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Issue Brief

Investing in Nonprofit M&A

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ISSUE CONTEXT AND DESCRIPTION

Strategic collaboration can be a powerful tool for nonprofit success. From mergers that fully combine two existing entities to alliances that enable groups to coordinate programming, consolidate expertise, or simply share back-office functions, the various forms of nonprofit collaboration hold promise both for cutting long-term costs and for increasing impact.

Such promise is especially appealing in the context of recent economic events. The last decade saw rapid growth in the nonprofit sector: from 1996 to 2006, the number of U.S. nonprofits increased by more than 36 percent from one million to nearly 1.5 million.[1] More recently, the economic downturn has hit the sector hard, reducing nonprofits' resources while, in many cases, expanding the need for their services. With financial pressures mounting and funders looking closely at how best to leverage their own reduced resources, many nonprofits have begun to explore M&A opportunities—where "M&A" stands for "mergers and alliances" rather than "mergers and acquisitions."

Nonprofit M&A is already more common than many observers assume. The Lodestar Foundation, for one, is already helping to raise awareness of strategic collaboration among nonprofits and to identify best practices.[2] Still, nonprofit M&A remains a sensitive subject for many. Donors approach it cautiously, wary of crossing the line between offering help and mandating change, and some nonprofit organizations view M&A solely as a last-ditch survival strategy.

Such concerns should not prevent donors or forward-thinking nonprofits from investigating the potential of M&A. Active donor involvement is often crucial to successful collaboration, and M&A efforts that begin proactively, by focusing on shared goals, are far more likely to succeed than ones that begin solely in response to financial fears. What follows is a closer look at what donors should know as they consider investing in nonprofit M&A.

SUCCESSES

Successful mergers and alliances can strengthen the organizations involved in a variety of ways.

Greater impact: Strategic mergers and alliances can enable previously competitive players to become partners, increasing the quality and impact of their services. The Chicago Wilderness Alliance[3] first formed in 1994 to preserve and restore the biodiversity of greater Chicago. Now encompassing 230 organizations, the Alliance has enabled its members to develop and implement a unified strategy, making them more effective in their pursuit of a common goal.

New funding options: Nonprofits that increase their capacity or strengthen their brand through M&A can often tap into new funding sources as a result. Dress for Success Worldwide[4] began by providing services to low-income job seekers in New York City. By collaborating with similar nonprofits, it built an international network of affiliates and gained access to national-level channels of in-kind and financial support. Each of its local affiliates retains significant independence, but all benefit from the larger organization's brand and donor network.

Economies of scale: Mergers and alliances require significant up-front investment, but resulting economies of scale can produce major long-term cost savings. In order to free up more resources for programming, a group of nonprofits from the Chicago Alliance for Collaborative Effort created the Back Office Cooperative (BOC). BOC enabled its members to consolidate several administrative functions, thereby increasing efficiency and lowering costs for each organization.

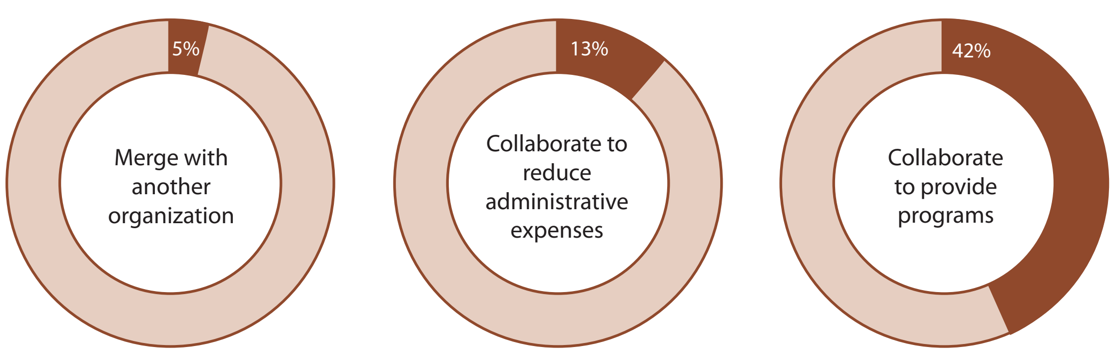
Expanded reach: Mergers and joint programming initiatives can enable organizations to expand into new geographic and programmatic areas. Arizona's Children Association[5] undertook six strategic mergers with complementary nonprofits in order to build out its continuum of care and expand into new territory. The organization, which began as an orphanage in Tuscon, Arizona, now provides a broad spectrum of services to children and their families across the state.

CHALLENGES

Despite their potential benefits, nonprofit mergers and alliances face a series of unique and sometimes prohibitive difficulties.

Insufficient funding: While donors increasingly express interest in nonprofit

What are nonprofits doing or planning to do to weather the economic downturn?



Source: Nonprofit Finance Fund survey

mergers and alliances, finding the funding to support a restructuring process from start to finish can be difficult. Lack of strong donor support may discourage some nonprofits from pursuing a merger or alliance and lead others to cut corners and undermine effectiveness.

Cost-cutting expectations: Mergers and alliances require large investments of time and resources. While cost savings can be significant in the long run, they often take time to realize. The patience and hard work demanded underscore the need for a mission-driven vision.

Desperate motives: Financial troubles can lead organizations to take drastic steps to stay afloat. When M&A is involved, such reactive and hasty measures often lead to unsatisfactory outcomes. Collaborative efforts are most likely to succeed when nonprofits consider them for strategic, mission-enhancing reasons and pursue them before a crisis hits.

Lack of leadership: Support from executive staff and board is crucial to the success of mergers and alliances. Yet individual egos and fear of losing an organization's identity often get in the way. Successful mergers and alliances often depend on leadership prioritizing an institution's mission above the institution itself. Mergers in particular often require selflessness since some staff, especially at the executive level, may lose their jobs.

Insufficient knowledge: While some literature on nonprofit mergers exists, organizations considering M&A suffer from the absence of a strong knowledge base and pool of experienced advisors. Resources and best practices for building effective alliances are especially lacking.

TRENDS

Despite these difficulties, mergers and alliances are becoming more common.

Hot topic in hard times: Veteran facilitators of nonprofit mergers say the field has never been more active. A recent survey by the Nonprofit Finance Fund found that 17 percent of nonprofit respondents would currently like help with merger feasibility analysis. It also found that 42 percent had recently collaborated with another organization to provide programs or planned to do so this year.[6]

More than just trendy: Though nonprofit M&A often goes on unnoticed, it is already fairly common. One recent study covering 11 years of merger filings found that merger activity is only slightly less common in the nonprofit sector than it is in the for-profit world—though it is far less common among very large nonprofits than it is among large companies.[7]

Increasing innovation: Amid the recent economic turmoil, a handful of groups have been exploring ways to further the field of nonprofit M&A. The San Francisco Foundation, Dayton Foundation and Toledo Community Foundation all have established funds to help groups defray the costs of restructuring.[8] Meanwhile, the Lodestar Foundation's Collaboration Prize has identified a variety of model cases for mergers and alliances.[9]

Donor engagement: In spite of the challenges and sensitivities surrounding M&A, donors often find effective ways to help. Foundations and other funders played an active part in more than half of the 644 collaborations nominated for the Collaboration Prize.

FUNDING OPPORTUNITIES

There are several ways that funders can help make mergers and alliances more acceptable, accessible and effective.

Start a conversation: Funders cannot force nonprofits to collaborate, but they can bring together grantees working in the same geographic or program areas to discuss common problems and strategies. Grantees who share information, ideas and difficulties may also organically identify creative opportunities for collaboration.

Invest in education: Donors can sponsor educational activities, both to raise general awareness about M&A possibilities among grantees and to develop knowledge within the field. The nonprofit sector currently needs more and better information about best practices and case studies of M&A.

Fund feasibility studies: There are real costs even to planning a successful merger or alliance, but money spent up front reaps significant benefits in the long run. Funders can help M&A candidates by hiring experienced consultants to conduct cost/benefit analyses and develop detailed plans for restructuring. They can also help by covering other typical M&A expenses, such as rebranding or IT costs.

Make tough choices: With impending budget crises, some nonprofits may face the challenging decision of pursuing a merger or alliance with a larger organization or going out of business. If a nonprofit fills a unique and valuable niche in the community, donors should consider supporting a merger that saves it, even in less-than-ideal circumstances.

Donor Considerations

When investing in nonprofit M&A, donors should consider the following:

Begin with a mission. M&A efforts that begin by focusing narrowly on the bottom line often go astray. When two organizations can put mission first, their chances for successful collaboration increase exponentially.

Enable, don't compel. Successful M&A requires steady leadership, ongoing cooperation and significant trust between the organizations involved. Compelling unprepared grantees to collaborate will likely lead to disappointment and frustration for all involved.

Look long term. Donors should resist the temptation to view M&A as an emergency strategy for saving struggling nonprofits. Consider supporting healthy, forward-thinking organizations in their exploration of restructuring, both now and in the future, and remember that realizing the benefits of successful M&A takes time.

Don't drop your support. Mergers can lead to long-term economies of scale, but they do not instantaneously or automatically reduce the merged organization's budget and need for support. If donors cut total funding in half when two grantees merge, they weaken the impact of the new organization and undercut the value of the merger.

1. "Number of Nonprofit Organizations in the United States, 1996-2006," from the National Center for Charitable Statistics. http://nccsdataweb.urban.org/PubApps/profile1.php?state=US
2. "The Collaboration Prize," created by the Lodestar Foundation. http://www.thecollaborationprize.org/
3. The Chicago Wilderness Alliance. http://www.chicagowilderness.org/index.php
4. Dress for Success Worldwide. http://www.dressforsuccess.org/
5. Arizona's Children Association. http://www.arizonaschildren.org/
6. Nonprofit Finance Fund survey. http://www.nonprofitfinancefund.org/content.php?autoID=166
7. Cortex, Alex et al. "Nonprofit M&A: More Than a Tool for Tough Times." Bridgespan Group: February 2009. http://www.bridgespan.org/uploadedFiles/Homepage/Articles/Mergers_and_Acquisitions/091702-Nonprofit%20Mergers%20and%20Acquisitions.pdf
8. The San Francisco Foundation's Nonprofit Transition Fund. http://www.sff.org/about/whats-new/nonprofit-transitions-fund-launches-to-support-intentional-change/
The Dayton Foundation's Nonprofit Alliance Support Program. http://www.daytonfoundation.org/041909dn.html
The Toledo Foundation's Strategic Alliance Partnership Grant Program. http://www.toledocf.org/site/c.iqIWL4PIJtH/b.994239/k.E501/The_Strategic_Alliance_Partnership_Grant_Guidelines.htm
9. "The Collaboration Prize," created by the Lodestar Foundation. http://www.thecollaborationprize.org/