangements enable charities to access expertise which they currently may not have in-house, eg IT processing and security services. Again it is important for charities to ensure that the arrangements made will deliver the expected benefits.

Shared services projects are enabling charities to further their activities, whether through increased efficiency, (therefore releasing charitable resources for more direct activity) or by enabling new areas of work to be established on a more timely and efficient basis than would otherwise be possible.

Chart 7: Types of services shared

- IT **(15%)**
- Payroll **(16%)**
- Management and administration **(23%)**
- Joint marketing **(11%)**
- Finance **(9%)**
- Property maintenance/mgt **(5%)**
- Purchasing services **(1%)**
- Premises **(8%)**
- Caseworking **(3%)**
- Other **(9%)**

Hints and tips: direct tax

Many charities work in collaboration with commercial organisations with the dual purpose of increasing profile and generating profit. Such ventures are usually constructed around a comprehensive working practice agreement. From time to time the charity and commercial partner will form a jointly owned company and distribute profit by way of dividend or management charge.

Since 2002 there has been an alternative structure to the conventional company limited by share, the limited liability partnership (LLP). The main advantage of the LLP is that it is transparent for tax purposes. Profits are taxed according to the tax status of the members. However, special care is still required if the new business is not a charitable activity. In such cases, the charity will be best advised to revert to a company limited by shares to protect the charitable assets from tax.

Hints and tips: VAT

From a VAT point of view, it is important to establish what supplies are being made between a charity and the commercial organisation that it is working in collaboration with and then applying the correct VAT treatment. Although they may be working in collaboration, in many cases one entity will be acting as the principal in delivering the main supply. It is important that this entity is identified because there could be a difference in the VAT treatment of the main supply depending on the entity that is the principal. In addition, certain VAT reliefs only apply to charities and therefore, VAT should be considered at an early stage in any proposed collaborative project.

Case study – Henry Smith Charity

The Henry Smith Charity is one of the largest grant making charities in the UK, distributing in excess of £21 million each year to numerous charitable purposes. Mindful of its desire to maximise efficiency in its operational and administrative function the charity successfully tendered to take over the administration of the Trusthouse Charitable Foundation. This has seen its staff provide shared services to both charities, therefore maximising economies of scale. The trustees think this arrangement will be good for both charities, both financially and in the development of their staff and other resources.

They are enabling charities to work together in a more flexible way than a merger would allow. 43 per cent of respondents saw this as a benefit of collaborative projects.

Buying groups

Although 80 per cent of all respondents considered that there would be financial benefits from membership of a buying group, only 13 per cent participated in one. Interestingly, since the benefit of a buying group is considered to be achieving better value for money through buying services or products on a larger scale, it is surprising that it is generally the larger charities that are involved in buying groups. From our survey 38 per cent of charities with income over £25 million participate in a buying group, compared to only 14 per cent for charities with income of between £1 million and £5 million.

Charities have obtained significant discounts from purchasing a wide variety of products and services through a buying group. The purchases range from utilities, stationery and telecommunications to insurance, beds, food and vehicles. From our survey, the most popular areas were utilities and insurance.

From other results in the survey it was clear that the decision to participate in a buying group was linked to whether it could help the charity achieve its objectives. It may be that additional resources could be made available through participation in a buying group. n

Case study – Charities Buying Group established by Leonard Cheshire

Leonard Cheshire has created the Charities Buying Group (CBG), the first of its kind led by a charity. It enables all charities and not-for-profit organisations, irrespective of size, to benefit from discounts that would usually only be available to larger organisations. Currently 300 charities are signed up.

Michael Hodgetts, managing director of the CBG says: 'This is a great opportunity for charities to save valuable charitable income – and it's completely free to join so charities have nothing to lose. If every charity in the UK signed up and saved an average of just five percent on expenditure that would equate to a collective saving of one billion pounds over the next three years – and that is serious money. Leonard Cheshire alone now saves a million pounds a year through these sorts of deals and during the past few months, members have seen 30 per cent reductions on electricity and stationery bills and 40 per cent on telecommunications costs. This translates into huge savings – between them several charities will save half a million pounds on electricity over the next five years.

'The group is also about more than just buying things. The strategic issues that affect Leonard Cheshire, such as accessing agency staff, are common across many charities, so this is also an opportunity to advise each other and collectively improve working practices. We're basically looking at how best to spend money, not just how to fundraise it in the first place.'

The CBG operates with a simple effective approach, by negotiating buying agreements for a wide range of goods and services issued as buyers guides. Members can view these online or in hard copy and contact suppliers direct. The CBG also issues e-bulletins, newsletters and highlights agreements via an online bulletin board. Furthermore the CBG goes out and sits down face-to-face with members to review and assist them with their purchasing needs.

This buying group unlike many others is not only operated by a charity but by offering a free service can support a diverse range of members from a scout group up to large organisations. The CBG's belief is that all charities and not-for-profit organisations should benefit from a common competitive price across the board, thus putting money where it belongs most, servicing members' needs and delivering against charitable objectives.

The Charity Commission's perspective

We are encouraged that 89 per cent of those surveyed thought it was a good idea for the Commission to provide specific advice aimed at facilitating mergers. This is very welcome, particularly at a stage when we are considering a range of options to provide this help as effectively as possible, from setting up a dedicated mergers unit to publishing new guidance.

As our Regulatory Report, *Collaborative Working and Mergers* explained, we believe all charities should consider whether they can maximise the benefits to their users by working together. As an element of good practice, it makes sense for trustees to be alive to the tangible rewards which mergers and collaborative working can deliver.

Our role is to encourage charities to consider joint working, up to and including merger in appropriate cases, where it's both best for beneficiaries and demonstrates the most effective use of charitable funds. However, it is not appropriate for us to push individual charities in the direction of mergers – this decision is for the trustees alone to make in the best interests of their users.

The survey showed that respondents had specific ideas about how the commission could best help the process – 28 per cent chose a new publication, 27 per cent saw enhanced staff training as a priority, 19 per cent want a dedicated unit and 18 per cent would like web-based advice.

While there are few legal barriers to working collaboratively or merging, there are risks involved and both effective planning and a detailed assessment of probable benefits are needed before proceeding. Speaking to the commission at an early stage can help create a smoother and more efficient process, particularly in dealing with the legal and regulatory issues.

Breaking down the 89 per cent 'in favour' figures from survey respondents shows a clear preference for the advice given by the commission to focus on good practice, commission requirements, due diligence and meeting legal requirements. This information will be useful as we develop our future approach to mergers.

But our role in the merging and collaborative working process is of necessity limited to specific areas. Some of the hardest obstacles in the process can be 'soft' issues, such as differences in organisational culture. Equally there are some legal issues, such as employment and contractual obligations, where we cannot advise charities. These highlight the need both for effective change management and specialist advice. We recommend that trustees consider taking advice from their professional advisers, as well as relevant sector bodies.

Charity law itself also imposes constraints on our ability to facilitate a merger. Obvious examples include the impact of restructuring on permanent endowment and the circumstances in which a charity can change its purposes. Of course, in some cases, we can use our powers to help charities deal with these. Additionally, the proposals anticipated in the draft Charities Bill are expected to include legal measures for additional flexibility in facilitating mergers.

The results of this survey provide a timely snapshot of the issues around collaborative working and mergers, and will help inform the way we move forward in advising charities considering how to work collaboratively. n

Carol Shooter is senior policy adviser at the Charity Commission

PRICEWATERHOUSECOOPERS NabarroNathanson

PricewaterhouseCoopers and Nabarro Nathanson will be running a series of events in July and September based on the results of our survey. If you would like to hear more about issues raised in this report please complete and return this reply slip.

Name ....

Position ....

Organisation ....

Address ....

....

Tel (inc std) ....

Email ....

I am particularly interested in:

- ☐ Mergers
- ☐ Collaborations
- ☐ Other ....

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