

MERGERS, AMALGAMATIONS & ACQUISITIONS

IN THE AUSTRALIAN NOT-FOR-PROFIT HUMAN SERVICES SECTOR



A Joint Research Report by RMIT University & CPA Australia

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Ethics Declaration

This study was granted ethics approval by the RMIT University Human Research Ethics Committee.

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First and foremost, we would like to express our sincere gratitude to the participants of this study who have generously shared their lived experience and deep insights into the mergers, amalgamations and acquisitions (M&As) in the Australian not-for-profit (NFP) human services sector. Their collective knowledge and wisdom has shed much needed light on the various risks and challenges confronting the M&A process, and the critical factors for successful organisational re-structure.

Further, we would like to sincerely thank the following individuals for their many insightful comments and support, namely Professor Lee Parker, Distinguished Professor of Accounting (RMIT University), Professor David Gilchrist (University of Western Australia), Professor Geoffrey Stokes (RMIT University), Ms. Karen Mahlab (ProBono Australia), Mr. Michael Goldsworthy, and the participants at the RMIT Roundtable on Not-for-Profit Governance.

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FOREWORD

The Australian Productivity Commission research report¹ (2010), entitled 'Contribution of the Not-for-Profit Sector' recognised the substantial contribution made by the nearly 600,000 entities in the Not-for-Profit (NFP) sector to the national economy. Nevertheless, the NFP sector is experiencing unprecedented pressures to reform in the face of funding shortage, growing demand for human services, changes in government funding policies, and increased marketisation and competition. Many Australian charities and NFP entities are compelled to review their strategic stance and alliances, and undertake organisational restructure through mergers, amalgamations and acquisitions (M&As) with the hope of gaining scale efficiencies, expanding market size and remaining competitive.

The option to undertake an M&A arrangement is available to all community organisations in Australia, regardless of their legal structure (i.e. incorporated associations, companies limited by guarantee, indigenous corporations and co-operatives). While M&As have grown in popularity in the Australian NFP human services sector, there is also evidence of de-mergers and cause for concern over the efficacy and outcomes of M&A initiatives.

The overarching aim of this research project is to identify and assess the dynamics among the key motivations, risks, barriers and opportunities associated with M&As in the Australian NFP human services sector. The data for this study is derived from twenty-one (21) in-depth interviews, conducted in 2017, of board members, Chief Executive Officers (CEOs), senior management and finance officers of NFP entities, including four who are specialist NFP governance consultants and legal representatives who have lived experience of M&As. Where possible, we reviewed the annual reports and media news information on M&A announcements.

Our findings support M&A uptake as an effective strategy for organisational growth, gaining scale efficiencies and enhancing service choice and quality within the NFP service sector. The M&A process itself however is often complex, time-consuming and can be costly. Some of the critical M&A success factors include board and CEO leadership, clarity of the social mission and goals, a well-designed merger plan, proactive communication and stakeholder engagement. We utilise the 4-P framework, representing 'purpose, people, process and policy' to elucidate the connectivities among the four different factors, and recommend a range of good practice guidelines for M&A success.

As the pressure for higher organisational efficiency and accountability continues to escalate within the Australian NFP sector, further study on the efficacy of the M&A process is both timely and warranted. We hope our findings will inform and sprout further inquiry into the risks and opportunities offered by M&A strategies for the Australian NFP sector.

On behalf of the research team

Nava Subramaniam

¹Australian Government Productivity Commission (2010), *Contribution of the Not-for-Profit Sector, Research Report, January 2010, Canberra.*

EXECUTIVE SUMMARY

KEY FINDINGS

Main Motivations For M&A

Almost all participants from NFP entities stated that they either completed or considered an M&A restructure for strategic organisational growth. Being larger in size is seen to confer several primary and secondary benefits.

The primary benefits are scale efficiencies, improved financial position, wider revenue base, increase in market size, provision of wider range of services, and acquiring critical technological and human expertise. In some cases, the M&A meant an opportunity to rationalise service offerings, close low demand services and remove operational inefficiencies.

The secondary benefits are perceived advantages derived from the primary benefits, which include enhanced reputation, being competitive in the market, improved capacity to win larger grants, and have stronger social impact.

A smaller proportion of participants reported 'rescuing another organisation' as a M&A driver, and this tended to more easily occur when there are gains anticipated from an additional revenue line or cost savings, or transfer of specific assets that are of benefit to the acquiring entity.



Risks, Barriers & Opportunities at Different M&A Phases

While many NFP CEOs are constantly on the lookout for M&A opportunities, there are various risks, barriers and opportunities in the different phases of an M&A set-up.



At the Pre-Merger Phase

- Finding the right partner/s, particularly those with similar social mission and values can be difficult.
- Board resistance, legacy issues, and member resistance can topple negotiations.
- CEO and board have limited vision and understanding of the M&A process
- Lack of resources (both financial and human) for conducting proper planning, due diligence and negotiations
- Not spending enough time on assessing the congruence in social mission, and rushing into due diligence and discussions on governance structural issues instead
- Poor understanding of the 'merged' or new business model and its financial implications

At the Post-Merger, Integration Phase

- Difficulties in integrating two or more different financial systems and operational procedures, resulting in running dual systems instead.
- Poor understanding and communication of the new organisational identity and its values. These act as barriers for bringing staff from different organisations to think and act as one.
- Attachment to legacy organisational cultural values and work norms. In some cases these did not surface until well after signing the agreement, affecting employee morale and productivity
- In several cases, the revised board had difficulties working together, partly due to lack of trust, and partly due to having to deal with a more complex organisational structure
- In cases of high workforce redundancies, and poor communication, there was low staff morale and loss of critical staff with important social connections
- In many cases, there was a lack in IT system capacity to handle larger and more complex organisational activities and transactions.

- Lack of clear implications on workforce, where often M&As may result in job loss or job sharing for some staff and in some cases loss of staff with critical expertise and social capital.
- Concerns over changes in performance management and reporting systems were consistently found to be a highly sensitive issue among staff.
- More than half the respondents indicated synergies and benefits anticipated at the beginning of the M&A process were not achieved in the expected timeframe.
- In almost all cases there was a lack of data to assess the full costs and benefits of M&As

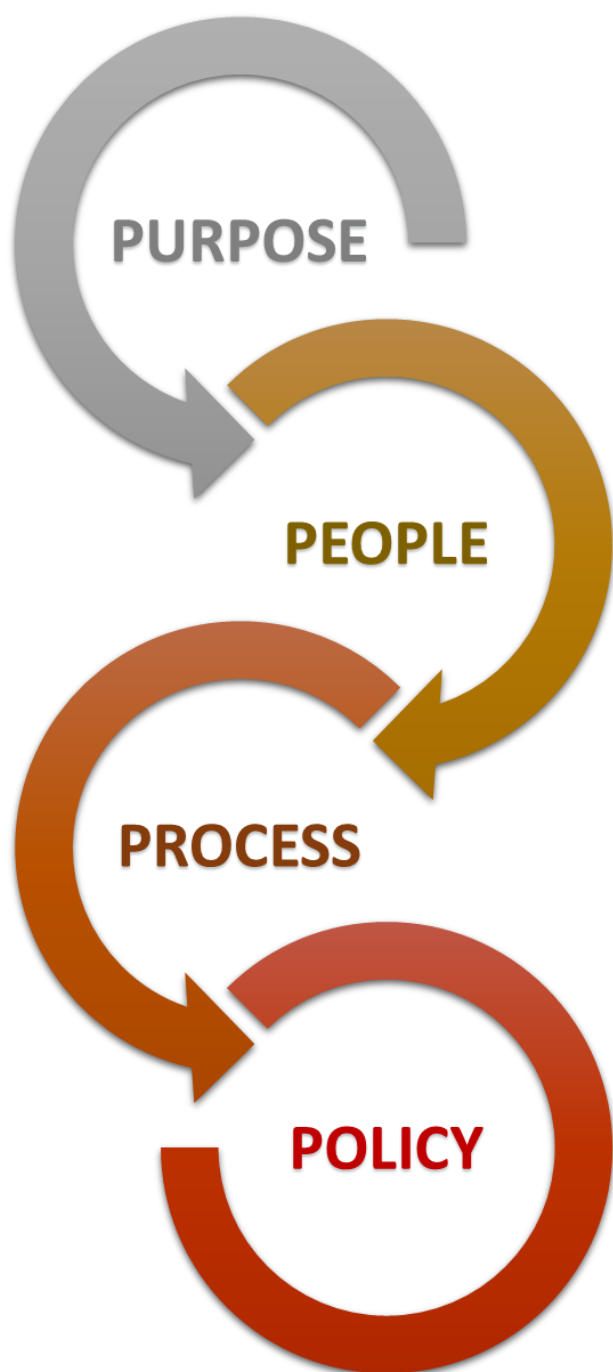
Outcomes of M&As

- The four most commonly cited positive outcomes are stronger market position, cost reductions, increase in services and programs for clients and opportunity to review and improve internal processes.
- On the downside, the three most common complaints are loss of organisational identity, increased workload and cultural disconnect among staff.
- In some cases, where a proposed merger did not eventuate, there was still value derived from the attempt to do so as it enkindled boards to become more pro-active in exploring and choosing alternate opportunities to improve their viability.

Descriptions of Mergers, Amalgamations and Acquisitions

- In a **merger** arrangement, two organisations may consolidate to form a new organisation where the assets and liabilities of both organisations are owned under a new organisation.
- An **amalgamation** is very similar to a merger and it only applies to incorporated associations operating in the same State.
- An **acquisition** or a take-over occurs when one organisation takes ownership of assets and liabilities of another organisation which will then cease to exist.





The findings of this study indicate the M&A restructure pathway as an important and viable means for NFP service providers in Australia to gain market share and scale efficiencies, improve productivity and deepen their social impact.

The M&A process is a dynamic function underpinned by the interconnections among the 4P-framework:

- 1. Purpose**
- 2. People**
- 3. Process**
- 4. Policy**

In this section, we offer several recommendations related to the 4Ps for enhancing the process and benefits offered by an M&A restructure. We also acknowledge that these recommendations are not exhaustive.

Purpose

- All M&A parties need to have a clear understanding of their purpose i.e. mission and vision and the value proposition of the merger to that purpose.
- Conduct an open and frank discussion of the alignment of the work-related values and norms of the merging entities
- Jointly set new goals, if needed for the merged organisation.
- Be consistently guided by the social mission, and at different intervals of the M&A process evaluate whether policy and processes are aligned with the mission statement.

People

Board Capacity and Incentives

- Develop board members' knowledge and skills in evaluating the risks and opportunities associated with M&As. The board's ability to assess the financial, cultural and social impacts of an M&A restructure is vital.
- Foster a culture of proactive, forward thinking and agile decision-making. In particular, actively manage or remove legacy members who are a hindrance to change.
- Board members need to declare any potential conflicts of interest and be guided by a code of conduct in M&A negotiations and decision-making.

CEO Independence and Incentives

- Establish CEO independence and objectivity safeguards which may include use of an independent recruitment agency, oversight by a remuneration committee, and having a code of conduct. This is because CEOs tend to face various self-interest threats in M&A situations (e.g. loss of his/her job, prospects of higher remuneration, changed work conditions, etc).

Specialist M&A Consultants; Legal Counsellors, Accountants and Management Consultants

- Gaining expert, external professional advice is always helpful, particularly in the pre-merger negotiation phase. Utilise professional consultants, legal and financial experts to help in due diligence and better understand the risks and opportunities arising from the 'revised' financial and business model as a result of the M&A.
- With a general lack in accounting and financial technologies within the NFP sector, accounting professionals can play a stronger role in supporting M&As. For example, management accountants and financial consultants can help NFP clients to build more rigorous and comprehensive financial models. They can also be involved in performance measurement and compliance audits to help enhance due diligence reviews.

Process

Establish an M&A Lead Team

- Establishing an M&A team to lead, negotiate and oversee the various phases of the M&A process is important. Build a diverse yet inclusive team with members who hold valuable organisational memory and social capital.

Have a Clear Understanding of Expected Costs and Outcomes

- Evaluate the new business model's viability in relation to re-structured workforce, customer demands and needs, and operational processes.

Develop More Effective Stakeholder Communication

- Ensure timely, honest and clear communication on the M&A process and outcomes with stakeholders. Although maintaining confidentiality and information proprietary to the organisation is equally important, shared understanding and acceptance of work-related values play a central role in NFP organisations. Articulating the organisational identity to reflect the full revised purpose of the merged entity is critical.

Respect and Value Workforce

- Treat workforce, full-time staff and volunteers with due respect and consideration. Keep them engaged and connected with M&A developments, and utilize both formal and informal socialization processes to address align organizational and staff interests.

Enhance Performance Measurement and Reporting

- Evaluate the appropriateness and effectiveness of extant performance measurement and reporting systems, particularly if employees and external stakeholder information needs are met. Co-create impact measures with service customers / beneficiaries where possible to fully assess and report on social impact.

Leverage Digital Technologies

- There are new technologies that can help with scenario-building and decision-making. Invest in digital technologies to better visualise and analyse how two or more organisations can come to successfully work together.

Policy

There are various regulatory policies and guidelines that government, regulatory agencies and professional bodies could develop to help NFPs cope with the different risks and challenges in the M&A path.

Support Grants

- Cost of restructuring can be high, particularly for smaller NFPs and those in regional areas. While there are pro bono advisory services offered to NFPs seeking to re-structure, additional private and public funding schemes that incentivise M&As restructure may help in improving sector efficiency.

Data Registry & Analysis

- Develop a public register of M&As, so as to track and understand the changing structural trends in the NFP sector. Further information on the number of mergers, types of mergers, changing governance structural arrangements can inform policymakers and other stakeholders, and enable large scale studies.
- Compare and Benchmark M&A regulatory policies with that in other countries e.g. New Zealand and Canada, where the policy suites are seen as being more varied and rigorous which will engender the development of high quality, globally comparable M&A ecosystems in Australia.

Innovative Funding Schemes

- Develop initiatives that encourage social impact investing and reduce regulatory barriers. Encouraging more proactive, innovative sources of funds e.g. social bonds, social enterprises, etc will better support organisational growth and related social innovations.



CONCLUSION

M&As continue to pose a viable and attractive pathway for organisational restructure and growth within an increasingly competitive and resource-constrained NFP sector in Australia. This study presents stories of various levels of M&A success. Successful outcomes from the M&A process included improved economies of scale, wider service choice, better service quality and stronger organisational capacity were achieved.

Nevertheless, an M&A involves organisations with different histories and 'ways of doing things' coming together. Consequently, many risks, barriers and challenges can potentially arise along the M&A process. We conclude that not only the 'why' but also the 'how' of a merger underpins the success of the M&A journey. In the previous section on 'Recommendations for better practice', we offer various suggestions

based on - purpose, people, process and policy for enhancing the M&A process. Looking ahead, we suggest several focal areas for improvement and development so as to fully enhance the prospects offered by M&A -based organisational restructures.



- Firstly, leadership is central for M&As. M&As need to be taken for the right reasons and with the right approach. Such leadership however not only resides at the level of the board and CEO, but also in the voices of the community an NFP seeks to serve. For an NFP, the social mission and goals is its *raison d'être*, and thus the planning for the success of any M&A must be undertaken accordingly. There is no room for legacy biases which can easily topple an M&A and threaten the very existence of the service organisation. We found time and time again, participants of this study relating incidences of resistance and reluctance to change.
- Another area of concern is the impact M&As can, and have had, on the NFP workforce. This includes paid employees as well as volunteers. Listening to the voice and concerns of your workforce is crucial for M&A success. It is often only in the post-merger phase that the loss of critical staff and their attributes becomes evident. Some of these staff will have held valuable organisational memory and social capital, and thus assessing the skills and capabilities of the new workforce in relation to this knowledge is important. The NFP sector has always prided itself on its ability to draw on its social capital. Thus how merged organisations treat their employees and volunteers is a crucial area of consideration. Nurturing an organisational learning culture can also help merged entities to explore how they can learn from each other, and produce new knowledge and skill-sets. Targeted investment into processes that engender trust and mutual respect of staff in the merged organisations is pivotal for staff well-being and productivity as a whole.

- The third focal issue relates to gaining a clearer understanding of the costs and benefits of M&As. CEOs and boards can spend an enormous amount of time chasing prospective partners which can often be futile. In an already resource constrained environment, the full cost and benefits of M&As remain questionable. Additional professional advisory support, especially in undertaking due diligence in the pre-merger stage, can be valuable for many NFP boards. The increasing expectations by donors and funders for greater social impact also puts the onus and spotlight on how organisations measure and report on their M&A success and failures. Further, there are also opportunities for NFPs to widen their revenue sources through M&As, particularly through acquiring social enterprises and similar ventures which balance commercial and social goals. Gaining financial and accounting knowledge, and skills to better develop more complex business models after an M&A is also another crucial step forward.



- An added issue is that NFP service providers need to be able to assess other options for organisational restructure besides M&A, such as resource sharing alliances or consortiums (e.g. sharing of infrastructure facilities, back-end office, administrative and marketing costs). Further research evaluating the efficacy of these different organisational restructure options is required to build better knowledge on and to improve the efficiency of NFP eco-systems. The current lack of any public register of M&As tends to cloud any systematic and comprehensive view on the changing trends and impacts of M&As within the Australian NFP sector.

Nevertheless, the uptake of M&As is likely to trend upwards as the NFP sector continues to be pressured towards gaining further efficiencies in a landscape of increasing competitive advantage and entry by larger providers (many being for-profit entities). Gaining economies of scale and developing creative resourcing behaviours will continue to matter, and so will staying true to one's social mission.

We trust the summary of outcomes of this study has helped to further define the factors that contribute to the complexity and intricate dynamics of the M&A process in the Australian NFP human services sector. It is envisaged that the findings will also contribute to developing appropriate organisational strategies and foster better organisational restructure policies and guidelines that are nuanced to the overarching landscape of the NFP sector.

Quotes from Interview Participants

Importance of Leadership

...I call them the leadership group, so a lot of the stability is around that, if you can get good consensus around that group you usually will find a way forward (for merger decisions), and you will be amazed at how well the organisation can go and how far they can progress ...

The Small Service Provider

The smaller providers bring history, longevity, connection to their community, credibility in the marketplace,, they bring those factors to the table...

Cultural Alignment

"...if you are going to acquire anyone you need a cultural alignment, the legislative frameworks and the financial frameworks are probably the easiest part to deal with, the cultural alignment is what is required to not disenfranchise the community in which that organisation may sit...",

M&A

Heart vs. Dollar perceptions

And I think that the problem with mergers is that a lot of not-for-profit's... There is a heart to them, and in a commercial sense a merger and acquisition would make sense when it all comes down to numbers, but I think with the not-for-profit's they are different, because people have hearts....

YOU DON'T
NEED A
REASON
TO HELP
PEOPLE



Size of M&As - Large is Good

...every time that I go to a board meeting, our CEO reports on you know what is happening in the industry, and most meetings, someone else is in trouble or has shut down or someone is going to be shutting down... You know there is a lot of closures... And a lot of people in trouble... So yeah... And I think if you are looking at mergers and acquisitions,, you would probably have to go large, because even the small to mediums are going to struggle...

The 'Blocked by Legacy' Story...

"...I'll say the word parochial because... I felt, it was without a view to the future of what was possible, and whilst their CEO and I spelt it out in detail what might be achievable over the next 5 or 10 years also, they couldn't get past the 'this is our board... our [service]... our management' type thing... so we thought 'ok, end of story'... we had given it our best shot, and I learnt from it, and I was thinking 'do I really want to go into business with people who could only see 2 feet in front of them and not 20 feet?' and I decided 'no I don't!'"

THE RESEARCH TEAM

RMIT University Team

Prof. Nava Subramaniam: Her research interests cover corporate governance, management controls and assurance, corporate social responsibility and the accounting profession. She has led two ARC-Linkage funded research projects in the areas of 'Corporate Governance in the Public Sector' and 'Carbon Emissions Risk Management'. Her positions at the College of Business, RMIT University are Director of Governance, Accountability and Law and Professor of Accounting. She also co-chairs the Australian NFP Governance Research Network.

Prof. Alan Lowe: His research interests include the impact on management accounting systems of changes in management philosophies, methods of performance measurement, and the application of qualitative research methodologies. He is a Professor of Accounting in the School of Accounting, and the joint editor of the prestigious British Accounting Review.

Dr. Yesh Nama: His research cover social studies of accounting and finance, methods of performance measurement and valuation practices with a strong orientation towards case study and qualitative methodologies. He has held positions at ESSEC Business School (Paris) and Kings College London.

Dr Raelene West: Her research areas include examination of support service frameworks for People with Disabilities and Older Persons, concepts of marketisation and individualised funding, ableism, social equity and legal frameworks of human rights. She has a PhD in Sociology and Disability and has been on numerous disability advocacy committees. She is a social researcher at the Social and Global Studies Centre (S/G), RMIT University.

CPA Australia Team

Ram Subramanian: Is a policy adviser in Reporting within the Policy & Corporate Affairs team at CPA Australia and holds technical expertise and knowledge to effectively communicate key messages in reporting to finance professionals and others with a stake in business and social enterprises.

Kerry Mayne: Is General Manager Public Sector Engagement for CPA Australia whose portfolio covers members and stakeholders in government and not-for-profit sectors and member volunteering initiatives. Kerry has had a number of roles with CPA Australia across two decades including external affairs, government relations, professional development, marketing, business development and prior to joining CPA Australia she worked in the university and community sectors.

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