Cobseo
The Confederation of Service Charities

Efficiency and Rationalisation Information Note

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Scope

There are numerous examples of cooperation between Cobseo Member organisations, and they often go unrecognised across the Service Charities Sector. When delivered successfully, they invariably lead to reduced overheads, the more efficient utilisation of resources, and an improved focus on services to beneficiaries. This Information Note presents a summary of the options available to improve how Members support their beneficiaries. It draws upon recent studies in the charity sector, Members' experiences, and the wider charity sector. The generic forms of collaborative working are described, as well as the typical issues to be addressed to achieve successful outcomes. The aim is to encourage Trustees to consider how their charity could be more efficient by working with other charities, and to consider the merits of more collaborative ways of working as part of their future business planning.

Charities as Discrete Entities

Every charitable organisation (charity or not-for-profit incorporated body) is created as a separate entity with its own charity Trustees (Directors in incorporated bodies). These Trustees are responsible for the organisation's governance and maintaining a focus on its support to beneficiaries. In normal circumstances, there is no external authority that can impose rationalisation or mergers*; rather Trustees have the executive and legal authority to operate independently. Nevertheless, Trustees and senior managers should remain mindful of the opportunities to generate improvements and efficiencies in their services to beneficiaries by reviewing how they operate, and considering the scope for partnering with other organisations. The Cobseo Governance Practices Aide Memoire and the Charity Governance Code both set out the expectations on Trustees, when undertaking strategic business planning, to consider whether such measures can lead to a more sustainable future for the charity and its beneficiaries.

* There are a narrow range of circumstances when regulatory bodies can intervene to change or closedown a charity.

Differing Forms of Collaboration

There are numerous subtleties to the types of efficiencies that can be devised. As an example, a sliding scale from informal to more formal collaborative arrangements are described by New Philanthropy Capital (NPC) in their April 2018 report that reviewed 'sharing' and merger models. The NPC found that a common like-mindedness between two or more organisations was the key factor in achieving a better outcome collectively, than they could obtain in isolation.

Collaborative working can be undertaken in a number of ways. Four generic models have been identified in this Information Note; each encompasses a range of ways to bring about an economical and positive change. Broadly, those efficiencies that involve less structural change within an organisation will be faster and easier to achieve; whilst deeper measures, such as rationalisation and mergers, often involve greater change and streamlining of services:

Convergence is the process whereby the organisation combines its multifarious funds and activities, possibly overseen by different groups of Trustees, into one or a few larger charitable organisations. The aggregation of separate charitable funds within regimental structures would be one example of convergence.

Cooperation is where two (or more) charities remain separate entities with their own management and Trustees but work together in one or more areas to be more efficient to increase their collective support to beneficiary groups. The cooperation between separate charitable organisations could include combining purchasing and contracting orders to get better value for money. The cooperation in supporting the welfare needs of service and veteran beneficiaries facilitated by the Case Management System (CMS) is a good example of cooperation.

Co-working is where two or more charities formally combine some of their functions, most commonly resulting in one charity undertaking those functions on behalf of the other. The driving force may be to reduce administrative costs (e.g. in HR, procurement, contracting and finance functions and/or IT services) to increase the efficiency of office-based activities and/or service delivery to beneficiaries.

Consolidation is the process where one entity is rationalised and taken into the structure of another entity. The rationalised organisation may or may not keep an individual nominal identity inside the larger body (e.g. as a separate marque or a restricted fund). The process of consolidation could go further with the combined entities being established as a new one with a revised Board structure, revised objects and branding.

Short case studies on each of these examples are available here.

Stimulus for Future Cooperation

The model of the independent charity or not-for-profit incorporated body has prevailed for many years. It remains the predominant mode of operation for a large majority of the c.168,000 charitable organisations regulated by the Charity Commission in England & Wales (2017); c.24,500 charities in Scotland (2018); and c.6000 charities in Northern Ireland (2018), based on the figures from the regulators. However, a study in 2019 by the Directory of Social Change (DSC), funded by Forces in Mind Trust (FiMT), on the size of the Service Charity Sector found that between 2012 and 2016, the size of the sector remained relatively stable (growing by less than 1.1% per year). Thereafter, between January 2018 and July 2018, the sector shrunk by 4.5%.

The report found local branches across the UK of larger associations were in decline with 152 less operating in 2018 than in 2012. The total number of welfare-focussed Service charities operating remained relatively constant from 2012 to 2018, with an overall increase of just 38 charities.

On closer inspection, this subsector appeared particularly volatile, with a high turnover of the numbers closing and opening. During this period, 135 welfare charities closed and 173 opened. Across the Service Charities Sector, there were 31 mergers between 2012 and 2018. Almost two thirds (64.5%) of these mergers involved welfare charities, whilst the remaining were heritage charities (22.6%) and Service funds (12.9%). The overwhelming majority (29 out of 31) of charity mergers took place between charities solely operating in England and Wales.

There is growing evidence that the environment in which many Cobseo Members are operating is changing. For some charities, the model of 'operation-in-isolation' may not be the most appropriate way in the future to best serve their beneficiaries. Charitable organisations across the entire third sector are reporting a sustained period of rising demographic, financial, competitive and regulatory pressures affecting their capacity to undertake their current and future operations:

Demographic – The Ministry of Defence in January 2019 published projections for military veterans over the next ten years. As the population cohort from the second World War decreases, the future trends indicate: i) fewer veterans will exist in 2028 (c.1.6 million) compared to 2016 (2.5 million); ii) veterans of working age will increase from 38% (2016) to 44% (2028); and the veteran population will decrease from 5% of household residents in 2016 to possibly as low as 2% in 2028. The overall impact will be fewer potential beneficiaries for charities to support. Although this data gives no indication that the nature or complexity of issues affecting future beneficiaries will be less than, the same or more than present day needs.

Financial – The cost of providing services is subject to inflation, labour, materials and administration pressures in a similar manner to other sectors of the economy. Consequently, the cost of 'doing business' is likely to continue to rise over time. In an environment where incomes from public grants, contracts and voluntary and philanthropic donations are uncertain or unpredictable, charities will need to find further ways to reduce costs and/or reduce the level of support they can sustain.

Competition – Competitive overlap between charities to assist similar groups of beneficiaries is inevitable in some areas of need. Where this coincides with a declining number of beneficiaries, then caseloads may decline to uneconomic levels for some charities.

Regulatory – The number of regulatory bodies, volume of regulation and rigour of public sector enforcement has increased and there is no indication they will decline. The general expectation within charities should be that regulation will inexorably increase as authorities react in future years to new public concerns.

Over time, the adverse impact of these pressures on the physical and fiscal resources available to support beneficiaries will rise. Looking ahead, the external pressures are likely to continue. To remain viable some organisations across the charity landscape, sooner or later, will have to take bold and far-reaching decisions on how they continue to support their beneficiaries in the future. The Service Charities Sector will not be immune from this trend.

It is widely acknowledged that the regulatory and trading pressures acting upon organisations are rising, the impact of which will most probably fall disproportionately upon small and medium-sized charities with few or no regular office staff. Consequently, for some Members, now may be the appropriate time for Trustees to examine if working more efficiently by partnering with other organisations has the potential to maintain or improve the charitable support they provide.

Trustees as the Drivers of Change

Collaboration between charities is not new. It has been a feature of the charity sector since its earliest days. The Charity Commission in England and Wales between 2008 and 2018 alone has logged over 2100 ‘convergences’ of funds and full ‘consolidations’ through mergers of charitable organisations. Common to all forms of efficiencies are the Trustees. They are the drivers of change. Not just when there is an insurmountable threat to a charity’s existence, but as part of their normal business review process. The greatest benefits from efficient working, for example in reducing costs, is extending the reach to more beneficiaries and broadening the quality of support provided. This should be regularly considered by Trustee Boards and be a standing consideration in their periodic rounds of strategic business planning.

Collaboration is most effective as a driver for mutually beneficial change when it is undertaken between viable and well-performing charities, rather than the more frequent situation of when the viability of one organisation is under serious threat. In situations where resources are not an issue, organisations normally prefer to operate as a self-contained entity. In doing so, management oversight and decision-making processes are based on familiar policies and practices; delivery of services is achieved by personnel sharing the same business culture and, generally, contacts and understanding between the various parts of an organisation are easy to maintain. However, in today’s resource-constrained environment this ideal rarely exists.

Collaboration is not the natural mind-set for most Trustees and management teams. Consequently, charities are often slow to recognise the scope for efficiencies, or when collaboration would be in the best long-term interests of their organisation. The approach of loyally following their own objectives with little regard to the possibilities for working with others inevitably, over time, increases the vulnerability of the charity to one or more of the significant external demographic, financial, competitive and regulatory pressures.

The Right Mind-set

The right mind-set for more cooperative working should be: an aligned vision for beneficiaries;

a measure of commitment; time; and importantly, compromise by all involved. It is important to recognise that the benefits to both parties are greater than the estimated effort required to see it through. And, it is important to communicate, internally, the progress being made to complete the exercise and settle with staff and third parties the uncertainties such a process of change can create. If the mutual advantages of the efficiency are not clear, or is found to be unachievable, then it is unlikely to succeed.

The financial savings and economies of scale that are possible from collaboration is the principal feature. The delivery of lower (or avoided) operating costs through combining the use of staff and physical resources; and/or increased access to capital and investment services; and/or the introduction of more available funds to support beneficiaries are central to all efficiencies. To paraphrase the experience of Lisa Harker, CEO of the Art Room charity, “a collaboration is a courtship” between the two Boards of Trustees and their management teams.

A successful courtship requires building a trusting relationship between the parties, which can take time and effort to get right. If the Trustees (and senior management team) of the two organisations cannot get beyond an initial pledge, then the initiative is unlikely to proceed. Harker emphasised that a successful merger is when Trustees and staff members are satisfied and feel that the two organisations are a ‘good fit’ together and share a ‘sense of mission’ on what is to be created by the rationalisation. Successful mergers often start in a small way and, over time, build into a deeper working relationship. The eventual, settled state may be co-working in various areas of mutual activity or possibly going that bit further to a full consolidation into a new entity. Experiences from across the charity sector suggest that, at the outset of a proactive collaborative initiative between two organisations, the eventual end state may not be entirely predictable.

Uncertainties to Address

When cooperation between parties is first contemplated there may be a variety of views expressed by Trustees, staff, beneficiaries and others; and it is unlikely that all will be supportive. These uncertainties need to be recognised and addressed positively and sympathetically within each organisation from the start of an exploration into working more efficiently. If not tackled, the uncertainties are likely to be raised by some individuals in an organisation that are opposed to change, which could increase in their intensity to create an insurmountable body of opinion against progress. This would be detrimental to realising the potential benefits to beneficiaries from achieving a successful outcome. The typical forms of doubt recorded during previous proposed efficiencies are presented below:

> **Protectionism** – A perceived loss of identity by one or both organisations; and/or a reluctance by Trustees to relinquish some part of their control of the organisation; and/or an emotional attachment by founding and long-standing Trustees with a reluctance to changing the status quo.
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> **Disbelief** – A perceived view in one or both organisations that financial or resource

pressures now or in the future are not serious enough to contemplate an efficiency.

Incompatibility – A perceived view in one or both organisations that the ethos, vision or ways of working in the other party are not well-matched.

Distraction – A focus in the preliminary discussions within one or both organisations on the reasons not to collaborate rather than opportunities for the charitable works undertaken. This can manifest by detractors dwelling upon an organisation's history, how things have been done in the past, or disagreeing on what is best now for their beneficiaries.

Inertia – A perceived view that the charity sector is not (or should not) be constrained by the same business pressures as the corporate environment, and reasoning that cooperation is not necessary, and/or a view that the effort involved will exceed the advantages and opportunities accrued.

Liabilities – A perceived view that one or both organisations have large liabilities (e.g. pension obligations, fixed asset obligations or contractual risks) that would make an efficiency unwise.

Complexity – A perceived view within one or both organisations that any form of efficiency is complicated and costly to set up, so why bother when there may be other, nearer-term priorities to focus upon.

Eastside Primetimers, a management consultancy for charities, reviews annually the climate for collaborations between charities and has described in greater detail the attitudinal and practical barriers to overcome, as well as the different options possible to develop successful efficiencies with others.

Getting Ready

The commitment of an organisation's time and resources to promote cooperative working requires the positive determination of its Trustees to see it succeed. The amount of effort in time and cost required by an organisation is broadly commensurate with the depth and complexity of the intended measures. Efficiencies involving the cooperation between two organisations with little change to the internal management or ownership arrangements within each is likely to be easier and quicker to establish than a co-working arrangement involving widespread realignment of services and resources. Consolidation and convergence options and/or rationalisation, where distinct organisations are merged into bigger organisational structures, are likely to be more intricate, potentially involving fees for legal advice, additional staff costs, and dedicated project management effort and due diligence expertise.

Senior executives in charities, that have been through these processes advise that they had to satisfy internal opposition and legal or organisational complexities before a collaboration could succeed.

Collectively, the typical steps to achieve a positive outcome can be summarised as:

1. Focusing on the business strategy an organisation wants to pursue and the place within that strategy for collaboration.

2. Making time to engage with key stakeholders, and to learn from the experience of others who have been through similar processes. It is vital for organisations to understand the environment in which we all operate and empathise with one another. It can also show how some charities are closely aligned in strategy and core values, and how cooperative working could benefit both parties.

3. Before approaching another organisation, be clear on the underpinning objectives and motivations, and then get the Board's thoughts and/or agreement on the measures proposed, and consider any concerns they raise.

4. Identifying and seeking Board agreement on the functions and services the organisation must preserve if they proceed (often known as the 'red lines').

5. Once the preceding steps are decided, examine if the potential partner(s) can meet the objectives expected, and where each organisation has strengths or development needs that would benefit from a collaborative arrangement.

6. Estimating the potential risks and issues (e.g. legal issues, financial debts, pension/employment liabilities, staff opposition), and how they could be mitigated. It is important to realise that not all risks can or need to be managed away, but their ramifications to each party and the associated liabilities, if any, need to be understood. Once arrived at, this clarity can help guide how the proposed collaboration develops and avoid potential pitfalls.

7. Where the possible impediments appear manageable, beginning initial discussions with prospective partners.

8. Focusing discussions first on the compatibility of future collaboration before deciding on the measures that would be most suited to the requirements of both organisations. This approach assists in defining the potential structure of the new joint arrangement.

All commentators urge charities contemplating a collaboration to engage with their personnel early in the process to explain the rationale behind it. Exploring such initiatives will inevitably raise questions about cultural differences, job security, and business continuity. Early and regular communication on how this is being taken forward, and the changes being considered, as well as taking their views and suggestions into account, will help to ensure understanding and support for the change journey.

Implementation

When driving change leaders need to keep in mind that 'culture eats strategy every time'. It is the culture and tone set by the Board and the Executive team that will facilitate the delivery of strategic objectives. If behaviours are not right, the benefits will not flow and it is unlikely the collaborative venture will succeed.

Over the past decade, experience gained across the Service Charities Sector, including the consolidation of several existing funds and organisations, found that successful collaborative ventures present a number of common features. Top of the list is a **good beneficiary-focussed argument** setting out the case for change, which gains broad acceptance by the Trustees, management, staff and supporters in both organisations. This is a pre-requisite to engender a positive attitude on both sides to persevere with delivering the arrangements to collaborate.

Trustees and management set the tone and attitude of an organisation. They should be visible in their support for the changes being progressed, and welcoming in embracing the partnering organisation into the new arrangement. When possible, the outputs and benefits achieved following implementation should also be communicated, without overstatement, through these teams to demonstrate the aims that are being delivered.

And this progress should be communicated clearly and regularly to **staff, members and supporters**, **volunteers and beneficiaries** in order to keep the focus on the benefits that will be achieved. When problems or delays in progress arise, they should be addressed transparently and supported by prompt communications with clear explanations to stakeholders. This is the best approach to avoid unrepresentative rumours developing. This is because there will inevitably be differences of opinion and legal and technical hurdles to overcome on the path to successful delivery. Maintaining constructive behaviours by all involved, especially those tasked with resolving any problems when they arise, is important to sustain a positive level of motivation.

It is important to emphasise that examples from the sector demonstrate that timelines for implementation from start to finish, can be long and, at times, frustrating. Five years or longer is not unusual to bring a vision to reality, particularly where it involves significant change within one or both organisations. Maintaining focus on the annual and monthly objectives of each organisation whilst at the same time managing the increased workload of a major change programme, is an issue that Boards will need to monitor to prevent overload on Executive teams. Creating a core, joint Trustee-management team to steer and guide the process is key.

In recent rationalisations involving convergence or consolidation of one entity into another, Members encountered various 'risk topics' that could require effort and external assistance to overcome. Not all will be relevant in every case of rationalisation involving one entity combining legally with another. The risk topics suggested are: assimilation of a branch network; tax (particularly VAT) issues; data handling and safeguarding its protection; legal and operational aspects of any trading subsidiaries; reconciling different financial accounting systems; agreement on new branding and publicity literature; pre-existing (particularly long-term) contracts and leases; and pensions and/or pre-existing debt liabilities.

For charities considering a consolidation or merger it might also be helpful to seek support from a neutral third-party. This could be a senior manager or Trustee of an organisation that has undergone a merger or experienced a consolidation of charities, or perhaps a consultant or external agency with relevant experience. They could act as an impartial mediator in helping to establish the terms for the changes envisaged.

There are several useful texts available to support charities seeking further information on the collaborative options set out in this Information Note, and a selection is listed below. There are also several texts available on change management, delivering transformation, and the human factors involved in delivering collaboration, which might be useful background reading, One example for the corporate world which was suggested by a Member is 'The Change Monster' by Jeanie Daniel Duck (ISBN 9780609808818).

Regulatory Guidance and Training

The Charity Commission provides a breadth of guidance on efficiency and rationalisation. It has published advice to encourage and support those considering co-working and similar initiatives. It has also prepared a checklist for charities considering full consolidation (in the Commission's words, a 'merger'). This accompanies a more extensive guide on completing a full consolidation by merger between two charities.

Free resources
See the New Philanthropy Capital for their resource hub on mergers. In particular, Members may find their free resources and blogs useful.

NCVO also have information on collaboration between charities and a range of merger resources available to any organisation looking at improving their efficiencies by working more collaboratively with organisation(s).

Additionally, KnowHow have guidance on mergers, and specifically how to execute them on their collaboration hub.

CharityConnect has prepared a useful article for smaller Members describing *5 ways charities can benefit from collaboration* by looking at ways to cut costs and improve impact.

Research

The Directory of Social Change's report, *Armed Forces Charities – Sector Trends* (2019), is one of the most recent studies into the Service Charities sector which explores how the sector has changed from 2012 to 2018. The report includes the financial patterns which impact the opening, closing and merging of organisations working within the sector.

The Institute for Voluntary Action Research, alongside Bates Wells Braithwaite, in their *Thinking about…* series have produced guidance for charities thinking about a merger. Read the report which includes reasons for merging, stages to the merging process and what makes a merger successful here.

The Good Merger Index for 2017/18 is a review of not-for-profit mergers providing the top mergers of the year along with the financial drivers if change.

The Social Finance have brought together key findings and recommendations on charity mergers in their paper *Charity mergers: Tackling the issues in practice.*

The British Association of Settlements and Social Action Centres (basccac), in 2005, also produced a piece of research on *Sharing Without Merging* to evidence good practice in shared services and broader more collaborative approaches.

Regional guidance
Those registered with the Scottish Charity Regulator (OSCR) can also refer to tailored guidance on amalgamating your charity with another body.

The Charity Commission for Northern Ireland has advice for charities operating in Northern Ireland. See their mergers and closures webpage for more.

For charities in Wales, the Wales Council for Voluntary Action (WCVA) has produced information sheets for informal and formal ways of working with others.

Legal guidance for the charity sector
Sayer Vincent published an article *Mergers Made Simple* that considers the legal forms of mergers and when to involve the Charity Commission.

Cobseo
2nd Floor, Mountbarrow House
6-20 Elizabeth Street
London, SW1W 9RB

Tel: 0207 811 3225
enquiries@cobseo.org.uk
www.cobseo.org.uk