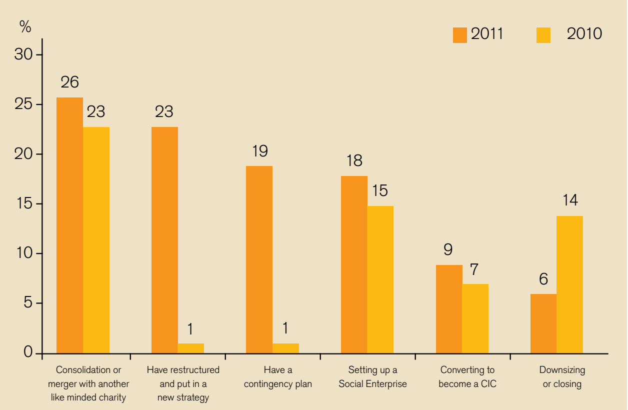
Preparing to meet the demands of changing times

We know from our recent survey of members that 43% of charities are considering collaboration and that 20% are actively considering a merger.[1] This is significantly up from previous figures. However, where charities have collaborated there are a significant minority that have not experienced the benefits that they expected and this has largely been a result of a failure to fully understand the risks. **We welcome this report as it will help charities engage with this complex area.**

David Membrey,
Deputy Chief Executive, Charity Finance Group (CFG)

Ecclesiastical research: ways charities are considering changing their business models to adapt



Changing times require changing strategies, so that charities can successfully meet the challenge of creating new opportunities within a tough economic environment, and effectively manage the risks that come with it.

Recent research commissioned by Ecclesiastical, in our capacity as a specialist charity insurer (in conjunction with independent research agency FWD), reveals that many charities are responding to the demands of this brave new world by planning to change the shape of their organisation.

One in four charities said they were reacting to changing times by 'considering consolidation or a merger with another charity' (26%). Importantly, 23% said they had already restructured and implemented a new strategy. And, of equal note, 18% said they were setting up a new social enterprise and 9% were becoming a CIC.

There is already useful guidance available for charities from the Charity Commission, CFG, NCVO and KnowHow NonProfit. Yet little, if anything, currently exists that explores the insurance implications – which can be significant.

This report examines the changing shape of the charity business model and highlights some of the practical ways that charities and not-for-profit organisations can successfully adapt and minimise their risks. **Being owned by a charity ourselves, we're committed to supporting the sector, especially in this brave new world.**

Martyn Turner,
Charity and Community Underwriting Manager, Ecclesiastical

1. Managing charities in the new normal – a perfect storm, CFG, Institute of Fundraising and PwC, 2012.

Evolving to meet the demands of a turbulent environment

Businesses of all types are feeling the effects of prolonged economic turmoil. But charities are definitely suffering under the strain.

More than 2,000 charities have had funding cut or withdrawn by local authorities. Between 2007 and 2009, voluntary donations to large charities fell by 11%. And a proposed £3bn is planned to be cut from government funding over the next five years.

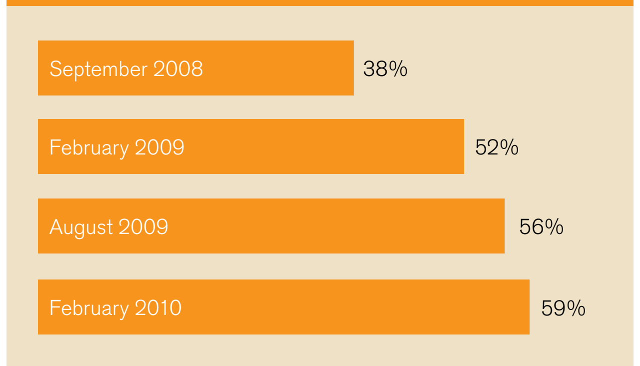
The result is that charities are being squeezed on three sides – from the decline in grants from local and national government, reduced income from donors, and growing competition for the remaining consumer spend. All of these, combined with a substantial rise in internal costs, are leading to a 'perfect storm'.

Unsurprisingly perhaps, in 2010 the number of UK charities fell by 1,600. By February of that year, the number of charities reporting that they had been affected by the downturn rose to 59%.

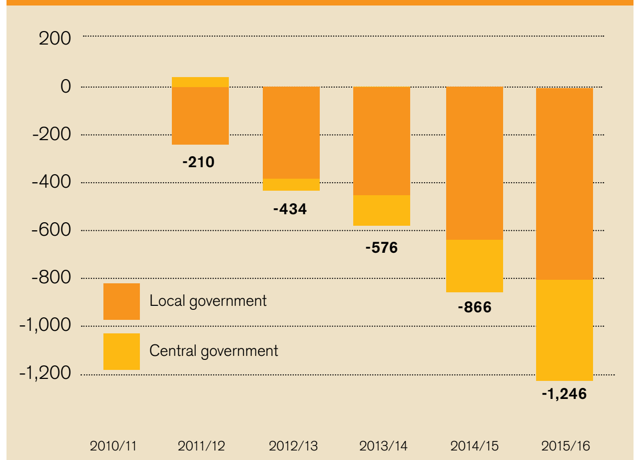
All this, with the prospect ahead of even deeper cuts in government spending on the sector.

But positively, our research also shows that fewer charities are expecting that they will need to close than in 2010 and are instead embracing the new opportunities.

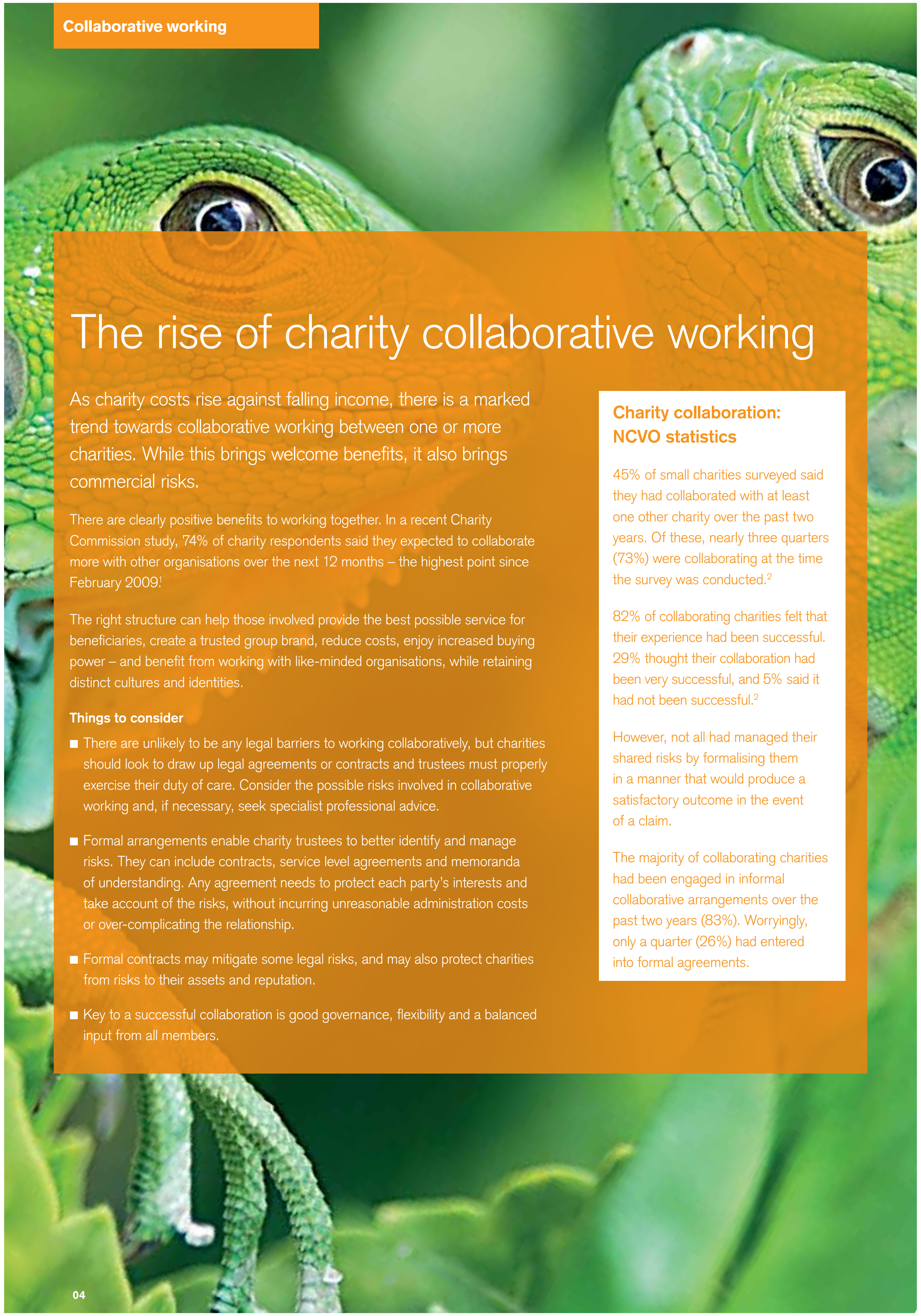
Proportion of charities affected by the economic downturn[2]



Estimated change in government spending on the sector (£ million)[2]



2. NCVO UK Civil Society Almanac 2012.



The rise of charity collaborative working

As charity costs rise against falling income, there is a marked trend towards collaborative working between one or more charities. While this brings welcome benefits, it also brings commercial risks.

There are clearly positive benefits to working together. In a recent Charity Commission study, 74% of charity respondents said they expected to collaborate more with other organisations over the next 12 months – the highest point since February 2009[1]

The right structure can help those involved provide the best possible service for beneficiaries, create a trusted group brand, reduce costs, enjoy increased buying power – and benefit from working with like-minded organisations, while retaining distinct cultures and identities.

Things to consider

- There are unlikely to be any legal barriers to working collaboratively, but charities should look to draw up legal agreements or contracts and trustees must properly exercise their duty of care. Consider the possible risks involved in collaborative working and, if necessary, seek specialist professional advice.
- Formal arrangements enable charity trustees to better identify and manage risks. They can include contracts, service level agreements and memoranda of understanding. Any agreement needs to protect each party's interests and take account of the risks, without incurring unreasonable administration costs or over-complicating the relationship.
- Formal contracts may mitigate some legal risks, and may also protect charities from risks to their assets and reputation.
- Key to a successful collaboration is good governance, flexibility and a balanced input from all members.

Charity collaboration: NCVO statistics

45% of small charities surveyed said they had collaborated with at least one other charity over the past two years. Of these, nearly three quarters (73%) were collaborating at the time the survey was conducted.[2]

82% of collaborating charities felt that their experience had been successful. 29% thought their collaboration had been very successful, and 5% said it had not been successful.[2]

However, not all had managed their shared risks by formalising them in a manner that would produce a satisfactory outcome in the event of a claim.

The majority of collaborating charities had been engaged in informal collaborative arrangements over the past two years (83%). Worryingly, only a quarter (26%) had entered into formal agreements.

Risks in collaborative working. The specialist insurer's view...

There are three main areas that pose potential risks in a collaborative arrangement:

1. A lack of clarity on who is insured can lead to gaps in cover. This uncertainty over responsibilities, as well as the type and the extent of existing cover, can leave both parties vulnerable. Dual insurance could become an issue where both charities have their own individual policies. Where this happens, it's possible the claim will be protracted as insurers argue about who should pay.

Key point: talk to your broker. If you use different brokers, ask the collaborating organisation for the copy of their insurance schedule so your broker can check for any gaps or duplication.

2. A lack of record keeping can also present problems. Charities entering into collaborative working need to consider their insurable interests and keep records up to date. Insurers can settle a claim only where there is an insurable interest*, and this may become complex if agreements between the two charities are not formalised. Equally, if an individual from one charity contacts their insurer about a claim for the other charity, it would be impossible to provide help if their relationship had not been made known to the insurer.

Key point: make sure you keep your insurer and broker up to date with any plans for collaborative working, as far in advance as you can, to make sure you're covered and reduce risks of having any claims refused.

3. Clarity on shared and individual liability, with a clear definition and accounting for what each of the relevant charities is responsible for, and liable for, is worth putting in writing. If anything goes wrong, issues of liability can have wider implications for the charities involved, and affect assets and reputation. That's why it's important to have a clear, formal agreement that's in proportion to the relative risks and complexity of the collaboration. A termination clause is a key element in any formal contract.

Key point: take legal advice if you need to, have formal written agreements on responsibilities and ensure key people including managers and trustees are clear and in agreement on this before you commence.

*Definition: **Insurable Interest** – an individual, business or organisation has an insurable interest in something when loss of or damage to that thing would cause a financial loss or other kind of loss.

1. Charities Commission. Strength in Numbers research. Small charities experience of working together www.charity-commission.gov.uk
2. NCVO – Charity Forecast 17 March 2012

Case study

Carers Trust: a positive approach to adapting to change

Mergers often pose a variety of people, property and liability risks. In this case, both Crossroads Care and The Princess Royal Trust for Carers were organisations that supported a network of about 200 local, independent charities across the UK.

The two charities had been in detailed negotiations for 18 months prior to merging, and previously had a strong history of working together.

The decision was taken to create a new charity called Carers Trust, and the assets and liabilities of both charities were transferred. As there was a risk of staff and supporters being disaffected, great care was taken to mitigate this by clearly outlining the benefits of merger.

In terms of property risks and merging of assets, Crossroads Care and The Princess Royal Trust for Carers had a number of premises to be considered.

No completely new risks were identified, but as the networks provided different services, it was felt to be important to develop understanding of the differences.

In terms of indemnity, Carers Trust was insured under the Crossroads Care Group insurance. The merger of the two organisations fell under the Group's insurance policy, which covered the Group's £77 million collective income and the merger was therefore absorbed as part of this.

Although both organisations had a good understanding of each other, the involvement and support of a specialist broker proved very useful in making certain all areas had been given care and attention.

The success of this merger highlights the key areas that charities need to bear in mind to achieve a successful restructure:

- Following a review, Carers Trust combined processes and policies including health & safety and a Risk Register which clearly flagged any issues in one place
- Due diligence needs to be proportional, but it's very valuable in terms of insight. Carers Trust made sure to involve senior staff
- Carers Trust had TUPE* transfer expertise in-house, but take specialist advice if you need to

Overall, we're very pleased with what we've achieved – with a successful merger that has taken into account hearts and minds, as well as the business model.

When you're going through such fundamental changes, it's vital to get the peace of mind from knowing that you have the right insurance cover in place. However, if you and your merger partner have a shared sense of the benefits – and regularly revisit them – then you can really focus on how through the merger you will be able to improve support for your beneficiaries. And that is vital at a time when more and more organisations are grappling with the prospects of reduced income and a growing need for their support.

Anne Roberts
Chief Executive, Carers Trust

*Definition: **The Transfer of Undertakings (Protection of Employment) Regulations (TUPE)** protects employees' terms and conditions of employment when a business is transferred from one owner to another.

Strength in numbers: charity mergers

Arguably the closest form of collaboration results in the merger of two organisations. There have been some very high-profile mergers recently – Age UK and Terrence Higgins Trust (and Crusaid) to name but two. In a similar move, Action for Blind People and the RNIB have become an association that leaves the two organisations as they are, but merges many of their activities.

Sometimes mergers are driven by the realities of economic necessity – and sometimes as the next step following collaboration. Among the country's largest charities, the appetite for mergers is growing.

Mergers between charities tend to be more administratively straightforward because of the expendable nature of their property. But the actual process of a merger between charities depends on the legal structures involved and the powers contained in each of the charities' governing documents.

When charity trustees are considering a merger and begin looking into the various options, they may identify legal issues which require professional, specialist advice. The Charity Commission has created guides to the overall process, available to download from its website.

A merger is a major undertaking, and rigorous project management is required to control the process of planning, timescales and costs as the merger progresses.

Useful resources

www.charity-commission.gov.uk
www.ncvo-vol.org.uk
www.knowhownonprofit.org
www.cfg.org.uk
www.thirdsector.co.uk

Case study

Terrence Higgins Trust: leading from the front, with an approach that always moves with the times

Terrence Higgins Trust was established in 1982. We were the first charity in the UK to be set up in response to the HIV epidemic, and we've been at the forefront of the fight against HIV and AIDS ever since. Now, we provide a wide range of services to over 100,000 people a year, and also campaign for greater understanding of the personal, social and medical issues surrounding HIV and sexual ill health.

We believe very strongly in the value of collaboration as a way to strengthen expertise and experience. We've a great history of partnerships and now have 560 staff and 1,000 volunteers. It's given us a unique perspective on the risks that need to be managed when a charity goes through any organisational change – whether it's a merger, or taking over a public service contract.

In our experience, communication poses the greatest overall risk to the process of change, so getting it right is a priority from the start.

When considering a merger, we believe that in addition to following TUPE regulations when it comes to consulting with employees, trustees also need to communicate clear reasons for the merger to everyone. It's important to avoid any potential risk of confusion or resentment, and to consider carefully the feelings of volunteers and service users. We've found that volunteers tend to be loyal to their chosen charity, and a merger creates a risk of losing their valuable support. And we're aware that employees and volunteers often see mergers between charities as hostile or predatory. So to counteract this misperception, we think it's vital to demonstrate that both trustee boards have actively chosen to make the change.

As well as people liabilities, a merger may create other, unforeseen risks – such as when one charity is currently doing something that the other is not. After our recent merger with Crusaid, for example, we took on Crusaid's highly successful charity shop in Pimlico. Whilst this was a great asset, we also needed to consider how to account for the shop and look after it. To achieve that we worked closely with our legal and accounting advisers to manage this new activity.

We'd also recommend the early involvement of specialist charity insurance brokers, whose experience can add value, especially as risks may include unusable premises, unattractively long leases, unaffordable rents, or a lack of required planning permissions.

In terms of financial risk, as part of the challenge of adapting our organisation to changing times, like many charities we have also experienced a shift away from grants towards contract-based funding.

Mergers can really help charities increase efficiency and improve effectiveness for beneficiaries. But it's important to consider a partnership at an early stage, rather than as an emergency solution. Get all the advice you need upfront – talk to your lawyers and accountants, and consult a specialist insurance broker who can make sure you'll be fully covered with the right specialist insurer. A lot of benefits can be unlocked by merging with other organisations who have similar aims and values, so start the process of talking to other organisations sooner rather than later.

Emma Snow,
Finance Director, Terrence Higgins Trust

Key risk questions to ask yourself and your broker

When you're considering the risks of a restructure, there's a lot to think about and it's easy to feel overwhelmed. Particularly, if this is an area in which your charity has no prior experience of.

A good way to start your planning is to focus on the areas of your organisation that are important and matter most to you. You'll find questions naturally arise within these areas that you can use to direct your thinking and ultimately shape your final decision, with the help of professional advice. There will usually be insurance implications and availability of cover that will help you protect your main concerns, and your insurance broker can advise you of these.

Liabilities

Consider your current business activities – is there potential for increased demand for your services? What about alternative income streams? Will staffing levels need to change? Are there any new risks that have to be considered (shops, events, volunteers forces for example)?

Are you properly assessing employment issues, such as any TUPE requirements, pension liabilities (in particular, final salary schemes) and compliance with employment law? What is the likely impact of redundancy on your charity, its reputation and your people?

Interestingly, 55% of charity CFOs anticipate redundancy procedures, yet only 10% of charities have legal expenses cover[1]. If you do have legal expenses cover, ensure you inform your broker and insurer before making any redundancies as it's probably a condition of your policy.

Could your charity cope with the cost of employment tribunals? Have you taken legal advice? Have you considered how you'll handle sensitive staffing issues, such as redundancies – perhaps even involving the most senior executives? Will you need to fill key roles, such as directors and board members?

Property

Will you need to relocate and move your people, equipment and other assets? Could this leave your current property vacant and therefore vulnerable? Would there be storage issues for surplus equipment? Could this cause health & safety risks in your new property? You'll also need to let your broker and insurer know if any of your properties will be unoccupied.

Trustee liability

All trustees must act prudently for the benefit of the charity, and to protect its assets. Are your trustees fully aware of their legal responsibilities?

Reputation and communication

Have you assessed the risks attached to the proposed merger, including operational and reputational risks? Do you have a communications plan in place for all stakeholders, especially if you are merging brands? Do you anticipate any adverse reactions, and therefore need to consider enlisting support from a PR agency?

1. CFG – new risks emerging from structured changes to charities report

Business with a purpose: social enterprises and CICs

The current economic situation has generated a real need for an innovative business structure that is able to provide both prospects for sustainable growth and opportunities to drive social change.

The financial crisis has led to extensive cuts to public services. And the degree of concern over how we can manage these cuts, yet continue to provide the best care for the most vulnerable people in our society, has brought social enterprise to the fore.[1]

There are an estimated 62,000 social enterprises in the UK and these are growing fast. In fact, social enterprises grew by an impressive 58% in 2011, compared with 28% growth for mainstream SMEs. Of these social enterprises, 14% are less than 2 years old, compared with 2% for mainstream SMEs.[1]

Social enterprises include everything from The Eden Project (insured by Ecclesiastical), to Jamie Oliver's restaurant Fifteen.

What makes them 'officially' social enterprises relates to their approach. The phrase is not a legal term, it's simply used to describe businesses that exist for a social purpose.

Alternatively, many charities and social enterprises are adopting the Community Interest Company (CIC) model.

In effect, CICs are limited companies with special additional features, created for the use of people who want to conduct a business or other activity for community benefit, and not purely for private advantage. CICs must serve the community interest and operate a statutory asset lock to ensure that all assets are retained within the CIC for community purposes.

At Ecclesiastical we are seeing more requests to cover new ventures formed as social enterprises and CICs, as well as existing charities setting up a social enterprise arm as an additional revenue stream.

The move to social enterprise or a trading venture has traditionally been a concern for many charities – not just in terms of the new and unknown risks it poses, but also the fear of appearing to be 'selling out' to generate new income streams. This needn't be the case, however. In fact, you might find you have an opportunity to raise awareness of your cause in a whole new way. And, most importantly, it can provide a sustainable income stream, as people feel they're getting something back for their contribution – which is becoming increasingly meaningful in the current economy.

1. Fightback Britain: A report on the state of social enterprise, 2011 www.socialenterprise.org.uk

Key risk questions to ask yourself and your broker

Once you have decided to take this route and taken legal advice on setting up your new venture, again there are some essential things to think about in terms of your insurance cover, as social enterprise and trading will considerably change your risk profile.

Again, you'll also need to talk this through with your insurer or broker as this will change your insurable interest, so you'll want to make sure you have the right cover in place and have the relevant risk management advice.

Liabilities

Are you aware of all UK legislation that you may need to comply with (depending on your activity), such as The Sale of Goods Act, Distance Selling and Food Safety? Are you clear on all financial and tax implications? The UK Trading Standards website can be a useful place to start **www.tradingstandards.gov.uk**

Have you created a risk register to identify all possible risks of the new activities, and how you'll manage them?

Have you got robust employment and health & safety policies and procedures in place? How will you recruit and train the right people to deliver your products or services and stay true to your organisation's vision?

Property

Will you be using new premises for the new activities, or trading from where you are now? Do you have a disaster recovery plan in place?

Trustee liability

Are you collaborating with any other organisation on the venture? Have you seen their policies and procedures? Are you clear and agreed between you on trustee and other liabilities?

Reputation and communication

Have you communicated your plans to all stakeholders, from both the existing charity as well as the new venture?

Insurance

What changes do you need to make to your insurance policy to make sure you've got everything covered? Does your current insurer understand your changing risks, and offer the cover you need?

Ecclesiastical provides Guidance Notes to customers that cover many of these areas in more depth.

Ecclesiastical Risk Services (ERS) is an independent risk management consulting service, designed to help organisations identify, minimise and manage their risks. Find out more at **www.ecclesiastical.com/ers**

Case study

The changing shape of Salter's Hill: from charity to social enterprise

Salter's Hill Charity provides services for people with a learning disability and promotes choice, independence, respect, dignity and responsible lifestyle choices. We support each individual to give them real choices and they have genuine influence on how our services are provided.

Now that the local authority funding landscape is changing, pressure is being put on our already low margins (margins that would not be commercially acceptable). This combination of changes to the regulatory landscape, further funding restrictions and cost pressures has driven the need for us to change.

We recognise that we may need to adapt by changing the fundamental way our organisation operates. To make sure we can continue our mission of effectively meeting the needs of adults with learning disabilities in the future, we're looking to change our business model and become a social enterprise within the next three to five years.

We've identified the commercial and insurance-based risks that we'll be exposed to when we become a social enterprise. And looking ahead, we may need different insurance cover depending on the activities we undertake – trading stock for a charity shop, or a café, perhaps.

One of the most important risks we'll need to consider is the financial reality of a reduction in local authority contract funding. As we are dependent on these funds to a very high degree, this is an important consideration for us. As a smaller charity, we don't have the more diverse income streams that bigger charities often benefit from. So the risk for us is relatively higher than it might be for a larger organisation.

We've developed a rewarding long-term relationship with our broker, and rely on his specialist knowledge and advice when it comes to making the right decisions for our organisation. We see his input as vital to the success of our plans to evolve our business model to include growth and diversification strategies, business management (as well as care management), and professional fundraising.

Rob Woolf,
Finance Manager,
Salter's Hill Charity Ltd

A new look to the landscape of public service delivery: bidding for contracts

The Big Society agenda has created some unexpected growth opportunities for the third sector to create sustainable, new revenue streams by bidding for public service contracts.

A bid of this nature requires skill sets that are not always available in-house with charities (such as the demonstration of risk management expertise).

The understanding of specific contractual obligations and their insurance implications is a highly specialised subject, and one where the support of your broker, along with a specialist insurance provider and legal adviser will be very valuable.

It's very common that charities tendering for public service contracts will be asked to show their health & safety policy and will be required to have a named competent person for health & safety advice. ERS can fulfil part of this service for smaller charities or provide back-up and advice to larger organisations.

One of the key goals of the Big Society agenda was to open up the delivery of public service contracts to a wider range of providers, including charities. With more organisations having the opportunity to bid, competition for the contracts will naturally increase. Although, that said, there may also be opportunities to collaborate with other organisations, which could add value to your bid.

It all adds up to a promising position for charities to be in. But if a charity decides to enter into a competitive tendering process, from the very start the trustees must carefully consider the risk implications of any competitive tendering process.

Key issues include:

- The legal implications of bidding mean it is generally considered that public service contracts are inappropriate for unincorporated charities, because of the high levels of risk that trustees would personally bear. If you are thinking about bidding for contracts, it's worth considering incorporating your organisation.
- Identifying and managing the possible and probable risks that a charity may face is a key part of effective governance for charities. That's why an early assessment of the likely risks should be undertaken well before any final decision to tender.
- Trustees should play an active part in this process, taking into account both the identified risks and likely opportunities. With this in mind, and to confirm that the terms of a contract are in the charity's best interests, it's well worth seeking professional legal and financial advice.

Key risk questions to ask yourself and your broker

When deciding whether to bid for service contracts, there are several issues, risks and steps that you need to consider. By asking some searching questions, you and your broker can determine whether your charity is ready to bid, has the resources that such a commitment would require - and the means to deliver the contract if the tender is successful.

Liabilities

Is this contract or service a natural fit with your current charity aims and objectives? Do you fully appreciate the consequences of taking on public sector employees? Will you have to consider redundancies or loss of staff and volunteers? Are you prepared for this? Do you fully understand current employment law and its implications? Are you insured for such exposure?

Trustee liability

Are you being asked to make any personal guarantees as trustees or directors? Could you be taking on any onerous terms and conditions or additional liabilities? Have you sought all relevant legal and financial advice?

Reputation and communication

Will all your resources now be redirected or can you still carry on with your usual activities? Have you discussed this with your supporters and beneficiaries?

Look carefully at the 'what ifs?'

Are you better off considering other options such as mergers, or collaborating with other charities to tender rather than go it alone? What if you do not win the contract, what next?

Insurance

Are you fully insured for any new or additional activities and/or services and have you discussed these with your insurance broker?

Taking cover: changing your business model could leave you exposed

This report has explored many of the common considerations and risks that charities need to manage in the process of change which we hope you've found helpful. The good news is that insurance cover is available to cover most risks and support you as you explore new ways of working.

Benefit from the specialist expertise of the charity sector's best insurer

As a charity insurance specialist, Ecclesiastical has been insuring not-for-profit organisations for 125 years. Today, we insure thousands of the nation's charities of all sizes and complexities – including youth and children's charities, pastime clubs, advice and support groups and many more. So it's no wonder we've been voted best charity insurer for the last five years running, by both charities and brokers.[1]

- Charities name our quality of service, our value for money cover and our understanding of the market as key reasons why they consider us the best charity insurer
- They also like the fact that we're committed to the sector and want to protect its future by defending unfair claims that could set a precedent
- Our in-house specialist charity underwriting expertise is built from years of experience, so we know what cover charities really need
- Our charity and community insurance cover has been developed from ongoing research and feedback from charities, insurance brokers, the sector, and our own claims analysis
- We take pride in high levels of claims satisfaction. In 2011, 98% of our customers were satisfied with their overall claims experience
- We help charities reduce risk – customers get free risk guides covering everything from events to outings and staff protection
- Ecclesiastical Risk Services is an independent risk management services company, offering risk consultancy services to help organisations such as charities identify, minimise and effectively manage their risks, and you can employ their services even if you're not an existing Ecclesiastical customer. Find out more at **www.ecclesiastical.com/ers**
- **We understand – we're owned by a charity ourselves and are one of the UK's top 15 corporate donors.[2]**

Ecclesiastical
Always on your side

125 years making a difference Ecclesiastical

Speak to your broker for more information about our approach to the charity and not-for-profit sector, or visit **www.ecclesiastical.com/charityinsurance** to find a broker.

1. Of those brokers who named an insurer in the survey, the majority named Ecclesiastical as the best insurer for insurance. Research carried out by FWD, an independent market research company.
2. The Guide to UK Company Giving 2011/12, Directory of Social Change.

05/2012