Shotgun Mergers amid Financial Crisis

by the editors

In the wake of the nation's worst economic downturn since the Great Depression, it's not difficult to find plenty of press on the subject, including tactics for survival. In turn, many philanthropists now extol the virtues of nonprofit mergers—particularly among their grantees.

"When we first started talking about this in advance of the economic crisis, I think there was a big pushback," notes the Boston Foundation's CEO. "There was a lot of unhappiness that we were even raising this issue. I think that's really changed."[1]

The chairman of the Stoddard Charitable Trust commended a merger involving a nonprofit he had funded. "From a foundation's perspective and as a taxpayer, especially in these times, I applaud a collaboration merger where it makes sense," he says. "In the for-profit world, businesses learn very quickly they have to make the bottom line balance out, or they disappear. Sometimes, in the nonprofit world, businesses can be a little slower to deal with that reality," the chairman opined. [2]

Commissioned by Mayor Gavin Newsom, a San Francisco Foundation paper boldly recommends merging or closing city-funded nonprofits to reduce San Francisco's $483 million annual outlay to nonprofits.[3] What's more, the foundation put its money where its mouth is by placing $250,000 into its Nonprofit Transition Fund to give nonprofits professional help and guide them toward mergers or shutdowns.[4]

Similarly, in economically plunging Detroit, a group of five foundations—the Skillman Foundation, the Kresge Foundation, the W.K. Kellogg, Foundation, the John S. and James L. Knight Foundation, and the Community Foundation for Southeast Michigan—has made a commitment to help the city in the epicenter of the manufacturing and subprime mortgage crises. The group has actively promoted the notion that neighborhood-based charities consolidate and reform as regional organizations.[5]

These foundation interests are hardly new. But the economy may have given the philanthropic sector's interest in mergers and collaborations new impulse. Underlying this view is an accepted economic determinism that suggests that it is high time to consolidate, lest grantees devolve into financial insolvency.

The jury is still out on whether the merger-and-acquisition juggernaut will result in many more mergers now than in better economic times and, more important, whether mergers will benefit the groups involved. But we know something about the challenges that the nonprofits trying to blend their operations and the funders trying to induce these interorganizational marriages will face.

Merger Limitations

According to most data from the for-profit sector, the failure rates for mergers are high. KPMG data indicates that half of mergers destroy shareholder value, and another third have no positive or negative effect.[6] Another source suggests 40 percent to 80 percent of mergers fail;[7] and others typically place the failure rate at two-thirds or more. According to one skeptic of the practice, the challenge of merging two previously independent organizations is a "Herculean" task of merging—or "smooshing"—not just the two organizations but also multiple departments.[8]

And then there is the well-known but generally unstated truth that "most mergers are really acquisitions," where a merger is simply a nicer name for an unpleasant process.[9] Just consider the recent mergers among banks or between commercial banks and brokerages, and spot the balance between merger and acquisition. It is no different in the nonprofit sector: "Most mergers in the nonprofit sector are really acquisitions," Jay Vogt writes. "Pragmatic partners quickly determine whether they are 'top dog'—or not—and act accordingly. The organization being acquired has to define its absolute minimum requirements. The organization doing the acquiring has to define what it is willing to give. Doing this calculus helps make the deal happen."[10] Even studies touting the potential benefits and alleged frequency of mergers sometimes reveal that they are talking about mergers and acquisitions, not simply mergers.[11]

Are Nonprofits Interested?

A year ago, we would have said that nonprofits generally smiled, nodded, and largely ignored funder remonstrations about the advisability of mergers. And we still believe that funder prescriptions have little effect (other than to annoy nonprofits). But we now hear more anecdotal reports from nonprofits that are considering mergers. Many nonprofits now seem to be approaching a recession-related financial cliff that may last through 2010.

As a result, will we see a spate of merger-related activity? And if we do, how much will be successful? Mergers take time, and more stable entities may find their boards to be less than enthusiastic about acquiring or merging with an organization that is destitute. Still, many anchor service agencies depend on a network of smaller agencies around them to create an entire service system (see "Advocacy in the Age of Obama" on page 26). Losing these partners' services may prove more of a problem than taking some of those organizations in as programs.

Thinking about Collaborations

Despite the financial incentives and funder inducements, nonprofits generally haven't considered mergers. This is demonstrated by nearly 1,000 nonprofits' minimal progress on mergers in a recent survey conducted by the Nonprofit Finance Fund. If you ask nonprofits, they say their emphasis is more on collaborations and networks, the ability of organizations with compatible interests and objectives to come together, sometimes formally through structured relationships, sometimes more informally or ad hoc, to achieve mutually desired goals while retaining their original missions and stakeholders.

A Moveable Feast amid Crisis

In these pages, we have noted that organizations are more inclined to come together in episodic, opportunistic ways while still investing significantly in each collective effort. A good example is in housing development, where one community development corporation (CDC) group in Memphis recruited other CDCs to collaborate on a combined application to the state for Neighborhood Stabilization Program funding to help nonprofits and public agencies acquire and redevelop foreclosed properties. After some resistance, 10 groups agreed to join together to request $12.5 million. The group internally negotiated target areas, funding levels, and a target number of housing units.

"We advised the state of our approach," says Tim Bolding of United Housing, the initiating group, "and got a 'We'll believe it when we see it' response. In fact, one person at the state told me, 'It would take a miracle for the folks in Memphis to cooperate on an application.'"

The result was that the 10 groups got the $12.5 million. This is the largest funding ever received by the CDC—and probably more than these organizations had received from the city's HOME program in the past 10 years combined.

The group is now cooperating on implementation and related policy issues. "We may have started the process reluctantly," Bolding reflects. "But I think we have found we have much more clout and control as a group than as 10 individual CDCs.

Merger Coercion Is Misplaced Energy

Most of the time, trying to force strategic alliances is a losing strategy. It produces a lot of misfires. In terms of collaboratives, our communities have long been chock-full of on-paper collaboratives that last only as long as the funding does. On the merger front over the years, all the enthusiasm of funders has resulted in little increased activity. And when the result has been a merger, the benefits are arguable.

We should distinguish imposed mergers from those freely chosen. The United Way's Collaboration Learning Project indicates that of the five mergers and collaborations (with the help of top-flight technical assistance) among Milwaukee United Way grantees, three of the five had gone out of business three years after their initial funding.[12] As the United Way project learned from its advisers, "If organizations court one another first, there is a greater likelihood for success."

Beyond simply the desire to collaborate (and the funding to make collaboration happen), the factors of success include serendipity, timing, and even luck.[13] As one interviewee described the factors in a particularly successful collaborative effort, "We worked well together, we were remarkably free of organizational culture problems, [our partner's] commitment to quality and content was as high as ours was, [the collaboration] met a need, and the market responded."

Less Social Engineering, More Sensing

Now funders should be poised to support a self-motivated willingness to work together—whatever it takes—particularly now that motivation for such stuff may be high. If small service-delivery groups begin to fail over the next six months, we may indeed see additional activity on the merger-and-acquisition front, but we are also likely to see unusual networks emerge. It might be wise for funders to remain open to all the possibilities for maintaining and rebuilding communities with residents at the center. Sometimes, it takes many small, connected entities to create social movement.

Endnotes

1. Laura Crimaldi, "Area Nonprofits Feel Urge to Merge," the *Boston Herald*, June 21, 2009.
2. Danielle M. Williamson, "YOU Inc. and Dynamy Will Merge at the End of June," *Telegram & Gazette*, June 19, 2009.
3. Meredith May, "Charities Face Cut in City's Funding," the *San Francisco Chronicle*, April 30, 2009.
4. Meredith May, "Foundation Gives Charities $1 Million to Unite, Survive," the *San Francisco Chronicle*, April 29, 2009.
5. Ben Gose, "Survival of the Fittest?," the *Chronicle of Philanthropy*, April 9, 2009.
6. "Takeovers, Alias Mergers & Acquisitions (M&As) à la David Warsh and Michael Porter," the Timesizing Wire (www.timesizing.com/2amwarsh.htm).
7. Niyati Oja, "Failure Mergers," JurisOnline, November 2, 2008 (http://jurisonline.in/2008/11/failure-mergers/).
8. Farhad Manjoo, "The Homeland Security Merger Mess," Salon.com (http://dir.salon.com/story/tech/feature/2002/11/21/merger_problems/).
9. See the M&A Group, "A CEO Roundtable on Making Mergers Succeed" in Peter J. Buckley and Pervez N. Ghauri (eds.), *International Mergers and Acquisitions*, 2002, 421, for a description of the "merger" between Bristol-Meyers and Squibb. Also see "Is Merger the Best Growth Strategy?," *CPA Practice Management Forum*, February 2005.
10. Jay W. Vogt, "Guidance Offered to Nonprofits Considering Merging with Others," the *Wednesday Report*, March 31, 2009 (www.massnonprofit.org/features.php?artid=1446&catid=60).
11. The BridgeSpan Group's recent reports on the value of mergers actually address M&As as a strategy, citing a cumulative merger-and-acquisition rate over the course of 11 years of 1.5 percent among the 3,300 organizations in four states examined (www.bridgespan.org/uploadedFiles/Homepage/Articles/Mergers_and_Acquisitions/091702-Nonprofit%20Mergers%20and%20Acquisitions.pdf).
12. *Nonprofit Collaboration & Mergers: Finding the Right Fit*, United Way of Greater Milwaukee.
13. For an exceptionally honest appraisal of what makes collaboration work, see John Emmeus Davis, *Bridging the Organizational Divide: The Making of a Nonprofit Merger*, Neighborhood Reinvestment Corporation, 2002.

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