

THE URGE TO

MERGE

‘Merger’ is often considered a dirty word in the not-for-profit sector, but as Claire Russell explains, mergers are likely to be an essential element in the establishment of a stronger third sector.

In the commercial sense, merger denotes ‘hostility’, ‘takeovers’ and ‘targets’. It implies aggressive, predatory behaviour which is anathema to a sector that is assembled to dispense benefits to society. This is contrary to the image most people have of the not-for-profit sector.

Nevertheless, despite the distaste that some not-for-profit organisations NFPs may have at being paralleled with commercial enterprises, as the global financial crisis rolls on and the balance sheets of many become increasingly strained, ‘merging’ may become the bitter pill that a shrewd board or committee will have to swallow to continue to secure and pursue its organisation’s mission.

Some literature suggests that NFP mergers are broadly viewed in the context of collaboration and partnership and are just another form of joint working, such as joint ventures or sharing resources.

What makes one board accept merging as a natural step in the evolution of an NFP, whilst others sputter and choke at the suggestion? I would suggest that education, information and legislation are all barriers to how merging can open up new opportunities for NFPs to better deliver their objects to their beneficiaries.

WHAT IS A MERGER?

The UK Charities Act 2006 defines a merger in two ways:

1. Where two organisations agree to merge and one of the organisations transfers all of its property to the other and then ceases to exist; or
2. Where two organisations agree to merge and both transfer all of their

property to a new organisation, following which, both original organisations cease to exist.

In Australia, NFPs are presented with the same options, albeit slightly more complicated depending upon where or how each of the NFPs has been incorporated.

AUSTRALIAN MERGER OPTIONS

An Australian NFP may incorporate under the Associations Incorporation legislation in its relevant state or territory or it may elect to register under the Corporations Act 2001. This presents the following merging options:

1. One incorporated association may agree to transfer all of its property to another incorporated association and then cease to exist.
2. Two incorporated associations may decide to merge to form a new incorporated association, following which, both original organisations cease to exist.
3. An incorporated association and a public company limited by guarantee may decide to merge and, depending on the state/territory legislation, may form a new public company limited by guarantee (whereby both original organisations cease to exist) or the incorporated association may transfer its property to the public company limited by guarantee (whereby the original incorporated association ceases to exist).
4. Two public companies limited by guarantee may decide to merge.

BENEFITS OF A MERGER

The urge to merge arises when two NFPs decide that each would be better off working together and sharing resources, than forging on alone.

The decision is typically made as a direct response to a financial crisis. However, this is not the only driver. Mergers may also occur when there is a change in leadership, a major shift within an industry or in response to the allocation of government grants.

Whatever the trigger, the decision to merge should always be taken in order to provide a better service to its beneficiaries.

The benefits of merging can be grouped into three areas: investing in and protecting a valuable asset; efficiency savings; and exploiting synergies.

ASSET PROTECTION AND INVESTMENT

Since most mergers occur as a means of rescuing a failing NFP, it implies that protecting something valuable is a key reason for merging.

It may be a brand that requires the protection of a merger for its continued survival or perhaps a community service. If an NFP is financially unable to invest in its asset, be it a brand or service, merging with another NFP that has a similar mission is a valid strategy to ensure not only the survival of that asset but even the improvement of the asset.

EFFICIENCY SAVINGS

There are definite and obvious savings advantages that arise following a merger between two organisations. In a UK

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survey, 54 per cent of respondents reported that a prime motivation for merging was to increase efficiencies.

With around 700,000 NFPs in Australia there is considerable duplication occurring among these organisations. Merging can deliver opportunities to exploit economies of scale by centralising some of an NFP's administrative functions.

If information about the activities of Australia's NFPs was readily available and easily accessible, NFPs would be better able to identify merger opportunities in overlapping markets and take advantage of the potential savings.

EXPLOITING SYNERGIES

A merger can also create opportunities for NFPs to exploit links and contacts and to share knowledge and skills. ‘Synergy’, in the context of mergers, has been described as: “The notion that the value of [an NFP] formed by the union of two organisations is greater than the sum of its parts.”

The merger of two NFPs may give the new organisation greater authority and robustness in negotiations with governments or potential corporate donors or sponsors. A stronger influence may be created merely by increasing in size and a stronger brand is helpful for income generation.

OBJECTIONS TO MERGERS

Of course, mergers are not a panacea for the financial pressures that many NFPs experience. Mergers are costly and, if proper due diligence is not conducted, a merger may result in large expenditure for little or no return. The central question has to be whether the merger will increase the service delivered to the intended beneficiaries.

LOSS OF REPRESENTATION

One of the major concerns with merging is that the absorption of smaller organisations by larger, more powerful entities will threaten the ability of communities to represent themselves.

It is believed that small, niche groups are more responsive to the needs of their beneficiaries. This is not, however, necessarily based on corroborated data.

The ‘perfect’ size of an NFP depends entirely on its functions. Prejudices about the size of an NFP should be replaced by considerations on what would be most effective to deliver the best services to the beneficiaries.

Community-based issues may be better served by smaller, local organisations, however, where large-scale investment is required, a larger organisation with greater sums of money to invest or with greater lobbying power, is likely to be more efficacious.

LOSS OF BRAND

Naturally, for the organisation being absorbed there is concern that hard-earned, valuable brands may be lost or irreparably damaged following a merger.

The importance of an NFP's brand cannot be overstated. It is the brand that gains the public's trust and attracts philanthropists and beneficiaries. Public perception and confidence is not easily won and it is not unreasonable for NFPs to jealously guard against losing what, in effect, legitimises their existence.

Whilst there is always a risk of brand damage, if thorough and attentive due diligence has been undertaken, the value of a brand, even where it is entirely subsumed into another organisation, can be retained.

TAXATION IMPLICATIONS

Tax implications must be considered before preparations for merging are initiated. In particular, stamp duty and capital gains tax advice should be sought prior to any formal steps being taken towards merging. Further, the tax status of the merging organisations must also be considered.

OTHER MAJOR MERGER ISSUES

Mergers invariably fail in the third sector when one or both of the parties see the merger as something to be won or lost. Third sector mergers must be a collaborative project undertaken by willing participants. The most important reason to merge is to enable each NFP to tap into the complementary strengths of the other. For this reason a merger is best considered before it becomes a necessity.

Deciding to merge, prior to the ravages of a global economic crisis taking hold, affords organisations time to carefully consider all of the issues which are often submitted as the reasons not to merge.

For example, the name of the new NFP will be important to retain brand recognition and relationships with the public. The direction of the new organisation, its goals, its constitution and objects, can all be allocated time for adequate consideration. Governance issues and human resources must also be deliberated and decided upon.

One important consideration is whether the anticipated benefits to be gained, outweigh the costs that will inevitably be incurred. It can be difficult to assign a financial value to exploiting synergies or determining just how improved economies of scale will directly translate into benefits to those who are served by the NFP.

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THE LEGALITIES

Many of the legal costs of merging arise as a direct result of obstacles caused by the legislative framework of the third sector. Unlike the corporations law, there is no single, national piece of legislation governing the sector. Consequently, decisions must be made at the commencement of the process as to the future activities of the NFP in order to determine the appropriate corporate vehicle to employ.

The law relating to how NFPs may merge depends upon where the original NFPs are incorporated. The differences between the legislation of the states and territories can be quite distinct. In New South Wales, the process for two incorporated associations to merge is set out in section 46 of the Associations Incorporation Act 1984, however, the Western Australian legislation is silent on this matter.

The legislation in both Western Australia and South Australia does, however, provide for an incorporated

association to merge with an existing public company limited by guarantee. In other states and territories, a genuine merge between an incorporated association and a public company limited by guarantee is not possible. To untangle the knot of legislation, particularly in cases where the individual NFPs are incorporated under different legislation, legal advice must be sought early in the decision making process.

CONCLUSION

Just as changes to the economic climate, technologies and methodologies employed in doing business are forcing corporations to consolidate and merge, so too will NFPs have to look closely at undertaking mergers.

Despite the absence of the same incentives that exist for corporations to merge, such as increased dividends or shareholdings, NFPs must begin their considerations on whether to merge before the next crisis seizes them.

To play an active part in the world

that emerges after the global economic crisis, the third sector must innovate and refresh and face up to the realities of the social and economic changes that will, of necessity, occur.

Openness and a readiness to merge will give NFPs the flexibility required to maintain their relevance, legitimacy and, above all, to deliver the essential services that are provided by NFPs and that underpin a civil society. ●

ASSISTANCE TO MERGE

In order to be better informed the third sector needs to be provided with:

- More opportunities to access information on the activities of NFPs.
- Education for board and committee members on the benefits of merging (as well as the risks).
- Streamlined legislation that reduces the costs of undertaking a merger and encourages the merging of NFPs to create a stronger, more effective sector.

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