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Nonprofit Mergers: Five Keys to Unlocking Value

Strategy & Operations

Introduction

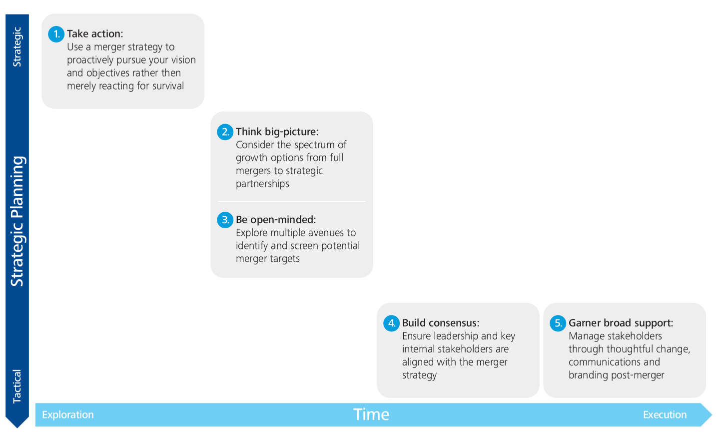
The number of nonprofit organizations in the United States continued to grow through the boom and bust years of the past decade, increasing 25 percent from 2001 to 2011[1]. Yet from 2008 through 2010, nonprofits struggled to maintain funding levels to sustain their programs[2]. Not surprisingly, the economic downturn and slow recovery were two key factors. History shows that the nonprofit sector tends to lag the economy by a year[3], and any recovery disproportionately benefits larger nonprofits at the expense of smaller organizations.

A recovery for nonprofits has been hampered by recent federal and state deficit-reduction efforts – another important challenge to the funding environment. Fewer government grants are available for nonprofit programs, and potential reductions in tax credits for philanthropic giving could further affect the availability of private donations.

In the face of these and other challenges, struggling nonprofits could find relief by sharing resources, collaborating, or even merging with other nonprofits. Such opportunities might soften the impact of ongoing economic challenges and afford nonprofits the opportunity to improve operational efficiencies. Yet some may be reluctant to pursue the opportunity — especially a merger with another organization. One reason, although certainly not the only one, might be because the organization's vision and objectives may be tied to a founder who views a merger as a failure and does not want to relinquish control. Whatever the reason, in our experience some nonprofits wait too long to make these tough decisions and either rush into a merger or acquisition at the last minute or close up shop entirely.

It doesn't need to end this way. The for-profit sector offers many valuable lessons on how to use a merger or acquisition as a growth opportunity — one that can sustain the goals of a founder and provide opportunities for the organization to thrive in the future. The following five simple considerations can help executives of struggling nonprofits in their efforts to find a viable path into the future (Figure 1).

Figure 1: Five nonprofit merger considerations



[1] The Nonprofit Almanac, Urban Institute, Washington DC, 2013

[2] Giving USA 2011: The Annual Report on Philanthropy, Giving USA Foundation, 2011

[3] Nonprofits Team Up For 2011, Sarah Duxbury, San Francisco Business Times, Jan 14, 2011

1. Take action

Use a merger strategy to proactively pursue your vision and objectives rather than merely reacting for survival

A properly planned and executed merger can be a powerful growth tool used to increase funding, expand community impact, and extend services to new geographies and populations. It can also cut costs, improve skills across the combined organization, and contribute to operational performance and stability.

"Among larger organizations, funds received in contributions have been rising, with new donors signing on and prior donors renewing their gifts. In these larger organizations (operating expenditures above $3 million), some plan to hire in 2012, some plan expansion of program activities, and some plan additional investment in fundraising, especially for major gift fundraising. The smallest organizations, in particular, are feeling many signs of fiscal stress. In response, a larger share of these charities are reducing staff and struggling to find ways to raise revenue..."[4]

To achieve such results, a merger should both align with an organization's long-term strategy and drive achievement of specific goals that cannot be attained organically. Often, however, the idea of merging arises only after funding challenges, leadership changes, or competitive pressures have taken their toll. Waiting can rob nonprofits of a merger's powerful benefits, instead creating a situation in which the participants could find themselves struggling to integrate two organizations that are fundamentally misaligned.

New York-based College Careers Fund of Westchester, Inc., avoided such a fate by strategically evaluating a merger opportunity during an economically challenging time. Created to extend higher education opportunities to educationally and economically challenged teens and young adults, College Careers found itself without an executive director and with limited board funding to sustain operations. Its board was divided on whether to identify a similar organization to merge with or to work internally to hire a new executive director and expand the board. Ultimately, the board determined that a merger would require College Careers to change its business model and abandon the unique value proposition that had made it successful for nearly a half century. The board decided that securing a new executive director and focusing on organic growth was the best path.

Walden House and Free Clinics also avoided waiting to make a decision. The two nonprofits merged to enhance the mission and vision of the joint organization. Vitka Eisen, Executive Director of Eisen House commented that, "the value of this [merger] is very high because it is another way to continue to serve clients. It will enable us to provide very robust, comprehensive, integrated services. That is hard to value, but is enormously valuable for our clients."[5]

The College Careers and Walden House/Free Clinics examples highlight different decisions, yet both produced rewarding results because they were made in a timely fashion—neither organization rushed into a potentially damaging situation due to eleventh hour pressures.

[4] Late Fall 2011 Nonprofit Fundraising Study, Nonprofit Research Collaborative, December 2011

[5] Nonprofits Team Up For 2011, Sarah Duxbury, San Francisco Business Times, Jan 14, 2011

2. Think big-picture

Consider the spectrum of growth options from full mergers to strategic partnerships

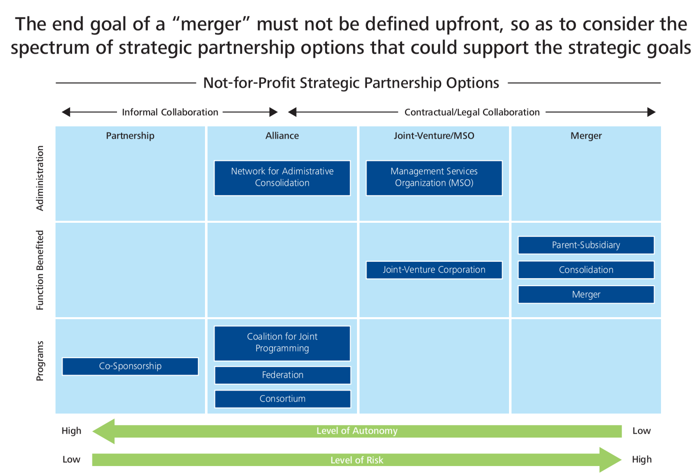
Sometimes a merger may not be the only, or the best, option for a nonprofit organization. It is important to fully understand the range of alternatives and the risk/reward profiles for each. Other types of strategic alignment, such as joint-ventures, coalitions, and informal partnerships, may better meet the organization's needs (Figure 2).

Mutual goals need to be defined before a structure is selected. A true merger should require both organizations to make strategic changes, including alignment of organizational strategies, consolidation of boards of directors, and financial investments in merger execution. Alternatively, informal and contractual partnerships can allow organizations to reach strategic goals through cosponsoring programs and services, developing coalitions to reach shared goals, and forming joint-ventures to reduce operational costs.

Central Square Theater in Massachusetts represents a successful partnership of two nonprofit professional theater companies. Both companies needed a permanent theater, but neither had the capacity to build one alone. The theaters created a 501(c)(3) partnership with a new, collaborative patron-engagement model and the goal of building a state-of-the-art theatrical facility. Both partners could benefit from combining resources, sharing staff, and attaining a level of artistic and organizational achievement only possible through joining forces.

Both theaters retained their 501(c)(3) status, unique artistic mission, and distinct identity. Understanding their goals helped the organizations pick the collaboration option that provided the best balance of autonomy and shared services.

Figure 2: Spectrum on nonprofit collaboration approaches



3. Be open-minded

Explore multiple avenues to identify and screen potential merger targets

Unlike the commercial sector, which can tap an entire industry to find M&A prospects, nonprofit organizations often have limited resources available and must rely on unofficial channels such as personal networks. Consequently, nonprofit organizations may not be as fully equipped to identify and evaluate potential merger candidates.

According to a survey conducted by Deloitte[6] with approximately 190 nonprofit participants, 98% of respondents have considered collaboration within the past five years. Additionally, while collaboration was top-of-mind, 59% of respondents felt "finding the right partner" was the greatest challenge to collaboration.

Grassroots programs and services are emerging to help nonprofits find partners that meet their needs. The Foundation Center and the Rhode Island Foundation are good examples of organizations that are initiating programs that seek to help identify ideal collaboration organizations, facilitate an open forum to post requests, share effective practices, and develop useful resources for nonprofits. Nevertheless, our experience shows that most collaboration and merger opportunities in the sector spring from personal, or "unofficial," connections.

While the challenge of partner identification can incline nonprofit organizations to tap unofficial sources, it is important to vet all possible opportunities. Conducting a thorough target screening that surveys the entire nonprofit landscape for similar, applicable organizations can allow nonprofit organizations to make informed, objective partnership choices. Supporting and leveraging the development of collaboration facilitation tools, will also become important as more and more organizations seek collaboration opportunities.

[6] Nonprofit Collaboration Survey within Rhode Island and Ohio, Deloitte Consulting LLP, United Way Rhode Island, Foundation Center, and Rhode Island Foundation Survey, January 2013

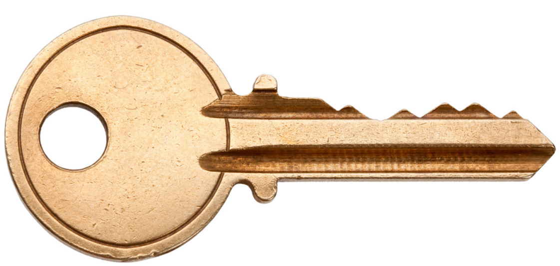
4. Build Consensus

Ensure leadership and key internal stakeholders are aligned with the merger strategy

Nonprofit executives, boards, and funders have significant roles in shaping an organization's direction, so their resistance or hesitancy to change can become a significant roadblock. This is why the buy-in of personally invested board of directors and key organization leaders is so important: a personally invested board can drive a higher level of coordination and communication among leadership to help gain 100% buy-in.

In a 2012 survey of 41 direct service organization mergers in Minnesota, 95% of respondents agreed that "if not for one of the executive directors, the merger would never have happened. In 61% of the mergers, having a board member from at least one of the pre-merger organizations pushing for merger was a primary reason for pursuing the merger. In 78% of the mergers, the decision to merge had strong support from board members." [7]

The National Mentoring Partnership (MENTOR) considered whether a merger with another mentoring organization would be the best way to achieve its goals of expanding its impact, raising additional funds, and lowering operational costs. Some members of the board believed that a full merger would require a significant realignment of MENTOR's organizational structure, board composition, and overall strategy that would not reflect the board's vision. Lacking full leadership support, the merger strategy did not gain traction.



[7] Synopsis: Success Factors in Nonprofit Mergers, MAP and Amherst H. Wilder Foundation, July 2012

5. Garner Broad Support

Manage stakeholders through thoughtful change, communications and branding post-merger

A nonprofit organization's stakeholder community, including internal talent and external clientele, should embrace and enhance the culture it is striving to create. The challenge of matching and merging two different cultures, as well as the potential of outside forces to throw off the cultural balance, make assessment, planning, and implementation essential in a merger. Through careful change management, a nonprofit can gain acceptance, engagement, and ultimately commitment among both sets of stakeholders.

It is important to incorporate a stakeholder feedback loop throughout the change management process. Nonprofit organizations tend to have passionate employees, clients, and followers in the community due to their mission statements and/or support causes, so they should understand the sentiments and engagement across these groups. Leaders can create an implementation road map with a feedback loop that captures comments and suggestions. For example, the more ingrained an organization is in its community, the more important it is to understand client concerns about ensuring the merger doesn't inadvertently reduce the impact and quality of its services.

When Opportunity Impact merged with Cultivating Impact, they formed Collective Impact, an organization focused on helping San Francisco youths find success in life through various programs. During the merger, Collective Impact's management not only solicited feedback from employees, it also chose to engage its end customers — the San Francisco community — on whom its mission had a real and immediate impact. Would Collective Impact be able to serve the community effectively? Would the merger affect overall service quality and create negative community reaction even though it made sense from a cost perspective?

Understanding feedback from all sources can also help inform future branding for a merged organization. Opportunity Impact and Cultivating Impact served two different communities in close proximity, so while the nonprofits had similar missions and offered similar services, their clients identified very differently with the distinct brands of the two entities. Under the Collective Impact banner, customers no longer identified with the organization, so a branding and brand awareness effort became a crucial success factor for the new organization. By synthesizing customer feedback, Collective Impact has created a new, unified message and brand for both groups of constituents.

Facing the Future Head-On

The challenges nonprofits face today might not diminish anytime soon. The Congressional Budget Office estimates that economic growth will remain slow this year "as gradual improvement in many of the forces that drive the economy is offset by the effects of budgetary changes that are scheduled to occur under current law"[8]. With federal and state lawmakers focused on fiscal improvement, new government support for nonprofits may be years away too.

Given these factors, executives of struggling nonprofits – and even those who are merely seeing hints of problems — can benefit from growth strategies that have been used successfully in the for-profit sector for many years. Acting early, thinking broadly, vetting many options, and engaging all stakeholders of the organization, both internally and externally, are actions nonprofit executives can take now to support the growth and effectiveness of their organizations in the coming years.

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[8] The Budget and Economic Outlook: Fiscal Years 2013 to 2023, Congressional Budget Office, Feb 2013