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Good practice
Guidance for senior managers
This report is for information and guidance

This document is aimed at higher education institutions considering merger. It provides general guidance on the process of merger, some of which may be relevant to other forms of alliance. It is not intended to be prescriptive, but where institutions seek funding from us we will expect them to follow the broad outline of this guidance.

Mergers in the higher education sector

A guide to good practice

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Mergers in the higher education sector: a guide to good practice

To	Heads of HEFCE-funded higher education institutions Heads of universities in Northern Ireland
Of interest to those responsible for	Strategic planning, Management
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Executive summary

Purpose

1. This document provides good practice guidance to higher education institutions considering merger.

Key points

2. Institutions are responding to the challenges of a rapidly changing higher education environment, and some are discussing mergers and other forms of alliance. This guidance describes a general approach to managing the process of merger. Elements of it may be useful in planning other collaborative arrangements.

3. The first stage is to develop a business case for consideration by governing bodies and relevant external bodies. With agreement to proceed in principle, the next stage is to develop a business plan, which sets out in detail how the merger will take place.

4. This guidance is not intended to be prescriptive, although if institutions intend to bid for discretionary funding, for example from the Strategic Development Fund (HEFCE 2003/28), we will expect them to follow the broad outline.

Action required

5. This report is for information and guidance.

Introduction

6. This guidance was originally issued for consultation as Circular Letter 18/2003, and incorporates comments and suggestions received from the sector. It is designed to assist institutions considering merger. Mergers arise in a variety of circumstances and take different forms, and so this guidance describes a general approach to managing the process. It is not intended to be prescriptive, and full merger should not be seen as the sole model for collaborations between institutions. Elements of the guidance may, however, be useful for other forms of alliance short of merger.

7. Paragraph 80 of the financial memorandum between HEFCE and institutions (HEFCE 2003/54) requires them to involve us actively at the early stages of any proposed merger. We have responsibilities in relation to the academic and financial viability of the institutions we fund, and a duty to ensure that the interests of students are not jeopardised. Even when no financial assistance is sought, merger proposals almost inevitably will have an impact on future funding requirements.

8. Where institutions intend to bid for discretionary funding, for example from the Strategic Development Fund (HEFCE 2003/28), we will expect them to follow the broad outline of this guidance – thereby demonstrating that value for money is being achieved – and their proposals will be evaluated against it. However, we recognise that each set of circumstances is unique and we will not seek to impose a single model or methodology. Mergers with or between small institutions are also likely to be different, and some of the following detail may not be appropriate to them.

9. In assessing whether to fund proposals, we will consider how they fit with our strategic priorities. We will act reasonably in requesting information and will have regard to the costs and burden of providing this information. We will respect the confidentiality of the institutions involved.

Project management

10. The process of considering and evaluating strategic options is likely to be time-consuming for senior managers in the institutions involved. To provide coherence and impetus to the project, institutions will probably need to set up a multi-disciplinary project team as soon as the opportunity or problem is identified. Such a team will need clear terms of reference and the authority to represent the institutions and commit them to act. Ideally, it should comprise senior staff from all the key academic areas and functions: for example, teaching and research, estates, finance, and human resources. In planning their programme of activity, team members will wish to consider the volume of work that will be necessary, timescales, reporting deadlines and the resourcing implications, and whether they need formal training in project management. In many cases it will be essential to have a dedicated project manager to guide the proposal through the processes of producing a business case and business plan.

11. There is often a role for external professional advisers to supplement the expertise of institutions' own staff, for example in identifying suitable options and appraising them, preparing an estates strategy, and considering ways of financing the merger costs. This may be particularly important where timescales are short or senior staff cannot be released from their existing duties. The role and terms of reference for such advisers, and their relationship to the project team, should be clearly defined at the outset.

12. Early and regular contact with us and other major funders and stakeholders is advisable, particularly where discretionary funding is sought. In our case, this contact should primarily be between

the project team and heads of institution and the HEFCE regional consultant. In reviewing funding requests from institutions, we will draw on expertise across the Council.

13. Where institutions seek funding from us, we will seek agreement to take the lead role, on behalf of most other public funding bodies, in evaluating the business case. This will reduce the burden on institutions, although in some instances these other bodies may have their own requirements and therefore ask for additional information. They may also have separate approval processes. Bodies such as the Learning and Skills Council (LSC) have to meet their own statutory responsibilities, and institutions should bear this in mind in planning their work.

14. In preparing a business case and business plan, institutions may wish to refer to other guidance we have issued, for example:

- 'Model financial memorandum between HEFCE and institutions' (HEFCE 2003/54)
- 'Investment decision making: a guide to good practice' (HEFCE 2003/17)
- 'Financial strategy in higher education institutions' (HEFCE 2002/34)
- 'Risk management: a guide to good practice' (HEFCE 01/28).

General outline of the process

15. In common with other major strategic changes, there are essentially two stages in the process of developing a merger proposal:

- building a business case
- writing a business plan.

16. The business case comprises all the work needed to identify the preferred solution to the strategic problem or opportunity, and to seek commitment from the governing bodies and relevant external bodies to proceed in principle. When the case has been adequately made, the more detailed work of the business plan can begin. This sets out how the institutions will implement the preferred solution.

17. Where institutions seek funding from us, we will expect to see a sound business case, broadly defined by the stages that follow, although modified by individual circumstances.

18. In practice, although the work can be formally planned as a project, much of it will be iterative. The development of the business case and business plan may run concurrently. For example, in conducting the assessment of options (see paragraphs 24 and 25), institutions may need to prepare detailed financial forecasts (see paragraph 48), which are logically part of the business plan stage.

Developing a business case

Identify the opportunity or problem

19. A clear definition of the strategic problem or opportunity forms the basis of the whole process. Governing bodies are likely to be involved at this initial stage, and throughout. The results of the appraisal may lead to a redefinition of the problem or opportunity, or call into question whether it does in fact exist.

Consider the strategic context

20. The strategic context comprises the missions, aims and objectives of the institutions involved and of their major stakeholders, such as HEFCE, LSC, the Office of Science and Technology and Regional Development Agencies.

Decide vision and objectives

21. The statement of vision and objectives sets out what is to be achieved, and defines a firm boundary to the appraisal. It provides the criteria for assessing the options and evaluating the project's success.

Identify the options

22. In the context of major strategic change, it is important to consider a range of options, even though some may be rejected at an early stage as being unrealistic. Institutions may need external professional advice to help them identify options and engage in market research.

23. The options should include 'do nothing' as a baseline or the 'base case', even if this fails to achieve the key strategic objectives. It will form the basis for comparing the costs and benefits of all the other options. Where 'do nothing' is clearly unacceptable, then 'do minimum' will be the base case.

Assess the outline costs and benefits, risks and uncertainties

24. The assessment of each option typically comprises:

a. Economic analysis – discounted cash flow forecasts, based on total costs, benefits and quantifiable risks (usually over 25 years), with key assumptions clearly stated, to yield a net present value (NPV).
b. Sensitivity analysis – how the NPV changes in response to variations in the key assumptions.
c. Appraisal of the non-financial aspects.
d. Risk assessment – risks and uncertainties are often best clarified by setting them out in a formal risk register. This should identify which factors will make it impossible to proceed with the merger.

25. The assessment of each option should also set out the impact on the following, as appropriate:

- the institutions' own strategies
- staff
- students
- if HEFCE funding is sought, HEFCE's core aims as set out in our strategic plan (HEFCE 2003/35):
  – widening participation and fair access
  – enhancing excellence in learning and teaching
  – enhancing excellence in research
  – enhancing the contribution of higher education to the economy and society
- other funders' core aims
- the region
- regional HE provision (for example, how it complements provision by neighbouring institutions; and diversity of provision, in terms of range, choice and quality)

- national HE provision (also including diversity of provision)
- FE provision (where appropriate, noting the risk of 'mission drift').

Communicate with staff and other key stakeholders

26. Before launching a proposal for merger, institutions will normally wish to take account of staff views through a formal consultation process. This might take place when the strategic opportunity or problem has been identified or during the assessment of options. Staff are likely to be concerned about the personal implications of proposals, but their insights might also help institutions to evaluate the options. Early and sustained communication with staff and trade unions will reduce the risk of alienating them during the process. Synchronising communications by the merging institutions will help staff to feel they are being treated equally.

27. Other key stakeholders will also expect to be kept informed, for example funding bodies, Regional Development Agencies and major benefactors, whose support may be important for a successful merger.

Select the preferred solution

28. The preferred solution must achieve the strategic objectives and be both viable and affordable. It may not necessarily have the highest NPV of the options assessed, as higher NPVs may result only from unaffordable levels of investment. It may be possible, however, to scale back some of the investment and still achieve the main objectives. There is therefore likely to be some iteration between the assessment of costs and benefits (above) and the assessment of affordability (see below). It may be necessary to weigh the financial advantages of one option against the non-financial advantages of another. The extent of risk and uncertainty will also influence the final choice.

Review and agree the strategic mission

29. Having identified the preferred solution, it is appropriate for the institutions to review and agree the strategic mission of the merged entity.

Develop an academic strategy

30. This should follow logically from the agreed strategic mission and will form the basis of the estates strategy and staffing plan.

Develop an outline estates strategy

31. Estates and infrastructure costs are often the largest cost in any merger. Reorganising the estate to meet the requirements of the merged institution can be one of the most complex tasks and take many years. At this stage the institutions will need to consider the estates implications of merger.

Identify savings and/or increased levels of activity

32. The economic analysis (paragraph 24a) will help to identify likely cost savings and/or increased levels of activity arising from merger. This may form an important part of the rationale for public sector investment (see paragraph 36). However, there are risks in assuming that merger will of itself deliver cost

savings, and in attempting to make savings too quickly. In the short term, the merger process may actually increase costs, because of the greater workload, and institutions should take a realistic view of the costs involved in managing the process.

Identify funding sources and assess overall affordability

33. The preferred solution must be affordable, within known or likely sources of finance. Total merger-related costs and the likely timetable of investment should be set out against (phased) funding, the sources for which might include:

- institutions' own funds (cash and realisable investments)
- asset sales
- borrowing
- Private Finance Initiative or Public Private Partnership arrangements
- grants from public bodies
- fundraising and endowments.

34. It is unlikely that total funding can be confirmed at this stage, but any material 'funding gap' will make it difficult for the institutions to proceed, and might make it impossible for public bodies (where appropriate) to give consent.

35. The assumed investment and funding must be realistic and affordable. For example, borrowing should not be so high that it will be difficult to raise finance, or that it will impose a heavy burden on annual budgets. Any assumed levels of public investment should be in line with what might reasonably be achieved and be consistent with the published criteria for such investment. Early contact with us will help to establish how much HEFCE funding might be available.

Provide the rationale for any public sector investment

36. Where the proposal involves bids for public sector investment, it should state clearly which bids are to be made and against which criteria. If institutions seek funding from us, they should explain how merger would support the achievement of our aims or cross-cutting themes, as described in our strategic plan. We will expect them to demonstrate a benefit to higher education as a whole, beyond that accruing to the institutions themselves.

Set out the process for merging the institutions

37. A merger will involve the dissolution of one or more institutions, so this stage of the process sets out what needs to be done, when and by whom. This is particularly important where consents are required from other bodies, such as the LSC or the Privy Council.

Set out the outline action plan and timetable

38. The outline plan will summarise the main actions that need to be taken, and by whom, to achieve the preferred solution within a realistic timescale. External advice in this area is particularly recommended.

Seek commitment of the governing body and external bodies and funders

39. Before the start of detailed implementation planning, the institutions will need to seek explicit commitment from their governing bodies and consent from any relevant public bodies. Governing bodies should give their approval to proceed only when they are satisfied that there is a sound business case, demonstrating that the proposal is viable, affordable and consistent with the institutions' strategic direction. Their decision should take into account the views of academic boards (or equivalent) and the results of consultation with staff. The success of proposed mergers depends on the early and continuing commitment of governing bodies and heads of institution.

40. At this stage the institutions should also seek indicative and in principle commitment to funding from relevant public bodies (subject to the more detailed business plan confirming the business case). The absence of such commitment might call into question whether the proposal is affordable.

Developing a full business plan

41. The information provided in the business plan should be consistent with the business case.

Confirm the assumptions and strategic context

42. When the governing bodies are committed to the proposal and the appropriate public bodies have approved it in principle and/or any funding for associated costs, the institutions can devote more resources to exploring the merger in detail. Depending on how much time has passed, they may need to confirm that the original major assumptions are still valid. If there are significant changes, the assessment of options may require updating, and this might lead to a different preferred solution, which in turn will require a new commitment from the governing bodies (and so on).

Conduct due diligence on the participating institutions

43. Institutions need to gain an objective view of the financial and legal position of the other parties. Due diligence work is often conducted by professional firms. Determining the financial position will include identifying possible or contingent liabilities, assessing future business prospects and testing the assumptions used in the business case. The results of this analysis will feed into the financial forecasts (see paragraph 48). Failure to clarify the legal or financial position and reach agreement on the acceptable level of risk will make it impossible to proceed with the proposal.

Agree the financial strategy

44. An agreed financial strategy will provide the framework for the staffing plan (paragraph 45), estates development plan (paragraph 46), other key strategies (paragraph 47), financial forecasts (paragraph 48) and the investment and funding plan (paragraphs 49 and 50).

Develop a staffing plan

45. It is now appropriate to consider overall staff numbers and grades for each of the principal activities and functions, and to set out the timetable, criteria and process for staff appointments. The policy on staff restructuring, if appropriate, should be stated. There may be issues about achieving common terms and conditions, which will involve discussions with staff and trades unions. It is

particularly important to be sensitive and as open as possible with all staff at this time, not least because this impacts on morale.

Develop a detailed estates development plan

46. A thorough assessment of the existing estate and future space needs arising from the various strategies and the staffing plan will form the basis of detailed planning for individual buildings and projects. There may be an opportunity to examine how to use space innovatively and to increase space utilisation. The results of this work may change the assumptions in the original assessment of options and affordability, in which case there may need to be iteration to ensure that the estates strategy and development plan are realistic and affordable.

Develop other key strategies

47. The institutions will need to develop strategies and plans in other key areas such as information and communications technology and information management, learning resources, and equipment procurement. It is important to plan at an early stage for the integration of management information systems and reporting systems, and the migration of finance and student records and HR systems.

Produce financial forecasts

48. The assessment of options will have identified the costs and benefits of merger. Those assumptions, now confirmed or revised as appropriate, will form the basis for financial forecasts extending over a number of years up to and beyond the date of merger. It will be helpful to prepare them in a familiar format, such as that used in the five-year forecasts sent to HEFCE each year (for example, refer to the tables in HEFCE 2003/19, 'Annual monitoring statements, corporate planning statements and financial forecasts 2003').

Confirm the levels and sources of funding, and consider financing options

49. The work on the estates development plan, staffing plan and financial forecasts will confirm the total level of investment and the timescale over which this will take place. Institutions will need to update their assumptions about sources of funding and, if necessary, scale back or change the timetable for the investment to match the available resources.

50. It is appropriate at this stage to explore in more detail the financing options and their associated costs. Institutions will need to consider the requirements of their financial memorandum with us at an early stage if they are likely to exceed the borrowing thresholds.

Develop governance arrangements and management structures

51. It is important to put in place new governance arrangements, consistent with best practice, to ensure that the merged institution is able to function properly from the date of its creation. This will include a clear process for the appointment of new governors to the board and its committees. Similarly, there should be agreement on the senior management roles and the process for making appointments.

52. Where there is to be a new institution, a 'shadow' management team and board should oversee the implementation plan up to and beyond the merger date. They will need to have clear powers and an agreed relationship with the existing management teams and boards.

Develop a comprehensive implementation plan

53. A comprehensive implementation plan will include the timetable for merger, with lead responsibilities clearly defined, a risk analysis, contingency plans, and an outline of project management arrangements.

Monitoring and evaluation

SMART objectives and targets

54. Monitoring of progress will be easier where objectives and targets are SMART: specific, measurable, achievable, realistic and time-specific.

Key milestones

55. The key milestones are those actions which drive the merger process and are essential for subsequent work to be done (such as appointing the new senior management team, and creating the new legal entity).

Monitoring process

56. Institutions will want to have an agreed process to monitor achievement of the implementation plan and the meeting of key milestones. Where we provide funding to support the merger, we will remain in regular contact during the implementation phase and agree a monitoring process.