Association of Colleges
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Briefing (Draft)

Title: Merger tips
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Merger Tips

Introduction

1. There are now 335 further education and sixth form colleges in England compared to almost 500 when colleges were incorporated in 1993.

2. The Government's national programme of area reviews of colleges has created a lot of interest in college mergers. The Department for Business, Innovation and Skills (BIS) and Department for Education (DfE) guidance published in September 2015 says that the process is:

   > "likely to result in rationalised curriculum; fewer, larger and more financially resilient organisations; and, where practicable, shared back office functions and curriculum delivery systems."

3. This implies mergers, demergers, federations, shared services and other structural changes. There is a risk that this will be costly and distract attention from everything else that a college does. The purpose of this document is to help college governors and leaders and all those involved in area reviews understand the issues related to college mergers by summarising the recent history and by explaining what is involved in a merger. The document is organised into two sections:

   Part One: An analysis of college merger issues

   Part Two: Merger tips

4. This document has been assembled from intelligence gathered by Association of Colleges (AoC) staff in the course of our work and with the help of a number of people in variety of roles including Matt Atkinson, Jean Inker, Chris Payne, Liz Phillip, Christina Sadler, Education Funding Agency (EFA), Skills Funding Agency (SFA), BIS and FE advisers. **The document does not replace the need for legal advice and it represents the situation at the end of October 2015.** Policies and processes may change. If you think there are errors or have suggestions for improvement, please contact Julian Gravatt (Julian_gravatt@aoc.co.uk).

Part One: An analysis of college merger issues

Merger facts and figures

5. There are now 335 colleges[1] but there were almost 500 at incorporation in 1993 and as many as 800 in the 1960s. In the aftermath of incorporation, the people regulating colleges created a number of new processes for merger which are still in operation today. These include:

   - A merger process which involves two or more colleges pooling their assets, liabilities and governance.
   - A transfer process into the higher education (HE) sector in cases where an FE college's HE student numbers exceed 55% of the total student population[2].
   - A process for creating new FE colleges[3].

6. The first college mergers took place very soon after all colleges were incorporated in 1993. There have been a steady flow of mergers in every year since for a variety of reasons. Some key causes and trends have been:

   - A decision by two or more governing bodies that a merger would create a stronger college in terms of finance and quality of provision.
   - External support for mergers for example via the Rationalisation Fund which was made available to colleges between 1999 and 2002.

7. There have often been cases where government departments or funding agencies have pushed a particular college to merge – generally in cases where its finances are weak or its quality has been judged poor. However in these cases, as in all other mergers, the decision on which colleges should merge and how has always been taken by college governing bodies. To date (since 1993), there have never been more than 10 college mergers a year in England.

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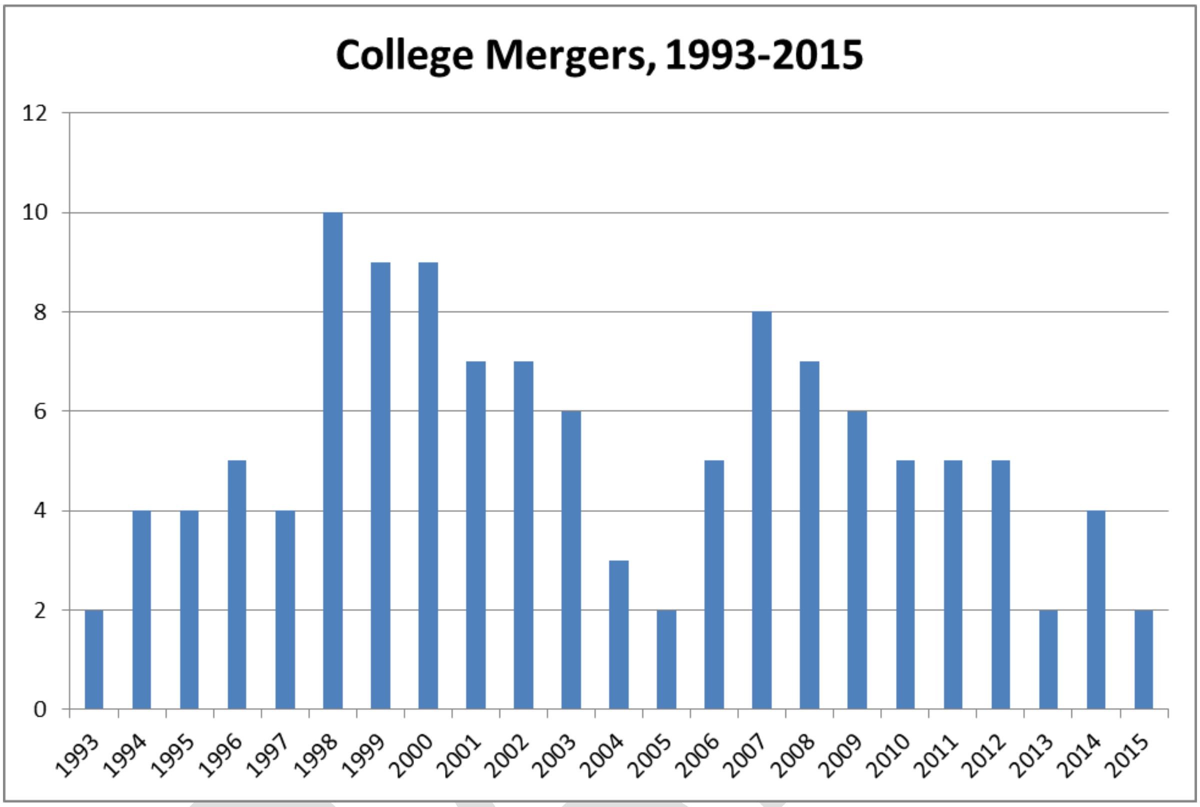
[1] There are 232 further education colleges, 93 sixth form colleges and 10 special designated institutions

[2] FE colleges whose HE student numbers exceed 55% of the total can apply to the Secretary of State to become HE institutions.

[3] In the years after 1993, the Department for Education and Skills converted a couple of local authority education services



Mergers in the rest of the UK

8. Colleges in Scotland, Wales and Northern Ireland were also transferred out of local government control in the 1990s, incorporated as statutory college corporations and given a direct relationship with national Government in terms of funding and regulation. In the other three parts of the UK, there have been simultaneous college mergers as a matter of policy:

- In Northern Ireland, the Department for Employment and Learning directed the 16 colleges to merge to create six larger colleges in 2007[4]. Colleges were given revenue funds to pay for restructuring costs and were given access to capital funds for new buildings. Since 2011, Northern Ireland colleges have been classified as public sector organisations.

- In Scotland, the Scottish Government passed legislation to complete the restructuring of colleges and to make them accountable to regional

[4] The plan for restructuring of colleges in Northern Ireland was outlined in a Northern Ireland Government strategy

boards. Between 2011 and 2014, the number of Scottish colleges reduced from 37 to 20 and there are 14 regional boards. Scottish colleges are also classified as public sector organisations. The Scottish government provided £52 million to support merger costs but anticipates longer-term savings of £50 million.

- In Wales the number of colleges has reduced from 25 to 13 but there was more scope for individual colleges to decide how to reach a certain size. Several of the Welsh mergers have involved colleges joining universities.

9. Mergers in Scotland provide various recent lessons on the process itself. The Audit Scotland published a report in 2015[5] which made several interesting recommendations:

    - The Government needed to specify how they would measure and publicly report on the benefits expected from mergers and on costs and savings.

    - College boards should comply with regulations and good practice when considering and approving senior staff severance and should complete remaining merger activities including standardising terms and conditions for all staff, curriculum reviews and integration of ICT systems.

10. College mergers take time. 18 months after most Scottish college mergers took place, the Scottish Audit Office felt there was more work to do.

Merger process

11. The college regulator (the Further Education Funding Council (FEFC)) designed a process to organise mergers properly and classified mergers into two types. These are:

    - Type A mergers (where all the existing corporations were dissolved and a new one created).

    - Type B mergers (where one corporation continued; the others were dissolved and the staff, assets and liabilities transferred into it).

12. AoC's analysis of the mergers shows that Type B mergers (single dissolution) have been used in 80% of standard college-to-college mergers. There are several reasons why Type B mergers are more popular:

[5] Audit Scotland "Scotland's Colleges 2015"

- Continuity of name and brand for one of the colleges.
- Continuity of employment and contracts.
- Easier to explain to students and stakeholders.
- Minimises risk of delay pending official approval.
- Likely to be quicker and more predictable because the colleges are in control of the timetable.

13. College-to-college mergers are only one of the ways in which colleges have changed their structure. Structural changes include:

- Three way mergers.
- Merger with a higher education institution.
- Merger with a school
- Acquisitions of private training providers or local authority service
- Partnerships which link relationship between two colleges.
- Legally binding federations.

14. Table 1 provides an estimate of the number of cases:

	Last 20 years	**Last 5 years**
New colleges	8	2
Type A mergers (double dissolution)	16	2
Type A merger (triple dissolution)	4	0
Type B merger (single dissolution)	99	12
Merger with higher education institution	12	1
Transfer to higher education sector	9	2
Merger with a school	2	2
Acquisition of private training provider	c150	c30
College partnership (parent/subsidiary relationship)	1	1
Legally binding federation	4	4

Legal status of colleges

15. It is necessary to understand something about the legal status of colleges to understand how and why they make decisions on mergers.

16. Colleges are statutory corporations. They were incorporated, or designated, under the Further and Higher Education Act 1992. This act transferred staff, assets and liabilities out of local government and created a corporation with a widely drawn set of powers and duties covering the provision of further, higher

and secondary education[6]. These powers are vested in the college's governing body (sometimes referred to as 'the board', or 'the Corporation'). The 2009 Apprenticeships, Skills, Children's and Learners Act created sixth form colleges as a separate category of college ("a sixth form college corporation") but did not change the legal fundamentals of their status[7].

17. Several features of college status have remained the same for the 20 years since incorporation:

- The common legal form for colleges has made it relatively simple for successive governments to apply legislation to college corporations (for example laws on freedom of information[8] or special education needs[9]).

- A clear legal separation from schools and from higher education which has limited mergers despite curriculum crossovers[10].

- Their charitable status which acts as a safeguard for their assets used for charitable objects[11].

- Their VAT status (a 20% tax on contracting out; one reason why all colleges spend more than 50% of income on directly employed staff).

- The requirement that they offer teachers' pensions or local government pensions to their staff (existing obligations on councils transferred to newly incorporated colleges in 1993).

18. Despite the rhetoric of the time, incorporation was actually a step away from full privatisation because it fixed colleges as charitable organisations with a number of public service duties. Colleges were incorporated whether their governing bodies or councils wanted this via a single act of Parliament and a single set of statutory instruments passed in 1992. The transfer was overseen by two quangos

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[6] Section 18 of the Further and Higher Education Act 1992
[7] Schedule 8 of the Apprenticeships Skills Children's and Learners Act 2009
[8] Freedom of Information laws cover many organisations outside the public sector including colleges and universities
[9] The Children and Families Act 2014 applied common duties on all colleges with respect to young people with Education Health and Care Plans
[10] College partnerships with schools and universities are covered in more detail in the rest of this paper
[11] Following the Charities Act 2006, the Secretary of State for Education was designated the charitable regulator of sixth form colleges while the Secretary of State for Business Innovation and Skills is the charitable regulation of FE colleges. Special designated colleges are registered charities and therefore regulated by the Charity Commission.

abolished a long time ago[12]. Once incorporated, colleges had considerable autonomy within a national framework set by Government funding, inspection and performance management. This involved greater competition between colleges for students, income and reputation.

19. It is instructive to compare the status of colleges with those of academies. Academies have also been transferred out of local government or created as start-ups but this has happened one-by-one. The legal structure created for academies has made mergers easier. Academies are companies limited by guarantee with a board of directors that acts as trust. The trust is the legal entity of which the school is part with many schools being part of Multi Academy Trusts (MATs)[13] or Umbrella Trusts[14]. The process of adding or removing a school from an academy trust is relatively quick and need not change the original trust, though it might involve a new funding agreement. Academies are public sector organisations. Any change of school status requires Secretary of State approval.

20. Colleges are self-governing organisations and are classified by the Office of National Statistics (ONS) as private sector, not-for-profit organisations. They nevertheless have a number of public service responsibilities which arise from their status as statutory corporations and from their stewardship of more than £6 billion in public funding (an average of more than £25 million per FE college and £10 million per sixth form college). The accounting status of colleges is a contentious issue. Colleges were classified as private sector organisations in the 1990s, were reclassified as public sector organisations in 2010 and were reclassified again in 2012[15] following the Education Act 2011. These accounting distinctions mean that colleges in England have greater freedom to determine their own mission and programme of activity; are able to keep and reinvest money from income-generating activities; and are free to make their own decisions on merger.

Transfers into and out of the college sector

21. Mergers are not the only way in which colleges change their legal status. There have also been transfers into and out of the school and university sectors. The boundaries between colleges, schools and universities are not always obvious particularly in cases where there are joint sixth forms or university centres run on

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[12] The Education Assets Board and the Further Education Funding Council

[13] Defined by DfE's National College of Teaching and Leadership as a trust "where a group of schools is governed through a single set of members and directors"

[14] Defined by DfE's NCTL as a trust which "permits schools of different categories to set up their own individual academies" but with "shared governance and collaboration"

[15] ONS explained the reclassification of colleges – and the original classification in a note produced in 2012 http://www.ons.gov.uk/ons/dcp171766_266962.pdf

college premises. Despite this, legal and regulatory differences have limited the number of mergers and transfers across the sectors.

22. Transfers into and out of the school sector have been surprisingly rare in the last 20 years. A large number of colleges have developed partnerships with schools via consortia and as academy sponsors but mergers have generally proved a step too far. St Mary's College in Middlesbrough merged with a secondary school in 2011. Christ the King College in London took over two 16-19 maintained schools in 2009 and 2013.

23. Transfers into the higher education sector were quite common in the 1990s, mainly involving art and design colleges. Some of the transferring institutions have acquired full university status in the years since. The legal threshold for transfer was defined in the 1992 Act but the process involves a Secretary of State decision. In recent years, Leeds College of Art and Plymouth College of Art have converted to become higher education institutions. BIS recently issued guidance on what colleges need to do to secure approval for a transfer[16].

24. Mergers between universities or higher education institutions (HEIs) and colleges were also more common in the past than more recently. This is partly because four mergers have unravelled in recent years with the university handing the FE provision back to another FE college. The universities concerned did not find a way to manage the FE provision in an effective way. Four university/college demergers have resulted in the transfer of colleges in Harrogate, Lincoln, Penrith and Reading back to FE colleges. A smaller number of university/college mergers have proved more sustainable (for example Derby University's takeover of Buxton College and Leek College). Leeds College of Music converted to HEI status in the mid-2000s but has been constituted as a company limited by guarantee and is a wholly-owned subsidiary of Leeds City College since 2011.

Demergers.

25. Mergers are rarely reversed but there have been some demergers in the last 20 years. A couple of mergers created the Pershore Group of Colleges but in 2007 it was split into two parts one of which transferred to Herefordshire College, the other which transferred to Warwickshire College. K College was created by a merger in 2009 and was then divided back in two in 2014 with one side reconstituted as South and West Kent College which is closely associated with Hadlow College and the other side merging with East Kent College.

[16] BIS guidance 15/522 Process and criteria for transfer from further education sector to higher education sector, September 2015

New colleges

26. New colleges are created when there is a Type A merger but the college has clear college predecessors so they are only new in the sense of legal status, name and governing body.

27. Apart from these mergers, there have been eight new colleges in the last 20 years created out of organisations which were not themselves colleges. In the mid-1990s, there were a couple of cases where local authority controlled education services were incorporated into colleges. In the 2000s several new sixth form colleges were created (for example Longley Park in Sheffield, Rochdale Sixth Form College and Lowestoft College). In each case staff and buildings were transferred from the school sector.

28. In 2014, Prospects College of Advanced Technology was constituted as an FE corporation and was the first conversion of a not-for-profit independent training provider into the sector. Following the Prospects incorporation, BIS published guidance on the process for creating a new college[17] and a paper which explained what lessons had been learnt from that case[18].

Mergers involving sixth form colleges

29. There have been relatively few mergers involving sixth form colleges in recent years, though there were more in the 1990s. There were 120 sixth form colleges in 1993 and there are 93 now. Many mergers involving sixth form colleges have been seen as a takeover by a nearby FE college but this is not an automatic outcome. In some FE/sixth form college mergers, the principal of the new college has come from the predecessor sixth form college. Two sixth form colleges (Stockton Sixth Form College and Prior Pursglove College) recently published a consultation proposing a merger in early 2016. The process for dissolving a sixth form college corporation and for creating a new one is similar to the process which applies to FE colleges but is not the same.

30. One complicating issue with sixth form colleges is the relationship that 26 of them have with the church or with trusts. There are 14 Catholic sixth form colleges and another 12 sixth form colleges that have linked trusts. The recent merger involving Herefordshire College and Ludlow College (a sixth form college) required the approval of both the Ludlow College corporation and the associated trust for the merger to proceed.

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[17] The process for creating a new college is outlined in Section 4 and Appendix 1 of BIS College Governance, A Guide, August 2014

[18] BIS Prospects College of Advanced Technology project report, February 2015

Acquisitions of private training providers or local authority services

31. There have been a large number of cases where colleges have taken over private or charitable training providers or local authority training services. This happened for various reasons for example because the owners have wished to sell up or cease providing Government training directly or because a partnership with the college would create a stronger organisation. There have been several large transactions (for example Newcastle College Group's purchase of Carter and Carter's training operation in 2009 or West Nottinghamshire College's purchase of Pearson's operation in 2012) and many smaller ones. There is no complete record of transactions but AoC staff estimate there have been more than 150 purchases and transfers in the last 20 years.

32. Mergers or acquisitions involving training providers require similar project management and due diligence to college mergers but the process is simpler because it need not change the legal status of the college. Generally the college buys the shares of the company or makes an agreement with the charity that constitutes it as a wholly-owned subsidiary. There can be advantages for colleges to organise activities and courses via subsidiary companies because this can ensure accountability and can make it easier to employ staff on more flexible terms and conditions. However subsidiaries need to be properly managed. The investigation into the Barnfield Federation describes a complex corporate structure and a number of irregularities[19]. Barnfield College extracted itself from the federation in 2014 and now runs in a simpler fashion.

Shared services

33. Shared services occur where two or more organisations giving responsibility for a discrete area of their provision to a separate business entity which is wholly owned by the organisations involved. Colleges have shared services for decades particularly where there have been benefits in jointly managing specialist activities or where there has been external encouragement for partnership bids. Government interest in college shared services grew in response to Sir Peter Gershon's report on efficiency in 2004. This prompted a Learning and Skills Council (LSC) plan to develop a national student record and finance system for colleges. That plan ended in 2007 when it was clear that the LSC would itself be divided up. A few years later the Government made £15 million available to promote shared services projects. AoC managed a share of these funds and has collected evidence on the outcomes and the lessons on our website[20]. Lessons include:

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[19] SFA/EFA/DfE Financial management and governance review of Barnfield federation, 2014
[20] AoC shared service website available at https://www.aoc.co.uk/funding-and-corporate-services/shared-services

- Colleges attempted large-scale shared services projects but found it was difficult to move forward in a co-ordinated way. Two ambitious projects involving several colleges (eg most of the colleges in central London or the north east) were started in 2011 but did not proceed because short-term costs outweighed benefits.

- A number of smaller sustainable shared services projects were created in this period. Bournemouth and Poole College and Brockenhurst College now jointly own a company which provides finance, HR and IT services[21]. South Essex and Chelmsford College jointly own Essex Shared Services Ltd which also provides finance services. City College Norwich have created a new legal structure involving a trust sitting above the college and a series of academies, a UTC and a shared service company[22]. Two pairs of colleges (Kingston College and Carshalton College; Reigate Sixth Form College and Coulsdon College) have both established shared services as part of federations (see below). Five colleges in Sussex and Surrey recently collaborated over the purchase of a new IT system.

- Colleges have encountered a number of obstacles when trying to share services including costs associated with VAT[23], legal difficulties over pensions[24], diversion of management time and disruption to partnerships created by inspection and funding changes.

- It is possible for colleges to create sustainable shared services. Those that have reported that the financial and organisational benefits outweigh the costs and the obstacles. There is not, however, a comprehensive solution for all the challenges that colleges face.

34. In recent years, there has been a lot of discussions about starting and setting up shared services but less about what to do when they close down. The colleges involved may decide to proceed to a full merger, transfer the activities to one of

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[21] Information on the Wessex Shared Services project is available here http://www.aoc.co.uk/sites/default/files/Wessex%20Education%20Shared%20Services%20Ltd.pdf.

[22] Information on the Norwich Shared Services project is available here http://www.aoc.co.uk/sites/default/files/Transforming%20Education%20in%20Norfolk.pdf

[23] Colleges can avoid VAT on transactions between them by setting up a cost sharing group but this is not a straightforward task and involves additional monitoring

[24] Staff employed by subsidiary companies owned by Colleges cannot access teachers' pensions and can only access LGPS pensions if the college provides a guarantee in an admission agreement

the partners or close the service down. In all cases, there will be legal, contractual systems and employment law issues.

Legally binding college federations

35. Colleges have legal powers to create federations. The process involves two or more corporations delegating legal authority to a joint committee. There is no data on how colleges have used these legal powers but it is possible that they can be used on a short-term basis where two or more colleges plan to merge. Kingston College and Carshalton College have set up a longer-term federation as have Reigate Sixth Form College and Coulsdon College which involves a shared principal and shared services but within a structure which retains two governing bodies. Both colleges have developed shared services within their federation.

College partnership with academies

36. Colleges have worked with schools for decades and have acted as academy sponsors since 2006. More than 50 FE and sixth form colleges have supported academies in a sponsorship role and have worked with mainstream schools, free schools, university technology colleges, studio schools and alternative provision academies in a variety of roles[25]. Partnerships between schools and colleges are not straightforward because there are different legal and regulatory regimes. Although colleges can form multi-academy trusts, they cannot join them. Colleges have nevertheless developed a number of innovative models. In 2012 the leadership at City College Norwich developed a new overarching trust, Transforming Education in Norfolk, which now oversees the college, a university technical college (UTC), several academies and a shared service company. Blackpool Sixth Form College has created a multi academy trust which encompasses a secondary and primary school and which also has teaching school status. Several colleges, including Bedford College, South Staffordshire College, Hadlow College and New College Pontefract, have all supported successful free school bids.

College groups

37. A number of colleges have a group structure for their internal organisation. Each college group differs in how they organise themselves but typically there is a corporate centre distinguished from individual colleges. The colleges are generally part of a single legal entity but have distinct names, advisory boards and managements. College groups were often created when two geographically distant colleges merged, when a private training provider was acquired or where

[25] This paragraph only covers a small sample of the work between colleges and academies.

the college has become involved in sponsoring more than one academy or UTC. Where a college has a group structure, it may be easier to add a new college by merger. The existence of a college group structure allows services to be shared between different organisations without the VAT, procurement and other complications which exist when the colleges are legally separate.

Intervention, the FE Commissioner, Sixth Form College Commissioner and area reviews

38. For the last 20 years, outside intervention has been a spur to encourage college mergers. In the last couple of years, the FE Commissioner and Sixth Form College Commissioner have recommended merger as a good solution for a particular college. In the next couple of years, the area review process is expected to lead to many more. There are a couple of general points to note:

- At its simplest, the intervention policy for FE colleges involves a referral to the FE Commissioner, a report back to the Minister and a letter from the Minister to the chair suggesting some actions. Throughout the process, the college corporation retains decision-making authority but in some cases the Minister will write to say that the college is being placed in "administered status" in which case the college's decision-making freedom is constrained pending a further report from the FE Commissioner[26].

- There is a similar intervention process for sixth form colleges but slightly different rules[27].

- The FE Commissioner and Sixth Form College Commissioner have visited a total of 30 colleges in the last two years. Three of the colleges visited have participated in mergers while more are contemplating merger. Merger has been one outcome of an intervention but is not the only one.

- The first area reviews (in Birmingham and Solihull and Greater Manchester) started in September 2015 and are due to finish in December 2015 but it may take a few more months to agree recommendations and publish reports. The full list of seven Wave 1 reviews will not be finished until close to Easter 2016 by which time Wave 2 and 3 may have already started. Area reviews may well trigger more mergers but these will take some time to take effect. Assuming that the national programme is completed by Easter 2017, it may not be until summer 2018 (three years from now), that we see the full impact on colleges.

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[26] BIS Intervention in Further Education, the strengthened intervention process, April 2014
[27] Explanation of SFC intervention process https://www.gov.uk/guidance/sixth-form-college-funding-agreements-for-2015-to-2016-early-intervention-and-prevention

- Many mergers happen as a result of internal initiatives or discussions between colleges. This will continue to be the case.

Research and more information

39. A number of reports have examined the advantages, disadvantages and issues involved in mergers and organisational change in colleges. These include:

- BIS "Current models of collaboration – Post-14 further education" (June 2015), written by the FE advisers who support the FE Commissioner.
- LSC "Evaluation of mergers in the FE sector 1996 to 2000" (2003) written by Warwick University
- KPMG "Delivering Value for Money through infrastructural change (2010)
- Department for Innovation, Universities and Skills(DIUS) "Models for Success" (2008) which raised awareness of other structural options available to colleges in addition to merger[28]. This was published at the same time as BIS "The Evidence base on college size and mergers"
- LSIS "Delivery Models" (2012)[29]
- Audit Scotland "Scotland's colleges 2015"

[28] Models for Success was published by DIUS after a number of years in which the Learning and Skills Council had encouraged and, in many cases, funded mergers *http://webarchive.nationalarchives.gov.uk/20130802100617/http:/lsis.org.uk/Services/Policy/Documents/BGModelsForSuccess.pdf*

[29] http://www.excellencegateway.org.uk/node/26012

Part Two: Merger tips

40. There is no secret to implementing a merger. Like any project, it requires leadership, management, communication and good sense. The report “Current Models of Collaboration” contains a useful description of five factors necessary for successful structural change:

- Clarity and realism about the process and outcomes
- Identifying and addressing vested interests
- Rigorous consideration of options
- Strong, sustained leadership
- Appropriate governance structures

41. Some of the hardest challenges in college mergers revolve around the simplest issues, for example the name and identity of the combined entity or who fills the senior roles. Colleges rely on the commitment of lots of people from a variety of backgrounds. Successful mergers require a strong focus on the culture of the new organisation and need a great deal of work to ensure that those involved understand its purpose.

42. Colleges also work within an increasingly challenging environment and when it comes to mergers need to deal with a complex web of laws, rules and contracts. A typical college merger might easily require the leadership to update more than 100 policies and processes.

43. The people aspects of college mergers cannot be separated from the legal and process issues. In his 11 June 2015 letter to chairs of governors and principals, David Collins rightly says that merger “does not mean that everything has to be harmonised and uniform”[30]. This has certainly been the experience in recent mergers but the governors and managers of the new college will need to work out early on what should be combined and what should be kept separate. If different policies apply to different groups of staff, these need to be properly justified to avoid creating a sense of unfairness. Efficiencies and scale economies will generally come from applying new systems and rules to all parts of the new college.

44. One recent lesson from mergers is that colleges need to maintain the confidence of financially important stakeholders. The views of students, parents, employers,

[30] FE commissioner letter, 11 June 2015 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/435433/Current_Models_of_Collaboration_-_FE_Commissioner_letter_to_the_sector.pdf

staff, MPs and councils all matter but funding agencies, banks and LGPS funds may have financial stakes which give them the ability to delay or prevent a merger taking place. They need to be involved at an early stage.

The legal process

45. Colleges are statutory corporations. A merger involves the dissolution of one or more corporation and the transfer of activities, assets and liabilities to another corporation. Using the Type A and B classification, a merger between two colleges involves:

- Type A: A double dissolution (of both corporations) and the creation of a new corporation. This involves a Secretary of State decision following a formal consultation.

- Type B: A single dissolution (of one corporation) and the transfer of activities, assets and liabilities to the other corporation. This involves one governing body deciding to dissolve and transfer its activities to the other in line with requirement.

46. Most college mergers involve a Type B process for the following reasons:

- Continuity of name and brand for one of the colleges.
- Continuity of employment and contracts for one of the colleges.
- Continuity of Ofsted grading for one of the colleges.
- It may make the transfer easier in terms of long-term loans, LGPS pension debts and VAT liabilities if one of the college has a zero-rated building[31].
- Possibly easier to explain to students and stakeholders.
- Lower cost and more predictable timetable.

47. There are sometimes good reasons for choosing a Type A process:

- It indicates a fresh start and avoids any suggestion of a takeover by one college of the other.
- The new colleges can be established before the existing colleges are dissolved.

48. The merger process for FE colleges and sixth form colleges is slightly different because the two groups of colleges are sponsored by different departments (BIS

[31] These issues are summarised later in the paper

and DfE respectively) and there are two different sets of regulations[32]. It is generally helpful for colleges to have early discussions with SFA or EFA relationship managers about merger plans and to ensure early support. If the colleges plan a Type A process, this also needs to be discussed with officials.

Pensions

49. Colleges are required by law to offer Local Government Pension Scheme (LGPS) membership to staff who cannot access the Teachers' Pension Scheme (TPS). Teaching staff in colleges are entitled to join the TPS. The 232 FE colleges and 93 sixth form colleges are described in the regulations as scheduled employers in LGPS and are assigned to one of the 81 different LGPS funds. If a college merges with a college which is an employer in the same fund, the LGPS issues are simple. Membership is pooled and there needs to be a legal agreement on liabilities for the former college/s.

50. LGPS pension issues can be more complicated if the two colleges are assigned to different LGPS funds. This either requires a negotiated bulk transfer of active members from one fund to another or a Directions Order signed by the Secretary of State for Communities and Local Government to transfer all members (active, deferred, pensioner and dependant) from one fund to the other. A bulk transfer involves the crystallisation of pensioner liabilities which would require a very large cash sum to be paid to the old fund to cover future liabilities. The normal approach in a cross-border merger is therefore to secure a Direction Order from the Department of Communities and Local Government (DCLG). Of the 120 college mergers in the last 20 years, about 15 have crossed LGPS borders. Four recent cross border mergers created Easton and Otley College and South Gloucestershire and Stroud College and the mergers between Cornwall College and Bicton College and between NCG and Kidderminster College.

51. The local government pension fund community wants to make progress in tackling scheme deficits[33] but at the same time has become more nervous about the financial stability of the employers who participate in their funds. There have been several insolvencies among government-funded charities which has left LGPS funds with insufficient funds to cover the long-term pension debts associated with the charity staff. In response to these events and guidance from the Pension Regulator, a growing number of LGPS funds are assessing the financial strength of their employers and using these judgements to set higher contribution rates for organisations considered to be more risky. The next

[32] Further Education Corporations (Publication of Proposal) (England) Regulations (SI 2012/1157) and Sixth Form College Corporations (Publication of Proposals) (England) Regulations (SI 2012/1158)

[33] The valuations in 2010 and 2013 reported assets averaging 79% of liabilities

nationwide LGPS valuation takes place during 2016. All colleges (and especially those planning mergers) need to maintain good communication with their LGPS manager.

Banks

52. If either college has a long-term loan, then their bank will need to be involved in the merger. There are more than 200 colleges with long-term loans of £1 million. More than 90% of loans by value are with Barclays or Lloyds. Santander and RBS account for most of the rest. Each bank has its own carefully guarded terms and conditions but all of them require their borrowers to abide by loan covenants. Covenants require borrowers to fulfil certain conditions or require them to seek permission before taking certain decisions. College covenants typically set financial thresholds but are likely to require bank approval for any change in controls. In recent mergers the banks have commissioned their own due diligence report which is paid for by the colleges. This has been necessary even in cases where the same bank has loans to both colleges because the combination results in a larger loan to a new entity. For those involved, the process is akin to applying for a new loan. Early discussions avoid last minute problems or delays. There is concern among college finance directors that a newly merged college may end up with a loan on worse terms or higher interest rates than the loans held by its constituent colleges but this needs to be assessed on a case by case basis. Working out whether a merger will lead to higher or lower loan costs should be an early priority.

53. Banks generally look for certainty and clarity from their borrowers. In a merger situation, this could have implications for other aspects of implementation. The college's bank may require all the significant contracts to be transferred to the new college by the time that the merger takes place. If so, this will require a substantial amount of legal work to be completed before the merger. It is worth having early conversations with the bank and with the organisation carrying out due diligence on their expectations, on the documents they require and the extent to which they are prepared to leave some minor tasks uncompleted.

54. Banking issues will be significant in many mergers but are not universal. Many sixth form colleges do not carry any long-term debt while there are some FE colleges with healthy cash balances and either no debt or unused credit lines.

VAT

55. Some colleges own new buildings that are used mainly for 16 to 18 education and that were paid for on a zero-rated basis (ie without VAT needing to be paid). The rules surrounding construction zero-rating are complicated but require the building's owner (ie the college) to sign a certificate promising to use the building

for a relevant purpose for 10 years[34]. For colleges, this has meant ensuring that business activities like fee-paid courses do not exceed 5% of usage. Where two colleges merge and the college with a zero-rated building is dissolved, it is possible that HMRC will consider that a disposal has happened and require VAT to be paid back. The rules were tightened up in 2011 and HMRC interpretation is unclear but this is an issue which needs to be considered in deciding the type of merger in order to minimise costs. VAT advice should be taken.

Competition regulation

56. Mergers involving companies are sometimes delayed by the need to satisfy competition regulators. This has not been an issue with colleges so far but could be an issue in future. The Competition and Markets Authority (CMA) has powers under UK competition law to intervene in cases where it judges that a merger will result in the lessening of competition within any market for goods and services within the UK. Case law confirms that education is considered a market. There have been no cases in the last 20 years where CMA or its predecessors has intervened to investigate a college (or a university) merger but the current guidance places an obligation on company boards (and therefore on college governing bodies) to notify them of a merger where the enterprise being acquired has a turnover above £70 million or where the market share of the combined entity is judged to exceed 25%[35].

Timetable

57. Those involved in college mergers often want to move quickly to completion but there are a number of things that can slow things down. College mergers typically take around six to nine months between the formal public announcement of a merger plan and the actual merger date but the time taken depends on circumstances.

58. Mergers involving FE colleges are covered by dissolution regulations published by BIS. These regulations state that:

- The publication of the formal consultation must take place at least four months before the proposed dissolution date.
- At least one month must be allowed for the consultation.
- At least one month must elapse between the publication of the draft dissolution resolution and the decision to dissolve.

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[34] HMRC VAT notice 708/10 Buildings and construction https://www.gov.uk/government/publications/vat-notice-708-buildings-and-construction

[35] CMA "Mergers: guidance on the CMA's jurisdiction and procedures" January 2014

59. Sixth form colleges do not have to follow these regulations but must allow sufficient time for consultation.

60. The case for fast action and a short timetable is generally strongest where it is necessary to maintain confidence, where one of the colleges is in a financially weak position or where there is a leadership vacuum (for example if one of the principals has left or is planning to leave). Speed may help the new college secure the benefits from merger as soon as possible.

61. The case for a slower, longer timetable is that it allows the colleges more time for implementation and planning. There are some big issues involved in bringing two different colleges together. These include:

- If there is a Type A process then the Minister and funding agency will need to review the proposal and regulations will need to be published and approved. The new corporation will need to be approved before the existing corporations can be dissolved.

- In every merger (both Type A and B), the governing bodies have to reach agreement on key issues in parallel. They need to approve the merger consultation document (or delegate authority to a joint committee). Following the consultation, they need to make the decision to merge in parallel with each other.

- Agreement from banks and other stakeholders (eg trust or landowners) plus legal processes relating to LGPS pension funds need to be completed.

- Decisions on the leadership of the new college needs to be settled in good time so that other decisions can be made. One recent document on public body mergers said that the chief executive for the new organisation should be in place six months before the completion date.

- Introduction of new computer systems or new names often needs to be carefully timetabled.

62. Mergers used to be timetabled for the start of the academic year or for the start of the term (ie 1 August, 1 April or 1 January). Although this may help produce a clean set of accounts, it is better to schedule a merger for a normal working day because this means that staff are available to handle any last minute hitches and also makes any transfer of cash and debts easier to arrange.

Merger documents

63. There used to be a standard merger process organised by the national funding agency (FEFC then LSC) involving a consultation document following a standard format and a "white file" presented to the Minister for final approval. Colleges now have more choice over how they conduct their merger but still need to follow a timetable with a number of stages:

- There needs to be a formal public consultation which explains the reasons for the merger, which outlines plans for the new college and which invites comments.
- Each governing body needs to consider a report on the merger consultation.
- Each governing body also needs to review due diligence reports covering legal, financial and other issues on the other college.
- Each governing body needs to make the formal decision to merge. This may involve the approval of a dissolution and transfer order or the approval of a decision to complete a merger on a Type B basis.

64. BIS require FE colleges to carry out a Structures and Prospects Appraisal before going to public consultation[36]. There is detailed guidance on what an appraisal should involve and some colleges have published theirs. Appraisals are supposed to evaluate various options including the status quo and full merger. In cases where the Minister has placed an FE college in administered status on the advice of the FE Commissioner, the Commissioner will carry out the appraisal. Where an area review has started, this effectively replaces the structures and prospects appraisal. The guidance says that colleges should not start a new appraisal once an area review has started.

Due diligence

65. Due diligence is the investigation of another organisation or person prior to signing a contract. Colleges embarking on a merger need to carry out due diligence because the transaction is so significant and because, as trustees or a charity, their governing bodies have duties and responsibilities to ensure that the college is well-run, delivers its charitable outcomes and avoids activities that might put its funds, assets or reputation at undue risk.

[36] BIS Structures and Prospects Appraisals Guidance April 2014

66. Both sets of governing bodies will need to commission, pay for and review a due diligence report before making the final decision to dissolve. This involved upfront costs and will generally involve a competition to choose suitable external advisors.

67. Colleges generally commission external advisors for legal and financial due diligence but larger colleges or colleges who have recently carried out a previous merger may be able to use their own staff for some of the work. Due diligence should sensibly cover a full range of issues and risks including those relating to employment, supply and service contracts, estates, IT and quality. It is sensible to sign non-disclosure agreements before starting the process.

College names

68. College mergers often involve a change of name. The merger may involve the change to the legal name for the college (or a new name if there is a Type A merger and a new corporation) but this does not automatically require a change in the name used for the courses at a specific campus.

69. Whether they are merging or not, colleges need to apply for permission to the Secretary of State if they wish to change their name. The BIS guidance on FE college name changes was last updated in 2010 but may be revised soon[37]. The DfE guidance on sixth form college name changes was last updated in 2014[38].

70. There have been more than 50 name changes in the last 20 years and there are some reasonably well-tested procedures which involve taking the views of neighbouring institutions (colleges, schools and universities) and consultation with councils and MPs.

71. Both colleges clearly need to think about the college name in advance to avoid unhelpful arguments or delay late in the day. It is normal practice to explain the proposal in the merger consultation document or to consult on a selection of options.

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[37] "Further education corporation names; guidance for existing corporations on changing college names or developing new names" 2010 is available on the BIS website here https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32309/10-1141-further-education-corporation-college-names-guidance.pdf

[38] Guidance on sixth form college name changes is available on the DfE website https://www.gov.uk/guidance/sixth-form-colleges-apply-to-change-name

72. Some names are legally protected (for example anything with university or institute in it)[39]. There have been cases where a preferred name has been blocked because of the intervention of a well-connected stakeholder.

73. The decision on the college name has implications for the college's brand, its internet domain name, the headed paper used in employment contracts, directory listings (including those used by emergency services) and local signs. Names matter a great deal to students, staff, suppliers, alumni and local residents so this issue needs careful communications. Name changes may require the new college to re-apply for certain awards or licences.

Costs

74. All mergers involve one-off costs which are incurred in the expectation of future savings or benefits. The precise nature of the costs varies but costs can easily reach six or seven figures and include the following items as a minimum:

Before the merger date
Legal costs (due diligence, merger documentation)
Project management
Communication and stakeholder engagement costs
On merger completion
Repayment of short-term loans to either college
Staff restructuring
Systems integration and updating
Premises improvements

Appointment of chief executive/principal

75. The decision on who should lead the new college is one of the most important that will be made in the merger process. The decision can also be legally tricky because of the employment law implications. There are a number of issues which governing bodies need to think through:

- Governing bodies have the responsibility for the appointment of the principal or chief executive of the newly merged college. The FE Commissioner letter sent in June 2015 notes that "leadership of large

[39] Companies House "Incorporation and Names" March 2015 has more information on protected words https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/418150/GP1_Incorporation_names_v5_4-ver0.29-4.pdf

organisations may require a different skill set to leadership of smaller organisations" and that "the choice of principal and the senior management team should not automatically be limited to internal candidates"[40].

- In most college mergers that have taken place in the last 15 years, there has been continuity in terms of the principal/chief executive role. In cases where there are two people in post and willing to continue, a common practice has been to ring-fence the recruitment. In some cases posts, have been externally advertised. In just two cases in the last 12 years, the governing body of a newly merged college in England selected an external appointment for the principal/CEO role in preference to internal applicants.

- Most colleges do not work well if there's a vacuum. Once a decision has been made to merge, it is best to act quickly to get a chair designate and a principal designate.

- Mergers sometimes involve one college which is financially weak or have an inadequate Ofsted rating linking to a college in a stronger position. In these cases, the obvious choice is often for the postholder in the stronger college to continue in post. Even where this happens, there may be a need to update roles and job descriptions.

Governance of the merger process

76. The way in which colleges tackle governance issues depends on their approach but there are a number of useful lessons from recent experience:

- A merger steering group is generally a good idea, comprising key governors from each college. Membership needs to be decided with a view to who might be planning to stand down and who would like to continue. This needs to be chaired and minuted so that there is effective communication to each Corporation using the same reports and minutes. It may be sensible to constitute this group as a formal joint committee of both colleges using the college federation powers contained in the Education and Inspections Act 2006.

- An early decision will be needed on how to involve the principals and senior staff in each college which, in turn, depends on what decision is made on

[40] FE commissioner letter to chairs and principals/CEOs, June 2015 available on BIS website https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/435433/Current_Models_of_Collaboration_-_FE_Commissioner_letter_to_the_sector.pdf

senior appointments. Some colleges say that having a single person designated as project manager makes a big difference to success.

- It is a good practice to use a merger to review board membership, to ensure that governors have the right skills for a new environment and to make the board more diverse in terms of background. Typically there is also a case for providing continuity in the short-term with the constituent colleges. These factors often lead to merged college boards being larger than average so there may be a case for planned departures.

- Mergers between geographically separate colleges may also involve the creation of local advisory groups reporting to the full governing body. This can be a way to maintain expertise without making the governing body too large to be effective.

- In the run-up to a merger, there is the need to formally appoint the shadow board. The process for selection needs to be defined well in advance. Powers and duties remain with the constituent colleges until they are formally dissolved but the shadow board can either have powers to make its own decisions or can act as a communication channel until dissolution happens.

Staff

77. Mergers have a big impact on the people who work in the colleges affected. When merger plans are published, statements about reducing duplication between courses or making savings inevitably raise concerns from staff because they are directly affected. Colleges typically spend more than 60% of their income on staff costs so getting things right is important. Any savings from a merger process will generally involve restructuring, job changes, redundancies and removal of vacancies. Once a merger has taken place, there will inevitably be pressures to harmonise HR policies and terms and conditions. This does not have to happen but if differentials remain between similar groups of staff, then they will need to be properly justified. There is a long list of HR tasks in a merger. These include:

- Sharing information about current organisation structures, staffing levels, contracts and HR policies. There will involve a detailed discussion of issues like pay, hours, holidays, sickness absence, expenses, appraisal and other issues.

- Designing new structures for the new college.

- Communicating with staff and consulting with recognised trade unions on changes.

- Working through the costs and employment law issues (including TUPE) or any planned changes.

- Working to ensure "business as usual" for the two colleges up until the merger date which needs decisions about what to do where there are vacancies caused by early departures.

- Deciding where to leave contracts and policies as they are. Differing terms and conditions can have a negative impact on morale once a merger has happened but there may be good reasons for keeping some things separate.

- Decisions on various policies affecting staff, for example those concerned with managing stress, work-life balance and travel. If multi-site travel is the norm for more than 24 months and for more than 40% of the time, the travel paid becomes taxable.

Students, parents, employers and other stakeholders

78. Students, parents and employers may be relatively unaffected by a planned merger because it does not directly affect the course, campus or service that they use. Nevertheless it is important for people to feel involved and to have the chance for give their views in the consultation and during merger implementation. The process could be disrupted by late objections and because engagement is likely to produce longer-term success. Merger planning needs to cover communications; there need to be consistent messages from both colleges and consultation needs to address the issues raised.

79. In addition to communications, there are some policies and processes relating to students and members of the public that need to be right from day one. The newly merged college needs to be physically secure and to have full protection for its IT systems. Safeguarding policies and procedures must be in place from day one. Disclosure and barring arrangements and lists need to be resolved. Health and safety arrangements including incident reporting needs to be clear. The constituent colleges will have all these systems and processes in place but there is a small risk that things could get missed in the transition, particularly where there are staff departures. Although there are good financial reasons to timetable mergers for a weekday (avoiding public holidays), there may also be a case for timing it for a day when the colleges are quieter (for example half-terms or the Easter break).

Ofsted

80. Ofsted inspections and Government performance data (school league tables, BIS success rate publications) have a big influence on college reputation, influence student/employer choice and also act as a trigger for government intervention. As a result, inspection and performance data shape decisions on merger and on federation. The rules and processes are not currently all written down, resulting in uncertainty for colleges contemplating merger. There are several issues to consider:

- The unit of inspection for Ofsted is the legal entity. A college that has diversified in a significant way or that has been created by merging two geographically distant operations is assessed in a single inspection report.
- Newly merged colleges are normally inspected on the same cycle as new providers. This means an inspection within three years unless Ofsted's risk assessment suggests the need for an earlier visit.
- Ofsted expect colleges to provide a single data set for merged colleges.
- DfE and BIS performance data and league tables judge colleges in the same way – on the basis of their legal status.

81. AoC has queried the approach taken by Ofsted, BIS and DfE because we believe that it prioritises legal form over substance. The rules have encouraged one or two colleges to maintain a legal separation (either via a federation or via a parent/subsidiary relationship) partly because this protects a good inspection grade or a strong league table record. Inspections and performance tables are designed to provide information to the public, to potential students, to parents, employers and others. If this is the intention, then it might make more sense for inspections and statistics to provide information on the performance of independently managed colleges within a group structure rather than on the group itself.

82. Whatever the legal and regulatory technicalities, mergers create an additional pressure to maintain or improve performance. There are a number of practical implications

- Ofsted emphasise the importance of students having a high quality of experience no matter which campus they study at or what the history of the organisation. This implies quick action to tackle underperformance.

- The management team in the merged college needs to be able to analyse data in a consistent way across the institution. This does not necessarily require a new student record system but it does imply investment in harmonising and extracting data so that it can be reviewed on a common basis. At the same time it will be necessary to analyse trends in comparison to the constituent colleges.

Business systems (eg IT, MIS, Finance, HR and Payroll)

83. Colleges work in a regulatory and funding environment which is dominated by data. Decisions on systems and data collection are incredibly important. Like it or not, a college with excellent teachers and bad data is likely to have more problems than a college with average teachers and excellent data. Just as colleges need to have full and early discussions about staffing issues so that plans can be put in place, so it is necessary to create a road map which clarifies which systems will be in operation from Day 1 and which will be changed later. It is obviously important to work out how and when to combine finance, HR and student record systems to ensure that normal business is unaffected (and hopefully enhanced) in the merger process.

84. Mergers will generally bring together colleges at different stages of development in terms of their systems. This may be an opportunity to extend one college's system to the merged entity or to start afresh with a new investment. A fresh start may be best in terms of achieving longer term gains but implementing several new systems at once is high risk and has a high staff impact. Care will be needed to ensure adequate resourcing until the new system is fully operational and documented. There are also risks associated with imposing the systems from one college onto another because it could breed staff resentment. Best results and long term harmony are likely to involve combined team working to identify the "best of both" systems for each area and use it as both a business reengineering and teambuilding opportunity.

Anticipating other outcomes

85. Some college mergers are planned but never take place. It is sensible to anticipate this from the outset and to limit the impact on each college by signing a appropriate confidentiality and non-disclosure agreements.

Julian Gravatt
Association of Colleges
30 October 2015