The Urge to MERGE

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The consolidation of the club industry is a reality that's a difficult pill to swallow. And amalgamations have never been more prolific than in these current challenging times. But while the concept of an amalgamation may leave some feeling apprehensive, there are a number of things to consider before determining if it's the right path for business survival.

There are great difficulties these days in running a club, and unfortunately there appear to be too many venues facing the same predicament – they're either financially restricted, their membership base is disappearing, or in some cases, their board and management lack the skills to execute a comprehensive due diligence of the business to identify an appropriate strategy to navigate long-term business survival.

It's against this backdrop of knowledge that an amalgamation will often be something considered by clubs. But is amalgamation always the answer? Not according to Greg Russell, Partner – Russell Corporate Advisory, who has managed a wide-range of amalgamations for clubs all around the State. "I've seen a number of clubs that left me asking why they're amalgamating. The reality was these clubs had assets and membership bases that were simply unexploited or were financially viable so as to revive the business for the benefit of existing and potential members if they simply had the necessary strategies in place backed up by appropriate skills."

However, as Russell also points out, amalgamations are also inevitable for other clubs. "In recent years the club industry has been subject to and involved in significant structural and organisational change," he continues. "This has seen a spate of club amalgamations, which has sometimes resulted in a reduction in the number of community venues available across New South Wales but it's also increased the long-term sustainability of financially viable clubs as well as the industry."

Industry consolidation is inevitable, and for many who are passionate about their club, it's a difficult pill to swallow. "Changing demographics, customer preferences, legislative developments and ramifications, and intra-industry competition struggling for the same membership and leisure dollar all play their part, so for some clubs, amalgamation is logical to explore," adds Russell.

Various causes have been attributed to the propensity of clubs to amalgamate. In broad terms there are three perspectives which may seek to explain what underlies →

or contributes to club amalgamations. Firstly, organisational arguments focus on factors internal to a club's operations. The structure, practices, and available skills within a club are seen to influence their susceptibility to face trading and financial difficulty. On the one hand, the size or changes in the size of the membership are also critical. Smaller clubs may have to amalgamate because of limited patronage, thus trade, which leads to problems of economies of scale that can't be overcome.

"Clubs experiencing a decline in members are often faced with a financial crisis and the prospect of organisational extinction. Although membership and financial problems are not featured in all amalgamations, they are characteristic of many," says Harry Harris, Associate Director – Russell Corporate Advisory. "On the other hand, the type of membership can also be relative. That is, changing demographics and a club's relevance to the changing cohorts around them can and will restrict expansion and business sustainability. Compounding this is a club with decreasing trade is competing with clubs in their immediate area in which membership overlaps."

The organisational practices and philosophy of a club have also been identified as a central issue in some amalgamations. That is, the preservation of systems of decision-making and organisational autonomy, for example, may determine whether an amalgamation is concluded. Similarly, ideological considerations are seen to have contributed to participation in particular amalgamations.

"This is where the perception of amalgamations may have been distorted," acknowledges Russell. "A lot of clubs think an amalgamation is costly, time-consuming, and ultimately the loss of their venue. These myths are still around today when amalgamations are the topic of conversation. As an example, in the last 12 months Russell Corporate Advisory has overseen a number of club amalgamations which were swiftly executed, had minimal costs attached, and has seen the consolidation of two clubs result in two viable venues.

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Whilst strategic value will be later addressed, a second perspective which underlies or contributes to club amalgamations is the political landscape. How a club adapts to legislative developments via government policy certainly plays its part – forcing boards and management to re-evaluate their strategic business plans, re-structure their organisational structure, acknowledge a severance from subsidisation, and explore options for diversification. And at the extreme, investigate amalgamation options.

And finally, there are economic factors – those which impact on the actual or prospective membership and the organisational resources available. The state of the economy vastly influences the character and operation of the market, which, in turn, impacts upon the structural constitution of a club. In this sense, peaks in amalgamation intensity are evident during downturns in the business cycle. Similarly, clubs operating in declining sectors of the economy experience deteriorating membership levels and trade, and as younger cohorts become the next generation for clubs to target, the evolution of how people connect and socialise has also had the effect of creating or destroying demand for particular facilities and services.

Each of these perspectives highlights factors which are likely to contribute to the 'urge to merge.' A strictly organisational approach, however, fails to capture the influences on membership. Size, change, and type are all likely to have underlying economic origins. Further, an emphasis on membership change and its causes tends to deny the impact of political forces.

On the other hand, while membership competition alone may initiate mergers, it appears that this, too, has its basis in economic factors. Although issues of organisational practice and philosophy may have a key place, their importance may depend on political and economic contexts. In short, amalgamations are driven by instrumental considerations. Threats to organisational capacities, borne of particular environmental settings, generally underlie merger motives and behaviour.

But the question remains: Why amalgamate? "Amalgamations often come about when a club is in financial trouble or is potentially at financial risk and seeks a merger with a financially stronger venue," explains Russell. "For the financially weaker club, an amalgamation will allow its culture and activities to continue in some form. For the stronger club, an amalgamation may allow it to obtain access to assets, particularly land and gaming, and an increased membership base that will also contribute to its long-term sustainability."

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However, Russell is quick to point out that there are a range of issues to consider when talking about or negotiating an amalgamation, as well as questions you should be asking, including:

- The length of time the amalgamation process will take.
- Will one of the clubs be in such financial difficulty during the amalgamation process that it may have to appoint an administrator?
- Which of the clubs will dissolve and which club will continue? Or, will both clubs dissolve and a new club be formed?
- Do the directors of both clubs support the amalgamation and if not, why not? Is there an alternative to amalgamation (mainly for the dissolving or financially weaker club)?
- Are the objects and activities of the clubs compatible or similar and if not, how

will the objects of the dissolved club be maintained by the parent club?

- What will happen to the dissolving club's assets? What are the constraints on the use of the premises?
- What will happen to the dissolving club's memorabilia? Will it be moved and displayed elsewhere, stored, or sold?
- How will the various classes of membership of the dissolving club be accommodated? How will those members be admitted to the amalgamated club? Will life members of the dissolved club be life members of the amalgamated club? Can the various membership classes of the dissolved club be accommodated in the parent club's constitution?
- What will be the financial position of the amalgamated club after amalgamation? Will it need to dispose of the dissolved club's assets?
- Are there any other constraints, which may hinder, prevent, or create obstacles to amalgamation? For example, the distance between the two club locations.
- The *Gaming Machines Act* may restrict the transfer of poker machines between premises. What gaming entitlements are involved?
- What will happen to the premises of the dissolved club? Will it remain licensed as part of the amalgamated club or eventually be sold subject to the restrictions?
- Are the staff members of the dissolved club to be retained or made redundant? How are their entitlements to be paid? Will the type of staff at one club still be appropriate when proposed changes come in?

"It's also important to remember that it's clubs that amalgamate – *not* members," adds Russell. "But in saying this, it's the members who determine whether the clubs will amalgamate and so ensuring they're fully informed about what what's being proposed is important. All too often I've seen a vocal minority of members create unnecessary issues as a result of their own personal self-interests. It can easily become a toxic environment as a result, and no doubt where some of the misconceptions of amalgamations have also come about as a result."

The message here is clear: Don't assume your members know the finer details of what an amalgamation is, and what it will ultimately mean for your club. Transparency is paramount, and if applied, you'll quickly discover the vast majority of your members will provide their support when faced with a categorical choice: Secure a future for their club, or simply lose it.

The length of time an amalgamation takes is also an important issue to consider and is often driven by financial imperatives. However, it's important to keep in mind that if neither club is in financial difficulty then the process will take as long as the clubs want. If one club is in financial difficulty then the process is obviously based on the sustainable business life of a weaker club can hold – but shouldn't substantially impact on the time required. In overview, the amalgamation process includes negotiation of the terms, potentially heads of agreement, deed of amalgamation, meetings of the members of each club to vote on whether the amalgamation is to take place, application to the Licensing Court, compliance with the requirements of the Director of Gaming & Racing, and a hearing of the application for conditional approval. On the assumption that one club is to dissolve, then the rules or constitution of the 'parent club' must also be amended by its members in general meeting to make provision for the entry of members of the dissolving club and their preservation for at least three years as a class of members from the parent club. →

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"In the event an amalgamation is conditionally approved by the Court, the application will move on to final approval after the dissolving club's members have voted in general meeting to wind up their club, a liquidator has been appointed, and the liquidation is thus completed," further explains Russell. "But the amalgamation process has certainly been streamlined for the benefit of clubs as long as two clubs or more are committed to the process. Ultimately, the process will take as long as the clubs involved want it to. And again I say, as long as clubs, in particular the child club seeking amalgamation understands their strategic value then the amalgamation process will work to the benefit of everyone involved."

Strategic value refers to the economic value that a club derives from its long-term competitive positioning. In the context of an amalgamation, strategic value is the child club's business and financial attributes and is important because those that know their strategic worth are more likely to find an appropriate club to amalgamate with and secure a long-term outcome that benefits everyone.

"Determining strategic value for amalgamation requires analysing several variables and applying a variety of valuation methods. And clubs on either side of the amalgamation are much more likely to succeed if they understand and leverage the strategic value concept," explains Harris.

For a child club, strategic value means fully understanding the club's attributes and how they might contribute to a parent club's long-term success. For example, attributes might include cost leadership, product differentiation, or product focus. In analysing its potential strategic value, child clubs should consider both business and financial attributes. Strategic value business considerations include:

- Does the club offer highly competitive, high-quality facilities and services?
- Does the club have unique distribution channels within their market, or access to further markets that other clubs don't have?
- Does the club have stringent procedures for underwriting and low losses?
- What is the outlook for the club? Does the club offer business growth rather than just merely business sustainability?
- Is the club's management strong, with a clear vision? Is it aggressive in setting direction and quick to react to challenges?
- How good is the club's technology and operational efficiency?

Meanwhile, financial elements of strategic value that a club should analyse include:

- Is the club's outlook for premium growth higher than normal?
- What's the quality of the club's business portfolios? Are its yields or earnings high or low?
- How much operating leverage and capitalisation does the club have?
- How efficiently is the club managing overheads?
- What capital expenditures will the club need to remain or become competitive?
- What is the club's return on capital?
- And, does the club have any significant contingent liabilities?

These are just some of the ways clubs should think about the value they bring to the negotiating table when an amalgamation is being considered. But strategic value is ultimately in the eye of the beholder. Clubs may weigh various attributes differently, depending on whether they need that attribute to grow its business strategically. Looking at a strategic value card offered by a prospective child club, the prospective parent club will ask: What will it add to our club strategically? Will it help us grow the business long-term?

In assessing a potential amalgamation, clubs must weigh the potential strategic value against potential risks, and factor both in the process. The risks typically include:

- ***Field of Dreams* syndrome.** To what extent is the parent club confident it really knows how to leverage the value from the child club? They certainly hope customers and profits will come. But will they?
- **Lack of due diligence.** Does the parent club really understand the child club's business?
- **Underestimating cultural differences.** How well will the club cultures gel post-amalgamation?
- **Slow value realisation.** How long will it take for the parent club to realise strategic value from the amalgamation? How long are they willing to wait?
- **Retaining key employees.** To what extent is the parent club confident that key management and other employees will stay post-amalgamation?

"The parent club must also consider both financial and non-financial investments needed to realise the desired synergies and ensure that the expected strategic value is created," adds Russell. "For example, how much management time and energy will be required to successfully integrate the amalgamation? Must the parent club invest in new or updated technology, operational systems, or staff standards and procedures to ensure viability? Will there be employee severance or early retirement costs? If cross-selling and cross-marketing are anticipated, what training costs have been factored, and how long will it take?"

Above it all, Greg Russell's advice is simple when it comes to strategic business value: "Know thyself...A club seeking amalgamation that understands their own strategic value will reap the benefits of recognising what makes them attractive. Clubs looking to bring a club into its operations and understand their strategic needs can avoid ill-advised amalgamations that are financially appealing but contribute little long-term value. Understanding strategic value ultimately benefits all clubs involved."

If you're managing a club that's contemplating an amalgamation, then you should obtain advice at the outset, before negotiating an amalgamation. The process doesn't need to be lengthy, complex, or even suffer from potential pitfalls. It's all in the approach taken. For more information, contact Greg Russell or Harry Harris at Russell Corporate Advisory today on telephone **02 9957 6700** or email **greg.russell@russellcorporate.com.au** or **harry.harris@russellcorporate.com.au** ■