In the eye of the storm

Moving from collaboration to consolidation

a PwC Public Sector Research Centre publication

talking points

PricewaterhouseCoopers

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talking points

Introduction

The HE sector is facing a challenging future and Vice Chancellors across the UK are bracing themselves for a tough fiscal environment.

The June 2010 emergency budget confirmed that almost all areas of public spending are subject to review, and added £200m of further cuts to this year's Higher Education (HE) budget.

The Secretary of State for Business, Innovation and Skills has made it clear that HE is almost certainly facing a minimum of 20 per cent real budget cuts over the four years to 2015/16. Against this stark backdrop of fiscal consolidation, one area that comes into focus for achieving spending reductions is greater collaboration between higher education institutions (HEIs), including potential mergers.

The implied logic is that such collaboration always yields net benefits, including efficiency savings. However, a lesson from previous private and public sector mergers is that mergers do not deliver savings unless they are based on a sound strategic rationale, are thoroughly planned, and well executed.

The act of merely adding together two entities with their respective attributes, challenges and weaknesses, creates a larger entity with the same underlying structures. The real benefits of a merger can only be delivered by fundamental change initiatives which require early consideration.

In a recent Talking Points publication, 'Weathering the Storm – coping with financial challenge in the higher education sector', we explored how a difficult economic climate combined with impending budget cuts might impact higher education institutions.

One potential outcome of tightening HE budgets is increased sector collaboration, including mergers between HEIs. Mergers tend not to be popular within the HE sector, for several reasons. Historically such unions have usually occurred in response to crisis, and not in pursuit of the strategic prize that might be available. Mergers are also often associated with a loss of institutional identity and there may be a perceived trade-off between the greater scale that comes with merging, and the pursuit of the core institutional mission.

> *I wonder how many people [within the HE sector] really – deep down – are psychologically prepared for a period of consolidation, perhaps even contraction. Because that is what we face…My department, whose biggest spending commitment is universities, was facing cuts of 20 to 25% if Labour had returned to office. I do not yet know where we shall come out but no one should be under any illusion that there will be any other than deep cuts in government spending on universities.*
>
> Secretary of State, Department for Business, Innovation and Skills, 15 July, 2010

Mergers are complex, and difficult to plan and execute successfully. There have historically been relatively few large scale mergers among HEIs and therefore inevitably the knowledge that resides within the sector is limited. Despite this history, in certain situations, such as the University of Manchester merger, the potential strategic benefits are great.

While the catalyst may be underlying economic factors, we contend that in appropriate circumstances a well planned and executed merger based on a sound underlying strategic rationale, if necessary pre-empting the point of distress or crisis, will enable some institutions to take a leap forward in terms of achieving their strategic goals and ambitions.

> *"...mergers do not deliver savings unless they are based on a sound strategic rationale and are well planned and executed."*

In this Talking Point we focus on the merger option. While we set this option in the context of the broader options for collaboration, we do not focus on the relative strength of the business case for one form of collaboration over another, which would be situation specific, and one size does not fit all.

We draw on our front-line experience of advising on the planning and execution of mergers in both the public and private sectors. This includes our recent work for the National Audit Office, reviewing recent reorganisations within central government as part of its review which led to the publication of 'Reorganising central government'[1]. This publication considers:

- Potential drivers and sources of benefits that a merger can deliver;
- A route map for a successful merger and the critical success factors; and
- The merger process.

Our experience:
The merger of Price Waterhouse and Coopers & Lybrand

John Berriman, the PwC Higher Education practice leader played an important role in the UK merger of the Price Waterhouse and Coopers & Lybrand firms that led to the formation of PricewaterhouseCoopers.

John was responsible for the merger integration of the UK Assurance businesses and for securing the synergies from the merger of UK business support functions. He has reflected on the key actions taken to help ensure the success of this merger of two large people businesses. They are included in the shaded boxes throughout this Talking Point.

1 http://www.nao.org.uk/publications/0910/reorganising_government.aspx

Collaboration options within the Higher Education sector

Merger in the context of this Talking Point means a coming together of two separate institutions to form a single, new institution, to meet their strategic ambitions and objectives.

The spectrum of collaboration options that are prevalent in the HEI sector, ranging from informal collaboration through to merger, are shown in Figure 1 on page 4.

- Informal collaboration is well developed among HEIs. Arguably the level of collaboration among HEIs, their departments and academics within them, is more developed than in the private sector.
- On a more formal basis, joint business ventures such as between the London School of Economics, NYU Stern and the HEC School of Management in Paris, for example, offer students on the Joint Global Executive MBA degree the possibility to learn in all three cities and is a major selling point. Furthermore, the reputations of the three universities are mutually reinforcing and allow the degree course to command premium fees.
- Consortia, such as the M25 Libraries Consortium, enable universities to leverage their collective scale, while a federation such as the University of London, which is formed of 19 colleges and institutes, allows them to share resources.
- Others go further, creating joint departments – such as WestCHEM, a joint research facility founded in 2005 between the University of Glasgow and Strathclyde University.
- There are also examples of HEI mergers. We have identified two broad categories of merger; horizontal mergers, for example the merger of two universities, and vertical mergers, for example the merger of a university with a Further Education institution. An example of the former is the 2004 merger of The Victoria University of Manchester and The University of Manchester Institute of Science and Technology (UMIST).

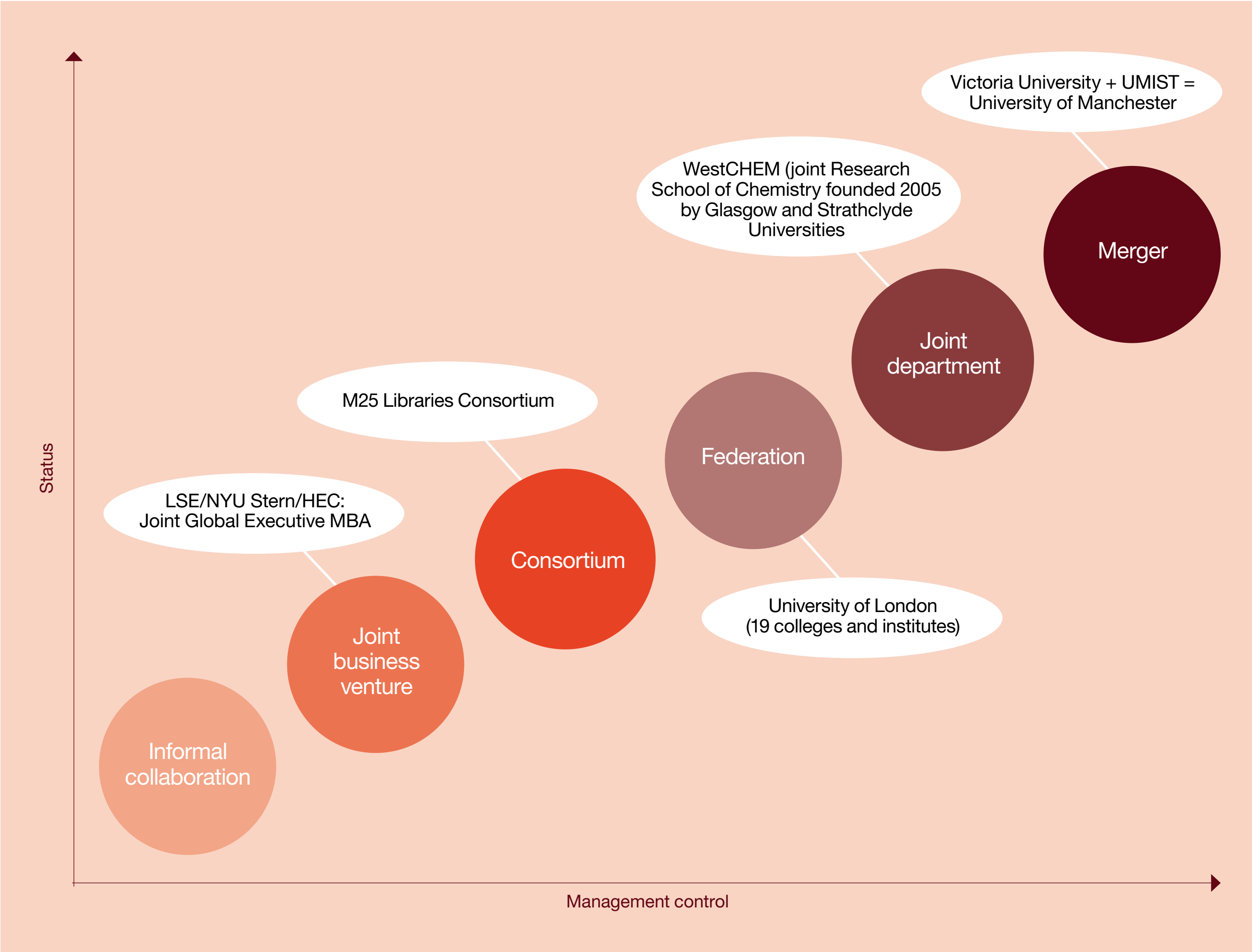
  This merger was executed with the aim of creating research strength in depth necessary to establish the market presence and reputation required to compete with the "Golden Triangle" (Oxford, Cambridge and London) and with international institutions. This was subsequently articulated in the combined institution's strategic goal of establishing the merged entity as one of the top 25 universities in the world by 2015.

Additionally, there is presently much debate in the public sector about the role of shared services to secure operating efficiencies and reduce back office costs. Whilst HEIs have so far shown little desire to pursue new shared service options aggressively, partly due to the additional VAT cost penalty that such an arrangement incurs, it remains another possible form of collaboration. There is increasing pressure for the VAT landscape to change in the future. Back office functions could be shared, either between HEIs, or with FE colleges or other local public sector organisations.

While the purpose of this Talking Point is not to focus on the relative strength of the business case for one form of collaboration over another, we would make a general assertion that while other forms of collaboration will allow some benefit, if material change is desired, the situation probably calls for a more cohesive structure such as a merger.

We are not advocating merger as a panacea but there will be situations where an appraisal of the options available suggests that the congruence between ownership and governance, which a merger offers, and that other forms of collaboration do not, is critical to achieving the benefits of collaboration. It is in these situations that the significant investment in pursuing a merger should be considered.

Figure 1: The spectrum of collaboration options in the Higher Education sector



Potential drivers and sources of merger benefits

The benefits that any proposed merger, whether in the public or private sector, is capable of delivering will be case specific and flow directly from the strategic rationale that is driving that particular merger. In the private sector mergers are generally, if not exclusively, undertaken to increase shareholder value. The components of shareholder value include those that lead to increases and improvements in the quality of revenue and those that drive cost efficiencies.

In the case of an HEI merger the sources of benefit cannot be brought together into one relatively objective measure such as shareholder value.

One major consideration for an HEI is how to best mitigate its risks, both short and long term. A formal quantification of strategic risk might of itself make the case for merger a compelling one.

Securing cost efficiency

In the current economic environment a key driver for HEI mergers will be the cost efficiency case focussed on securing sustainable efficiencies and, in extreme circumstances, as a response to financial distress. There is a number of areas where the consolidation of HE bodies has the potential to deliver efficiency savings. These include:

- The economies of scale achievable from combined functions, adoption of common processes, and the removal of duplication within back office administrative functions. Figure 2 illustrates the scale of possible savings seen in the private sector;
- Property and infrastructure efficiencies, which may be realised over time, from estate rationalisation and efficiency of use. This in turn will lead to lower capital expenditure needs;
- Synergies from subject/module analysis, which eliminates duplication;
- Lower stakeholder engagement costs across for example the HE sector, public sector providers and student services; and
- Reduced management costs, including lower costs associated with executive team and governance arrangements.

PwC merger action

Cost synergies – these were driven out over an extended period – in the initial two years the short term synergies were derived and in the subsequent two years major structural cost change was effected

Figure 2: Indicative range of administrative cost merger savings

Function	Range of efficiency savings	Ease of achievement
Marketing	10-15%	High
Central functions	15-20%	High
Finance and administration	10-20%	Medium
Procurement	15-20%	Medium
IT	20-25%	Low
Aggregate level	**15%**	**Medium**

Source: PwC

Optimise scale of operation

Seeking size and scale may be another factor that underpins merger initiatives in the current environment. In the context of a merger, size and scale is not restricted to becoming larger but rather may be aimed at gaining scale in specific elements of an organisation's operations and using these elements to increase competitiveness. For example, in the context of HEIs, this might include: breadth of subject teaching offering; geographic spread of operations; and research strength and depth.

The benefits that may result from increased size and scale for HEIs may include greater success in attracting both students and funding, increased research profile and enhanced international reputation.

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Business support – key early decisions were taken around finance reporting & systems, property, facilities management, people, technology integration and other business support activities

Success in attracting students

As students bear more of the burden for the cost of their education, the balance of power within higher education is subtly shifting, with students both expecting and demanding a clear return on their investment. As a result, HEIs are currently under pressure to become more 'consumer-focused' as student engagement and the student experience become a vital part of the educational programme. Furthermore, universities face not only regional and national competition for students, but global competition as well – from their traditional rivals in the US and Europe, as well as from those with newly global academic ambitions such as China and the Far East. With many universities dependent on overseas students to subsidise their programmes, attracting the brightest and most talented students internationally is crucial.

Success in attracting funding

The current HEI funding regime appears to be driving funding towards the larger, more established universities. Research funding is primarily targeted toward research HEIs with high quality research, particularly those with a 5* quality rating.

However, Recurrent Grant funding is calculated on a Full Time Equivalent student number basis, which gives a clear advantage to a larger HEI. So as public funding tightens there is an inevitable funding challenge for smaller HEIs.

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Brand and identity – this was selected to represent the best of both merger partners having regard to external market research. The importance of heritage was well understood and never under-estimated

Brand leverage

Benefits may be achievable around brand and particularly the greater leverage of brand for the legacy organisations. For example, association with a stronger more established brand may improve market positioning and unlock benefits in terms of attractiveness to students.

A route map for a successful merger

While the potential benefits can be great, mergers are complex. In the private sector a high proportion of mergers fail to achieve their strategic objectives. Over the decades research has consistently shown that a majority of mergers and acquisitions in the corporate world are considered unsatisfactory by their stakeholders, are outright failures, or fail to match the companies' previous organic performance. In August 2004, the Financial Times reported a failure rate as high as 75%. Public sector mergers fare no better.

In March 2010 the National Audit Office published a report titled 'Reorganising central government'. Since 2005 there have been over 90 reorganisations including mergers. Supported by PwC, the NAO surveyed over 50 of these seeking to understand whether the reorganisation had delivered value for money.

The report concluded that there is no standard approach for preparing merger business cases or assessing expected costs and benefits, no requirement to set reorganisation budgets, and no requirement to disclose the costs of reorganisations post-completion. Unsurprisingly, given the lack of a co-ordinated and rigorous approach, the success rates for public sector mergers is very low.

Public sector organisations and HEIs face the specific challenges of complex political landscapes where parties' objectives can be unclear and sometimes in conflict, where the definition of success can be ill-defined and flexibility is generally limited.

Planning and managing a merger in whatever form is a complex process. Most organisations will only ever do such a reorganisation once, and so both individual and institutional expertise is likely to be limited.

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Culture – this emerged slowly as 'best of breed' underpinned by working groups which explored the different ways of working within each legacy organisation

The NAO has made some firm recommendations on how future reorganisations should be governed to ensure greater transparency and professionalisation of the process, leading to delivery of greater certainty over the delivery of value for money. The recommendations have drawn on private sector good practice.

There are three broad steps on the way to a successful merger. These are:

- A clear strategic rationale and business case;
- Efficient execution; and
- Delivering integration benefits.

A clear strategic rationale

Determining a clear strategic rationale is especially important in the context of the HE landscape due to the diverse forms and functions of institutions, the political dimension and in differing levels of underlying performance.

Figure 3 below shows the steps that an individual institution might take on the journey to develop a clear strategic rationale.

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Strategic rationale – this was documented and explained to senior stakeholders clearly before the merger took place, focussing on benefits to clients and to the two merging organisations

Baselining

The starting point for identifying potential merger candidates is a robust baseline that sets out the current function, form, cost and efficiency of each organisation. This will in turn inform a perspective on the fitness for purpose and potential options for merger. This baselining exercise should be driven on a top-down basis with significant 'on the ground' input to ensure a consistent, robust and objective evidence base. The evidence base will form the basis for the options development and evaluation to develop a picture of a new organisation that reflects a set of roles and functions that are in line with policy.

Figure 3: Determining a strategic merger rationale

Baselining	Options development and appraisal	Business case development
Segment HE landscapes	Clear definition of new role	Verify 'merger' candidates
Map current roles, functions and courses	Definition of desired outcomes and measurable performance criteria	Validate key sources of magnitude of benefits/targeted savings
Understand current effectiveness	Options development around evidence base and available organisational changes that may be required	Define how value will be delivered and an action timetable
Analyse the financial cost base		Agree measures of success/policy

Options development and appraisal

The second step is to develop the alternative options available. Potential candidates for merger are likely to exhibit one or more characteristics that will need to be considered:

- Significant reliance on public funds;
- Similar/complementary courses;
- Lack of strategic focus/clarity;
- Lack of sustainable critical mass, including limited research capability; and
- Ineffective use of resources/poor service delivery.

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Governance – structures were established in principle at merger negotiation stage and safeguards were built in to protect the partners (owners) of each merging business

Business case development

Once merger candidates have been identified a business case development phase should be used to challenge and evidence initial assumptions and hypotheses and provide a realistic appraisal of likely implementation costs, together with the cost savings which can be achieved.

Consideration of the business case should include the following:

- A detailed understanding of the stand-alone organisations in terms of role, responsibilities, governance and financial performance;
- An agreed set of objectives with all stakeholders obtaining a shared understanding of what the potential benefits of the merger are expected to be;
- An agreed and documented governance structure setting out the ongoing responsibilities of stakeholders and key individuals; and
- A clear understanding of how success will be measured, with a well-established baseline against which benefits can be monitored.

Efficient execution

Where a strong strategic rationale for merger has been established and the policy objectives of the revised organisational model have been agreed by the stakeholders, execution should be a matter of following a well trodden path. Nevertheless, a number of key issues need to be managed to ensure a well run and smooth execution process:

Clarity in relation to approvals process

The nature of the execution process will largely be dictated by any formal approval process and the legal powers of the parties involved. It is imperative at the outset that the process is mapped out, including the timescale of implications of any new legislation and/or charity commission approval required for dissolution or establishment of bodies;

Strong leadership and governance

Robust project governance and clear leadership will provide the right framework for executing a merger. There are many examples where this has not been effectively communicated or agreed.

A recent merger of two NHS organisations failed as a direct result of a lack of clarity in leadership. This is not uncommon as the public sector tends to focus on “mergers” as a marriage of equals, but this has the potential to hinder the implementation of change and the achievement of benefits;

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Leadership – top team leadership established on an equal footing as a merger of equals at the outset. Intermediate management established to give regard to talent and capabilities of both merger firms.

Adequate and appropriate resources

The merger of organisations will require resources to be invested to support the execution and implementation phases. This may take the form of additional staff or specialist advisory support but will be most evident in cases where investment is required to release the anticipated efficiencies. Individual departments will need to ensure adequate resource is available if a wide ranging programme is to be developed;

Meaningful engagement with staff and unions

A critical area during the execution phase is the correct engagement and consultation of staff. It is likely and desirable that unions are engaged in the development of the merger plans and that staff issues are brought to the forefront of both the appraisal and execution process.

The merger in 2004 of The Victoria University of Manchester and The University of Manchester Institute of Science and Technology provides an example of successful early and effective staff engagement. Part of the solution to smoothing concerns was the extension of the terms of both respective Vice-Chancellors and written commitments that there would be no forced staff redundancies.

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People – an active communications programme was put in place for all people. Common grading, recognition, reward, appraisal, training and development systems were designed and implemented

Active communications

In order to mitigate the risk of staff unrest and also to maintain and secure stakeholder engagement throughout the process, good communication planning is a strong feature of successful projects.

> **PwC merger action**
>
> **Communications** – weekly updates to all partners and directors of each firm to keep senior stakeholders up to date on the merger progress. Cascade communications were used throughout the business

Delivering integration benefits

Mergers do not of themselves deliver value, particularly if ineffective and underperforming organisations and functions are merely consolidated or absorbed elsewhere. In order to maximise the gains achieved from the rationalisation of HEIs, other fundamental issues will need to be addressed, including dealing with overcapacity of staff, adopting an effective performance management regime and the appropriate use of shared services.

Furthermore, any large scale redundancy programme requires a determined and focussed management team, with the necessary skills around consultation and execution that such a programme requires. This includes being prepared to address union and staff concerns, as well as possible negative media publicity. One of the factors behind ineffective mergers is lack of credible management execution skills, and inability to explain credibly the rationale for the changes brought about by the merger.

Robust merger integration is critical to lock in the strategic value from the merger and to ensure a smooth delivery without unnecessary disruption being caused to the wider organisation and activities.

Integration challenges

Merger integration programmes have typically been the preserve of the private sector and present profound challenges to management, not only around delivery of financial benefits, but also to the organisational structure, customer operations, culture and people of the business. Wider stakeholders, such as regulators, also need to be managed. All of these areas need to be focussed on under an effective and dynamic governance structure, which begins planning for the execution of change in a timely way before the conclusion of the deal.

Those mergers that do not deliver value are often seen as having underperformed because:

- Integration planning began too late, in some cases after the deal has completed, and;
- Management teams focused exclusively on delivery of synergies and benefits and lost focus on the wider business, leading to drops in service standards and alienated customers.

The 100 day plan

A commonly used tool in the private sector to manage the integration process is the 100 Day Plan. This plan is the key initial output for merger integration, covering the activities that are required during the first three months of merger activity.

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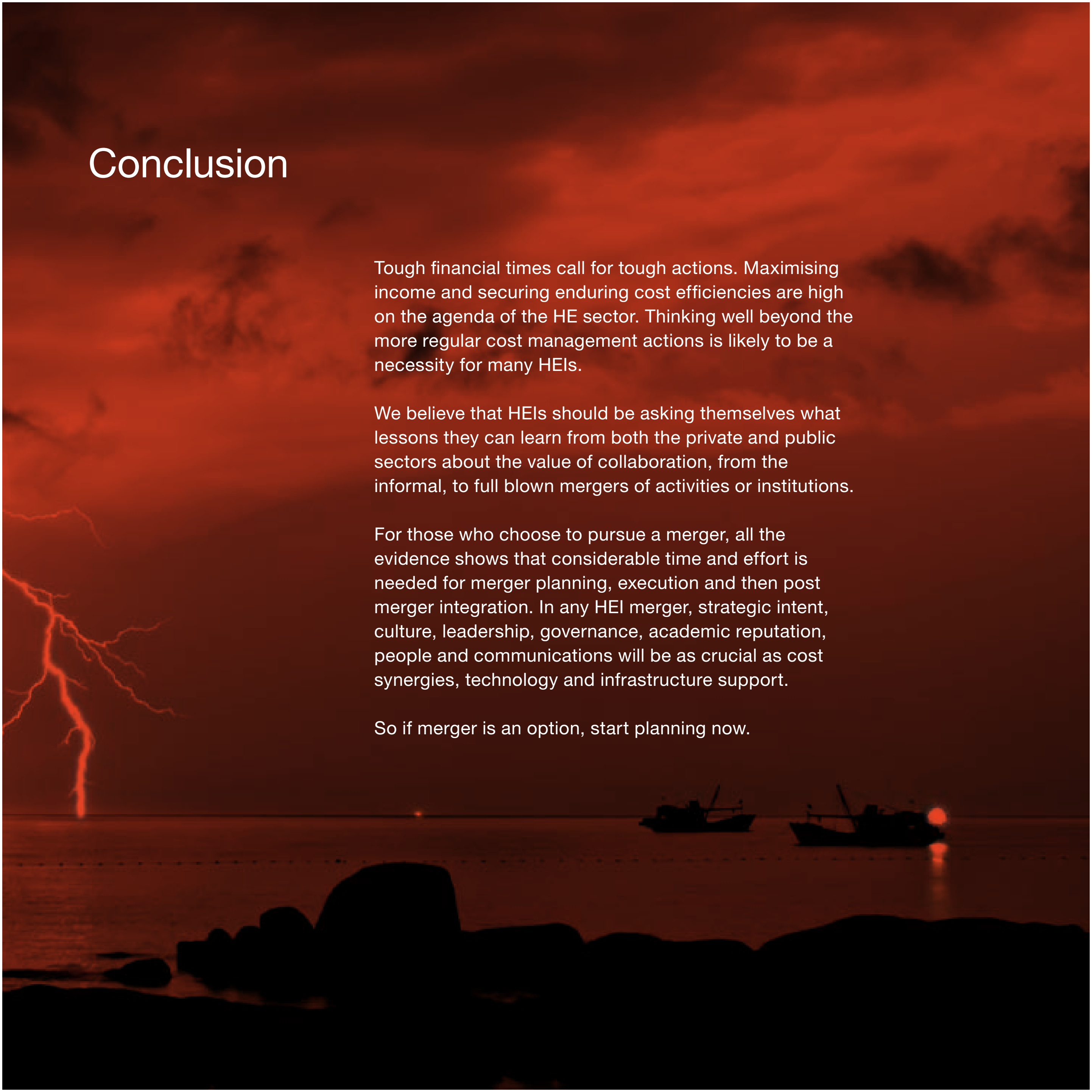
Methodologies – an immediate focus was put on establishing common working methodologies. A common business language, approach and risk management processes and procedures were established

Workstreams are set up to cover key areas (such as Customer Operations, IT, Procurement, People and Culture) reporting into the governance structure, with a fit-for-purpose series of performance indicators to track progress. A programme management office co-ordinates activity across workstreams and acts as a central hub for managing issues, risks and dependencies.

Workstreams look initially for quick wins that can deliver benefits in the first 100 days. The core element of the plan, however, looks at the longer term drivers of the business and examines what needs to change. This typically covers the target operating model, systems and processes, changes to terms and conditions and cultural change. These include the difficult and often painful adjustments an organisation has to make to deliver the greatest benefits, including redundancies, where required.



Conclusion

Tough financial times call for tough actions. Maximising income and securing enduring cost efficiencies are high on the agenda of the HE sector. Thinking well beyond the more regular cost management actions is likely to be a necessity for many HEIs.

We believe that HEIs should be asking themselves what lessons they can learn from both the private and public sectors about the value of collaboration, from the informal, to full blown mergers of activities or institutions.

For those who choose to pursue a merger, all the evidence shows that considerable time and effort is needed for merger planning, execution and then post merger integration. In any HEI merger, strategic intent, culture, leadership, governance, academic reputation, people and communications will be as crucial as cost synergies, technology and infrastructure support.

So if merger is an option, start planning now.

About PwC

PricewaterhouseCoopers' Government & Public Sector practice has been helping government and public sector organisations locally, regionally, nationally and internationally for many years. We work with organisations across sectors as diverse as health, education, transport, home affairs, criminal justice, local government, housing, social welfare, defence and international development. Our people combine deep specialist expertise with a genuine understanding of the public sector. Our Government and Public sector practice comprises some 1,300 people, who work across advisory, assurance, and tax. We bring specialist expertise from both our private and public sector practices to advise the higher education sector.

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