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To the Power of Good.

NONPROFIT MERGERS

A Strategic Tool for Impact and Sustainability

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EXECUTIVE SUMMARY

The nonprofit sector is undergoing significant transformation. The demand for services continues to rise, yet there is considerably less public funding available and increased competition for donated dollars. There are growing calls for organizations to track the results they hope to achieve and to be accountable to those outcomes. Technological advancements, new social media outlets and demographic shifts are altering the way donors give and nonprofits operate.

Given all these changes, nonprofits must consider how they can work more strategically to strengthen their impact and long-term sustainability. This new nonprofit landscape is leading more organizations across the country to consider mergers and other forms of strategic collaboration.

WHAT IS STRATEGIC COLLABORATION?

Mission Capital defines strategic collaboration as **two or more organizations working together** in a meaningful, well-defined, deliberate manner **to accomplish a set of shared, mutually beneficial objectives** they can better achieve together than alone. *See page 21 for more on strategic collaboration.*

THE CENTRAL TEXAS NONPROFIT SECTOR

The topic of mergers and strategic collaboration may be of particular importance to the nonprofit sector in Central Texas. **The Austin Metropolitan Statistical Area (MSA) is home to over 5,660 nonprofits**, which is more nonprofits per capita than any other major MSA in Texas and in the Southwestern United States.[1] The vast majority of nonprofits in Central Texas are very small, with 72% of organizations under $100,000 in annual income and all but 8% under $1 million.

WHY CONSIDER MERGERS AND OTHER FORMS OF COLLABORATION?

Although the local nonprofit sector works hard to solve tough social problems and improve the quality of life for all its citizens, there have been ongoing concerns that **the sheer number of organizations creates inefficiencies, duplications of infrastructure, and less than optimal service delivery**. There are also concerns that too many nonprofits are poorly run or are not impacting the community in meaningful ways. National thought leaders have also noted that organizations operating below a $1 million annual budget often lack the kind of infrastructure and scale that is required to ensure long-term sustainability and optimal effectiveness. Mergers and other forms of strategic collaboration, therefore, are important tools for Central Texas organizations to consider as they work to advance their missions.

IN LIGHT OF THESE ISSUES, MISSION CAPITAL SET OUT TO LEARN MORE ABOUT MERGERS IN THE CENTRAL TEXAS COMMUNITY. SPECIFICALLY, WE SOUGHT TO DISCOVER:

1. How common are nonprofit mergers?
2. Why do nonprofits consider merging?
3. What factors support successful mergers?
4. What are the challenges?
5. What are the benefits?

To answer these questions, Mission Capital conducted interviews with 22 nonprofit leaders from 12 organizations that participated in a merger or acquisition over the past 10 years. We also reviewed national studies on mergers and strategic collaboration, and collected data on the nonprofit sector in Central Texas.

[1] The Austin MSA, also referred to as "Central Texas" includes the counties of Travis, Williamson, Hays, Caldwell, and Bastrop. Data on the number of 501(c)(3) public charities is from the Urban Institute's Center for Charitable Statistics from August 2012 IRS Master Files.

ANSWERS TO KEY QUESTIONS

1

AT LEAST 24 MERGERS HAVE TAKEN PLACE AMONG CENTRAL TEXAS 501(C)(3) NONPROFITS SINCE 2003.[2]

This number represents less than 1% of all nonprofit organizations in the Central Texas region.

2

THE MAJORITY OF NONPROFITS IN OUR STUDY PURSUED MERGERS AS A WAY TO STRENGTHEN THEIR ORGANIZATIONS' IMPACT IN THE COMMUNITY by serving more people and/or increasing effectiveness. Most nonprofits also hoped that merger would improve their long-term sustainability. Contrary to conventional wisdom, nonprofits typically did not pursue merger because of immediate threats of closure or instability.

3

TEN FACTORS WERE IDENTIFIED AS CRUCIAL TO A MERGER'S SUCCESS INCLUDING:

- **Strong leadership** from board members and/or executive staff who shared a passionate belief that merging was the right thing to do for the organization and the community.
- The development of **trusting relationships** among key leadership.
- A deliberate **due diligence process** to ensure there was an adequate assessment of the risks and potential benefits of merger.

4

STUDY PARTICIPANTS REPORTED A NUMBER OF CHALLENGES DURING THE MERGER, INCLUDING:

- Resolving contentious **deal-breaker** issues.
- Managing the higher than anticipated **costs** of merging.
- Navigating the complex **logistics of integrating two or more** organizations into a cohesive, well-functioning operation.

5

NONPROFIT LEADERS CONSIDERED THEIR MERGERS TO BE SUCCESSFUL. The most commonly reported outcomes include expanded services, increased efficiencies, and strengthened organizational capacity. Most organizations did not report significant cost savings as a result of merging, although some organizations reported that budget funds were redistributed in ways that increased sustainability and better met community needs.

CONCLUSION

Mission Capital is committed to promoting increased collaboration and partnership among nonprofits. We hope this research will provide nonprofit executives, board members, staff, funders and stakeholders with a deeper understanding of mergers and will assist nonprofit leaders in making more informed decisions. While the work is challenging, we believe that **mergers and other forms of partnership are crucial to the nonprofit sector's long-term goal of creating positive, lasting change in our communities**.

The nonprofit sector needs a keen market focus and an ethic of responsibility to mission over empire building or organizational self-preservation. By integrating nonprofits into fewer, stronger, more flexible and effective structures, resources and focus can be redirected to strengthening and advancing missions that...result in improved community outcomes.[3]

David La Piana, nonprofit merger expert

[2] Information is from the Texas Secretary of State and Mission Capital' research. The Central Texas mergers referenced in this report include outright mergers and parent-subsidiary structure. For more information on types of merger, see page 19.

[3] La Piana D. (1998). *Beyond Collaboration: Strategic Restructuring of Nonprofit Organizations.* National Center for Nonprofit Boards.

I. HOW COMMON ARE NONPROFIT MERGERS?

Based on data from the Texas Secretary of State and Mission Capital's research, we found 24 mergers that had taken place among Central Texas 501(c)(3) nonprofits since 2003. This number represents less than 1% of all nonprofit organizations in the Central Texas region.

How does a merger rate of 1% compare to other areas of the country? While data on the number of nonprofit mergers that have occurred nationally appears scarce, a study produced by the Bridgespan Group evaluated 11 years of merger filings in four states (Massachusetts, Florida, Arizona, and North Carolina).[4] They found that more than 3,300 organizations reported at least one merger or acquisition over a 10 year period, a merger rate of 1.5%. Although this rate is higher than Central Texas, the Bridgespan study includes all nonprofit organizations, not only 501(c)(3) public charities. The Bridgespan report also noted that the comparative, cumulative total for mergers in the for-profit sector is about 1.7 percent.

II. WHY DO NONPROFITS CONSIDER MERGING?

A primary research objective of this study was to learn what led Central Texas organizations to consider merging. We knew from prior, national research that **expanding programs**, **serving the community better,** and creating **organizational efficiencies** are often primary factors for why mergers are considered.[5] Here in Central Texas, nonprofit leaders identified similar factors, with a focus on **increasing services, enhancing effectiveness, and strengthening long-term sustainability** at the top of the list.

WHO INITIATES MERGER TALKS?

In about half of the cases in our study **the conversation began at the board level**, typically between board presidents. In the other half of cases, the conversations were initially **led by the executive directors**.

We found that, when organizations began contemplating a merger, typically **a partner was already identified.** These partner relationships usually were developed because of:

- A prior relationship between Executive Directors and/or Board Presidents
- Previous collaboration between the organizations
- Board members, executive leadership and/or funders who noted the similarity in mission and vision of the organizations and encouraged the idea

We did find one example in which a nonprofit conducted research to identify potential collaborators and then approached selected organizations for more in-depth discussions.

[4] Cortez, A, Foster, W., Milway, K. (2009). Nonprofit Mergers and Acquisitions: More Than A Tool for Tough Times. The Bridgespan Group.
[5] Dewey & Kaye (2007). Nonprofit Mergers: *An Assessment of Nonprofits' Experiences with the Merger Process,* The Forbes Fund

INCREASING SERVICES

Nonprofit leaders we spoke with identified an "increase in service delivery" as a primary or partial reason why merger was considered. They hoped the merger would result in an **expansion of programs** and more **opportunities to fill service delivery gaps**. For several organizations, merging also represented the chance to not only create a larger footprint in the local community, but to expand services across multiple counties or across the state. For example, when four regional affiliates of Girl Scouts decided to merge, one of the goals was to take the best programs from each affiliate and expand them to other areas within the jurisdiction.

ENHANCING EFFECTIVENESS

Many of the nonprofit leaders we spoke with also hoped that merging would **increase the quality of services** offered to clients and the community. Merging was also seen as a way to enhance **service delivery effectiveness**. For example, when United Cerebral Palsy of Texas began merger negotiations with Easter Seals Central Texas, they realized that each organization offered a unique complement of services to clients. They believed that as a merged organization, they could provide a greater continuum of care to individuals and families in the community.

STRENGTHENING LONG-TERM SUSTAINABILITY

Several leaders in our study noted that nonprofits today are increasingly faced with competition for funding and resources. **They viewed merger as a strategic step that could provide their organizations with a competitive advantage and a way to strengthen their financial footing.**

Nonprofit leaders we spoke with identified **four key ways in which they hoped sustainability could be achieved:**

CREATING EFFICIENCIES. Many leaders saw merger as an opportunity to create more efficiencies in their organizations. They recognized that other nonprofits were doing similar work in the community and/or going after the same funding dollars. By combining infrastructures, nonprofits could take advantage of economies of scale and the efficiencies that are created from being part of a larger organization.

"We had the same vision, we seemed to be compatible... Here we were in two different areas doing the same thing... it just made sense to see if we could work together." — executive leader

ENHANCING ORGANIZATIONAL SKILL SETS. Nonprofit leaders also saw mergers as a way to infuse their organizations with new resources, skills, and talents. They believed that combining skills and talents would lead to greater impact and sustainability. Some leaders also saw the merger as an opportunity to diversify staff positions. For example they could hire a development director in the place of two executive directors.

BEING BETTER POSITIONED TO RESPOND TO ENVIRONMENTAL AND MARKET CHANGES. Several nonprofit leaders shared that their decision to explore a merger was based in part on changing market dynamics or environmental factors. They wanted to be able to respond proactively to these changes in order to better position their organization for continued growth and success. For one organization, new mandates related to electronic health records, along with reduced government funding, also put a spotlight on the need for merger.

"I could see our future was largely dependent on our ability to partner with someone else to gain strength in size." — executive leader

In another example, a nonprofit leader noted that in the wake of the Sarbanes-Oxley Act[6] his organization needed to focus more attention and resources on ensuring financial compliance. Rather than spending more resources on hiring an accountant, they believed it made sense to merge with a larger organization that could provide additional competencies in this area.

COST REDUCTIONS. While "reducing costs" was rarely cited as a primary reason to merge, a number of leaders indicated this was a partial motivation. They hoped that by combining resources and infrastructures, some cost savings would be realized. A couple of respondents also shared that this was a way to help "sell the merger" to board members and other key leadership.

TRIGGERS THAT INFLUENCED A DECISION TO MERGE

While **increasing services, enhancing effectiveness, and strengthening long-term sustainability** were the primary factors that led organizations to merge, we also identified several, specific triggers that put merger talks in motion:

DEPARTURE OF EXECUTIVE DIRECTOR. **Six of the organizations in our study were experiencing an executive transition** at the time the merger was considered. While only one nonprofit leader indicated the leadership vacuum was a primary reason for merging, several other organizations viewed the transition as a "trigger." As one respondent stated, the resignation of the long serving Executive Director forced the agency's board to think through things that they might otherwise have pushed off for several months.

FINANCIAL DISTRESS. In two of the mergers we studied, **immediate financial distress of one of the partners initially drove the merger talks.** Several national studies have also found that financial distress is a trigger in a small subset of mergers. Organizations in financial crisis may see a merger as the only way to continue serving the community, yet the pros and cons of merging must be carefully weighed by both partners. In some cases, it may make more sense for the struggling organization to cease operations, or consider a transfer of assets to another entity, rather than pursue an outright merger.

ENCOURAGEMENT FROM FUNDERS AND NATIONAL NONPROFITS. While none of the leaders in our study described "pressure from funders" as a primary reason for merging, **several nonprofits noted that funders nevertheless played a critical role in educating groups about mergers** and their potential benefits. There were also a couple of cases in which funders who were providing financial support for the merger provided strong encouragement to move the process to completion.

We also spoke with several local affiliates of national organizations including Planned Parenthood, Easter Seals, and Girl Scouts. Some of these leaders shared that mergers have become a significant trend among national nonprofit groups, and they learned more about mergers from other affiliates who had gone through the process. This educational process helped to demystify mergers and encouraged local leaders to seriously consider merging as an option.

[6] Sarbanes-Oxley Act, passed by Congress in 2002, requires publicly traded companies to conform to new standards in financial transactions and audit procedures. BoardSource recommends nonprofits voluntarily comply with certain provisions of the Act.

III. WHAT FACTORS SUPPORT SUCCESSFUL MERGERS?

When the decision is made to actively pursue a merger opportunity, organizations must invest significant time, resources and energy to **ensure the merger is a strategic fit and that risks and benefits have been adequately assessed**. Then, once the deal is signed, organizations must work to integrate programmatic and administrative operations. **Our study has identified ten key success factors in creating a successful partnership.**

1. STRONG LEADERSHIP WHO SHARE A PASSIONATE BELIEF IN MERGER. During our interviews, we heard over and over again that strong leadership from Board members and/or executive staff propelled the merger forward. These leaders served as “merger champions” and shared a common belief that merger was the right thing to do for the organization and community. They demonstrated a willingness to “rise above the noise” and set aside personal considerations for the larger good of the agency and community. They then worked tirelessly to convey this message to the rest of the organization and focus others. Without their strong guidance, these mergers would not have happened.

“You have to look at the overall mission of who you’re trying to serve and ask yourself, ‘Will I be able to reach more people or be more impactful?’ If you can do both of those then how can you not do the merger? To me it came back to that every single time.” — board member

2. TRUST. The words “trust” and “transparency” were repeatedly used by the nonprofit leaders we spoke with to describe an absolutely critical element of a successful partnership.

“Trust is huge. Everything we’re talking about is built on dialogue and trust.” — board member

Along with trust, respondents emphasized the importance of developing meaningful relationships with the board and executive leadership of the partner organization. One board member noted that the Merger Exploration Team (comprised of board members from both organizations) was “joined at the hip” and these personal connections led to a successful outcome.

“This is a deal of personalities. It’s all about who the people are who are involved. If that trust and relationship isn’t present, the deal won’t move forward.” — board member

3. DELIBERATE DUE DILIGENCE PROCESS. The nonprofit leaders in our study stressed the importance of using a well-defined, thoughtful due diligence process. They took this process very seriously, and spent time thoroughly reviewing financial and legal documents. Bylaws, human resource policies and benefits packages were also analyzed as organizations began the process of redefining how the new organization would operate.

The leaders we spoke with emphasized that the due diligence phase was needed to ensure the merger was a good choice for both organizations and those they serve.

“I wanted to be careful about it. I was a champion, but I wanted to focus on the due diligence. I think there were some folks that just said, “Why don’t we just talk about it. We don’t need to spend money and bring in consultants.” I said “No. You have got to know exactly what you are getting into.” — board member

NONPROFIT MERGER PROCESS

Mission Capital recommends a three-step process once organizations begin discussing a merger.

Phase 1 – Due Diligence & Letter of Intent

- Form joint merger exploration task force and conduct 2-3 task force meetings
- Engage independent facilitator/ consultant
- Gather confidential information from board and key stakeholders
- Conduct initial due diligence
- Develop a business case for the merger
- Set up communication channels
- Identify and seek resolution on key “deal breaker issues”
- Develop and secure board approvals of a Letter of Intent to merge or agree not to pursue merger

Phase 2 – Merger Planning & Agreement

- Complete more detailed due diligence
- Seek resolution on non-deal-breaker issues
- Determine merged board structure, budget, organizational chart
- Begin discussing system integration
- Determine legal structure of new entity
- Negotiate merger agreement and seek board approval
- File formal merger agreement forms with the state and IRS

Phase 3 – Implementation

- Communicate merger with stakeholders
- Develop detailed plans for integration
- Integrate program operations, finance, development, human resources, and other support functions

4. RISK ORIENTATION. Merging two or more organizations is a significant undertaking, and the ultimate outcomes are never certain. While the nonprofit leaders we spoke with pursued merger cautiously, they also demonstrated a willingness to take risks and say “yes” when they believed it would lead to improved community impact and a more sustainable organization.

“Our business means occasionally taking risks.” — executive leader

5. PRESENCE OF AN INDEPENDENT CONSULTANT.

The majority of organizations in our study employed an independent consultant during the merger process, and nearly all said that if they were to merge again, they would definitely use a consultant. Respondents identified several ways in which consultants, most often a single consultant jointly hired by both merging nonprofits, offered critical support. First, consultants provided merger teams with a clear framework in order to ensure the steps of the process were followed, and that everything was completed according to specified time frames. Experienced consultants also brought with them information on best practices from other mergers they had supported, and they served as a “neutral intermediary” to help organizations work through challenging issues.

“I stand firm that I don’t think it would have happened without {our consultants}. They created an infrastructure for us to get the questions answered in a way that made both sides feel really safe about everything. ...in the end, when each board made the decision, everyone felt well-informed and that we had done our homework.” — executive leader

6. RELATIVELY STRONG DEGREE OF MISSION FIT.

Most of the leaders we met with classified the degree of mission fit with their merger partners as "strong." They saw significant mission overlap and viewed this factor as being important to a successful partnership.

While mission fit appeared to be the norm among mergers in our study, we did find examples in which the merging partners used the process as an opportunity to redefine the mission and vision for the newly created organization. For example, when the Austin Museum of Art and Arthouse at the Jones Center entered into negotiations, they acknowledged there were significant differences in the two museums and the types of art exhibited. However, both boards agreed to use the merger as an opportunity to develop a new mission and vision for the merged AMOA-Arthouse organization.

"I think it was really about looking at the vision and mission match of both organizations. We had the same vision and mission, just different delivery mechanisms. I think once people realized that, it was just a no-brainer that we should be working together."— board member

7. BOARD ENGAGEMENT. Typically during merger negotiations, a Merger Exploration Team is formed which is comprised of a subset of the Board and in some cases, the Executive Directors. This team does most of the "heavy lifting" during the merger process, but ultimately both boards must give their approval of the merger. The nonprofit leaders we spoke with emphasized the critical need to keep board members informed and "in the loop" at all times in order for members to make an informed final decision regarding the merger.

8. FUNDER SUPPORT. There are many expenses associated with a merger, both before the deal is completed and during the integration phase. Some nonprofit leaders noted the importance of obtaining financial support to help underwrite the many expenses associated with merging. A number of organizations solicited grants from foundations in advance of the merger to cover some of the costs, and for the most part, organizations found funders to be supportive.

"There was an interest in supporting the merger. We had special audit costs in closing out and we had a funder who funded all of that. They were supportive of mergers."— executive leader

Funder support is also important even after the two organizations are fully integrated. Previous research has found that funders often see mergers as an opportunity to reduce funding.[7] Our research found that this was not the case with the organizations in Central Texas, as the majority of funders continued to support the organizations post merger in similar levels as they did pre-merger.

[7] Gammal, D. (2007). *Before You Say "I Do".* Stanford Social Innovation Review.

9. EARLY AGREEMENT ON EXECUTIVE DIRECTOR. Many of the nonprofit leaders we spoke with recognized that one of the most contentious issues that can arise during a merger is deciding who will serve as executive director. As mentioned earlier, six of the organizations in our study were going through leadership transitions at the time of the merger. Several respondents acknowledged that this leadership transition eliminated a potential merger challenge and allowed for a smoother process. In several other cases, the current Executive Director gave signals to the board that they were comfortable stepping down from the position, which again helped eliminate a potentially difficult situation.

"One of the things I remember doing is letting both sides know that I had no problem stepping down. It would not be a competition of who would be president and CEO." —executive leader

"We were very sensitive to how the press and public would react to it. We actually hired a PR firm to help us with this. We very carefully planned out how stakeholders would be informed every time there was an announcement."—executive leader

There were also a couple examples of boards who took the courageous step early on of having frank conversations with their executive directors about the need to hire a new director. These boards then supported the outgoing directors' transition, in some cases providing a severance package.

10. CAREFUL COMMUNICATION. Nonprofit leaders noted the importance of honest, but carefully planned and orchestrated communication regarding the merger. Several people shared that a communications plan was developed early in the merger discussions which outlined how the merger would be announced to donors, clients, and other key stakeholders.

Others emphasized the importance of staff communication. They shared that while confidentially was very important, especially during the early phases of the merger, they nevertheless tried to keep staff informed to the greatest extent possible because, as one Board Chair emphasized, "this is people's livelihood."

"I talked to staff at the very beginning of the process and said the board has made the decision to do some exploring. I told them that we didn't have a specific timeline or outcome in mind, but that I would continue to keep them updated as the situation progressed." — board member

It is also worth noting that some nonprofit leaders, particularly board members, seemed to treat the issue of staff communication with less concern. A recent national study on merger success factors found that **communication with and buy-in from staff prior to the merger was associated with significant positive outcomes, including financial stability, service quality, and organizational reputation.**[8] In light of this research, it is important for nonprofit leaders to consider how they can prioritize staff communication and buy-in during the merger process.

[8] Owen, G., Pittman, B., Kelly, L. Reed, R. (2012). Success Factors in Nonprofit Mergers. MAP for Nonprofits.

IV. WHAT ARE THE CHALLENGES?

The ten key success factors are critically important to a merger experience. Employing these factors can help to lessen the difficulties associated with a merger but cannot eliminate them entirely. The leaders in our study identified **six major challenges** that were encountered as they navigated the merger process.

1. RESOLVING CONTENTIOUS ISSUES. While the pre-merged organizations often agreed on the fundamental reasons to pursue merger, talk of a merger raised many questions about how the new organization would operate including:

- Who will be the Executive Director?
- Who will serve on the board? How many seats does each partner organization receive?
- Will the organization be renamed?
- How much debt will we acquire if we merge?
- Is this an acquisition and if so, will we be "swallowed" up by the larger organization?

Working through these often contentious issues came close to derailing the entire process for a few of the organizations in our study.

Several leaders also noted that organizations should not always count on working through these issues in a linear manner. They recalled that they would reach agreement on a particularly controversial issue at one meeting, only to find disagreements and tensions arise at a later date regarding the same issue. Leaders also shared that issues that they believed had been worked out to everyone's satisfaction during due diligence would sometimes later reemerge as a problem during the integration phase.

2. HIGHER THAN ANTICIPATED COSTS. The majority of nonprofit leaders in our study reported that merger costs were more than they had originally anticipated. They noted that in addition to the costs associated with the actual merger, there were significant expenses related to integration including rebranding and marketing and new communication systems. One of the most substantial costs for several nonprofits was the expenses associated with equalizing the salary and benefits packages for all employees across the merged organizations. Participants also found that while there some cost savings, for example consolidating two office spaces into one, these were typically more than offset by other expenses.

"Mergers don't save you money. They don't save you a dime. Now it doesn't mean you can't make your organizations much better through merger; you can increase efficiency, you can increase effectiveness, you can make yourself a stronger organization from mergers but ultimately you don't save money." — executive leader

For at least two of the organizations we spoke with, the significant merger expenses had a destabilizing effect. These organizations had expanded services rapidly after the merger but had been unprepared to manage all the integration expenses. They lacked specific funding from donors for the merger and, therefore, paid for most of the expenses out of general operating funds. These nonprofits were able to point to many positive benefits that have resulted from the merger, but it also has created significant challenges within the organizations.

3. GIVING UP CONTROL AND AUTONOMY. At the core of many contentious issues is the recognition that mergers often mean giving up a level of control and autonomy previously enjoyed. In our study we found this to be especially true for the merging partner who was smaller in size. Some participants recalled how their board or staff expressed concerns that they would be "taken over" by the larger organization and feared a loss of influence. For the organizations in our study that merged with nonprofits located in other areas of the state, there were also significant concerns about giving up local control and local representation on the board. A few nonprofit leaders also recalled that the merger was an emotional experience for some board members who believed that the merger meant giving up their organization's history and past accomplishments.

4. LACK OF TRUST. Just as the presence of trust and honest relationships is a critical factor in merger success, an absence of trust makes it extremely unlikely that the merger process will move forward. One board chair recalled that during a critical stage in the merger process, negotiations had come to a stalemate. He noted that many of the problems they were experiencing originated from the sense of fear and distrust that was present between the two boards. He made clear to his board that if they were not able to all "get on the same team," the process would undoubtedly fall apart.

POTENTIAL MERGER COSTS

The potential costs associated with a merger (which may not apply in every situation) tend to include:

- Engaging a merger consultant/facilitator
- Engaging external CPAs or financial analysts to assist with financial due diligence
- Engaging an attorney(s) to draw up the final legal paperwork, depending on merger type (often can be done pro bono)
- Engaging HR/benefits consultants to assist with salary and benefit rationalization
- Actual salary/benefits changes post-merger
- Engaging IT consultants to assist with systems integration
- Engaging marketing/ branding assistance if new name, logos, marketing materials, signage, etc. are needed, and then the actual costs of producing materials
- The "soft costs" of staff time allocation to the merger process

5. MANAGING THE LOGISTICS OF INTEGRATION. Significant time must be devoted to due diligence and formal agreement to merge. However, for many of the organizations in our study it was the post-merger integration phase that proved even more complex. During this phase, organizations work to figure out how to operationalize everything agreed to during the merger talks. Interviewees were surprised by the sheer number of logistics to be worked through— combining all systems and data, creating new structures, developing bylaws and personnel manuals, arranging office space, and setting up computers, to name just a few. This created a huge work load issue for all staff and in some cases, morale suffered as a result.

"I think we could have done a better job on the integration piece. We spent so much time discussing the merger and signing off on the merger on paper but the real work was the integration, and that's where we were woefully lacking in understanding the efforts, needs, and support that needed to happen there." — executive leader

HOW LONG DOES IT TAKE TO MERGE?

There was significant variation in the time it took for the nonprofits in our study to officially merge. The shortest merger was completed in about six weeks, and the longest merger took over two years. On average, most mergers were completed in about six months.

So how does this compare to mergers in other areas of the country? A recent study of mergers in the Pittsburgh area reported that the majority of mergers were completed in 6-12 months, with a few also taking as long as 2 years to complete.[9]

Once the merger is finalized, the integration phase can officially begin. Integrating all administrative and programmatic functions typically lasts much longer that the initial merger phase. A study published in the Stanford Review of 200 nonprofit organizations in California found that full integration efforts usually took three or more years.[10]

For the nonprofits that had merged with groups located in different parts of the state, the logistical process also included learning how to manage a multi-region operation and learning how to overcome the new communication challenges associated with communicate with board and staff members located outside the area.

A couple of nonprofit executives noted that the commitment to ensuring that everyone's voice was heard during integration created some challenges. Leadership sought input and ideas on the new systems and structures that were being created, which brought more work for the staff involved.

6. CREATING A UNIFIED ORGANIZATIONAL CULTURE. David La Piana, a national expert in mergers and collaborations, has found that integrating organizational cultures can be extremely challenging and that differences in culture do not become apparent until staff begin to work together.

The leaders in our study also reported challenges associated with cultural integration.

"I think there is a big difference between espoused culture and actual culture. I think there were a lot of similarities with the espoused culture but major differences with the actual culture. It was later that those differences arose and needed to be worked through." — executive leader

Some organizations experienced increased staff turnover following the merger and found that it took significantly longer than they originally believed it would to integrate cultures. This seemed to be the case for mergers between larger nonprofits in particular which brought more staff and more complex organizational cultures to the merger talks.

ORGANIZATIONAL CULTURE DEFINED

Organizational culture can be described as "the way people communicate with each other, how they resolve conflict, how they celebrate, reward, lead, manage, do their work, break down and assign work, and relate to each other. **It is the core of an organization's belief system**."[11]

[9] Dewey & Kaye (2007). *Nonprofit Mergers: An Assessment of Nonprofits' Experiences with the Merger Process*, The Forbes Fund
[10] Gammal, D. (2007). *Before You Say "I Do"*. Stanford Social Innovation Review. Before You Say I Do
[11] La Piana (2003). *Strategic Restructuring: A Tool for Improving Organizational Effectiveness*, The Forbes Fund

V. WHAT ARE THE BENEFITS?

Despite the challenges that organizations experienced, the nonprofit leaders we spoke with believed the effort had been worthwhile and almost all consider their mergers a success.[11]

"I believe it's a stronger organization now than it would be if they'd stayed separate."
— executive leader

While the degree of success varied, and some interviewees noted that time would help clarify the full extent of the benefits, almost all of the organizations in our study were able to identify specific, positive benefits from the merger. These include:

"It has been very positive, and we wouldn't have been able to make the strides that we have if we had stayed like we did."
— executive leader

EXPANDED SERVICES. Expanded services was the most commonly reported outcome. For United Way of Williamson County, this meant the opportunity to provide services to more areas of the community.

"I think we have done a really good job of accomplishing our larger vision which is to reach out to the underserved parts of the county while still maintaining service levels in the more populated parts of the county." — board member

For Girl Scouts of Central Texas, the merger was used to expand opportunities to girls across the region.

"Our biggest success has been the expansion of our programs. We now have three camps that girls attend. We are also excited about the expansion of our specialty programs, especially our technology programs. We are now able to offer those programs to girls across the Councils' jurisdiction." — executive leader

GREATER CONTINUUM OF SERVICES. In addition to service expansion, merging has given some nonprofits the ability to serve clients more effectively by offering more comprehensive programs and services. One Executive Director described it as creating "one-stop shopping" while another Executive noted that her agency is now more of a "full-service organization."

For BookSpring, the organization that resulted from the merger between Capital Area Reach Out and Read and Reading is Fundamental, the integration has created a continuum of programs to serve children from birth all the way through elementary school. As one BookSpring leader noted, it has helped, "amplify the impact of the program."

INCREASED ORGANIZATIONAL CAPACITY. Another commonly cited outcome was the ability to increase internal capacity. Merging provided an opportunity to build new structures, systems, and skills into the merged organization to enhance effectiveness and efficiencies.

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[12] All of the organizations in our study are currently operating with the exception of Marywood Children and Family Services. Marywood was acquired by Catholic Charities of Central Texas and ceased operations in late 2012. For more information on the Marywood merger, please see the blog "When Merger is Not Enough" by David La Piana.

Organizational capacity was strengthened in the following ways:

DIVERSIFICATION OF STAFF ROLES. Mergers give nonprofits an ability to redistribute funds to achieve a more professionalized workforce. Instead of paying the salary of two executive directors, for example, organizations can afford to hire IT, human resources, and/or fund development support. Two nonprofits in our study hired development directors following the merger, which led to additional fundraising success for their programs.

It's worth noting that staff diversification does not always lead to positive outcomes. One interviewee remarked that a merger was pursued in part to benefit from a larger organization's development department. After the merger, she came to realize that the department itself was fairly ineffective at raising funds.

> **"We needed a professional leader for both organizations. ...These institutions can't begin to function, much less thrive, without a great professional leader and there was no way that these organizations could attract that person on their own. It's remarkable that together they have attracted a person of such high caliber. He never would have considered it without the merger." — board member**

ATTRACTING & RETAINING TALENT. In some cases, mergers helped nonprofits recruit new leadership. Several board members shared that, as a larger and more sophisticated merged organization, they had the ability to attract executives who brought new skills and strengths and enabled them to succeed at a higher level.

SHARING INNOVATIVE PRACTICES. Each nonprofit brings a unique skill set into a merger. As a unified organization, these skills are combined to enhance a nonprofit's ability to serve the community. Several leaders in our study noted how a merger led to this sharing of resources. For example, when three Planned Parenthood affiliates merged to form Planned Parenthood of Greater Texas, each offered a unique compliment of strengths. The Waco affiliate was experienced in taking private insurance, the Austin affiliate was experienced in managing fee-for-service clients, and the Dallas affiliate was a leader in the implementation of electronic health records. As a combined organization, Planned Parenthood was able to take advantage of these three distinct skills to improve their operations and serve a broader range of clients.

STREAMLINING OPERATIONS. For a number of organizations in our study, mergers lead to a variety of operational efficiencies. One nonprofit leader shared that they were able to combine 19 separate intake forms into one. This not only created efficiencies for the organization, but also helped clients have an easier time accessing services. Other examples of organizational efficiencies included the creation of a centralized call center and streamlined donor databases.

LONG-TERM SUSTAINABILITY. When asked if the merger had led to greater sustainability, some interviewees said "yes." They pointed to examples of capacity-building efforts that led them to better financial footing. Others said that it was still too early to tell if this will be an outcome of merger, while a few leaders said merging had not increased sustainability—at least not yet. One interviewee shared that her organization continues to struggle due to the economic recession and the loss of public and private funding dollars. However, she also added that without the merger, it is possible neither organization would have survived these funding hits.

RECOMMENDATIONS

Nonprofits today are faced with significant challenges as they attempt to do more with less. In an era of reduced public funding and increased competition for dollars, mergers and other forms of strategic collaboration can offer important ways to survive and even thrive. Within this context and in light of our research findings, **Mission Capital recommends a number of practical steps for nonprofit leaders** to consider when contemplating a merger, **and for funders** to consider in supporting merger and collaboration efforts.

8 RECOMMENDATIONS FOR NONPROFIT LEADERS

1 CONSIDER WHAT FORM OF COLLABORATION, IF ANY, MAKES THE MOST STRATEGIC SENSE. Spend time learning about the various collaboration options available. David La Piana encourages nonprofits to think of mergers and other forms of collaboration as strategic tools. Organizations should first develop a clear understanding of the strategies they are trying to implement. Then ask the question, is merger or another form of collaboration the right tool to achieve those strategies?[13]

2 IF MERGER APPEARS TO BE A GOOD STRATEGIC OPTION, DEVELOP A CLEAR UNDERSTANDING OF THE OUTCOMES YOU HOPE TO ACHIEVE. Be realistic about these outcomes. For example, if your organization is primarily looking to cut costs, merger probably isn't the answer. However, if you are hoping to serve more people, provide higher quality services, enhance sustainability, or to redistribute dollars in such a way as to achieve more impact, then merging may be a good option.

"Nonprofits should never enter into merger exploration on a whim but instead with their eyes wide open and with a clear strategic purpose in mind. A documented "business case" for merging should be agreed upon early on in the process by all parties, and it should serve as the guideposts for the entire merger process."
— Matt Kouri, Mission Capital ED

3 SEEK ASSISTANCE FROM AN EXPERIENCED CONSULTANT. Employing a consultant who can help your organization navigate the complex process of a merger is extremely important. The nonprofit leaders in our study emphasized the value of hiring an experienced consultant who can help mediate challenges. Several leaders also recommended utilizing consultants during the integration phase since they wished they had received more support during this part of the process.

"I am also a huge proponent of not doing this yourself. You really need to hire a savvy consultant. Everybody is too close to their own stuff and having a process just to keep you going to whatever end makes sense is essential." — executive leader

[13] La Piana (2010). *Merging Wisely*. Stanford Social Innovation.

4 DEVELOP A TIMELINE THAT IS REASONABLE AND FLEXIBLE, YET INJECTS A SENSE OF URGENCY. Merging can be a highly time intensive process and takes staff and board away from the regular operations of the organization. In most cases we believe it makes sense to complete due diligence and negotiations in about six months or less. This allows enough time for thorough deliberation, yet helps ensure the process will not drag on. However, some more complicated mergers can take longer, and each involved organization needs to demonstrate schedule flexibility to ensure that the right outcome is achieved, even if it takes longer than expected.

5 SET A REALISTIC BUDGET AND SEEK FINANCIAL SUPPORT. As mentioned earlier, mergers can be expensive and can occasionally have a destabilizing financial effect. It is important to develop a reasonable estimate of the costs associated with merging, including all expenses related to programmatic and administrative integration. It is also important to budget for contingencies that may arise. Then, reach out to funders who may be willing to support your organization's exploration of the process and implementation. Funders can play a critical role in ensuring the new organization will be well positioned for success. Also consider setting aside money before the merger to help pay for some of the expenses incurred during the process.

6 DEVELOP A PROCESS THAT BUILDS TRUST. Building trust is one of the most important elements in a successful merger. Throughout the negotiations, consider ways to develop trust and goodwill into the process. This trust is absolutely crucial in order to work through contentious issues.

7 PROCEED WITH CAUTION AND DEMONSTRATE A WILLINGNESS TO TAKE RISKS. As our research uncovered, mergers have the potential to generate many benefits including increased services, strengthened programs, and enhanced organizational capacity. Mergers are also complex to navigate, expensive, and not right for every organization. It is important to both treat the process with care, and at the same time demonstrate a willingness to say "yes" when a merger makes good strategic sense.

"I can't over emphasize enough the importance of doing the appropriate due diligence and really taking the information seriously. That said I also am not an alarmist...If you are merging for all of the right reasons—those right reasons have to do with expanding your impact, expanding your capacity as an organization— then be aware but don't be scared."
— executive leader

8 RECOGNIZE STAFF EFFORTS. Mergers can create significant anxiety for staff who may face major changes in their work environment and the potential for job loss. Additionally, integration efforts are highly time intensive and often lead to significantly more work for staff. It is important for organizational leaders to acknowledge with staff the challenges and stress associated with a merger and consider ways to reward staff for their extra effort.

5 RECOMMENDATIONS FOR FUNDERS

1 REMEMBER THAT INCREASING MISSION IMPACT IS THE PRIMARY REASON FOR AND BENEFIT OF MERGING. Our research underscores that a merger should not be primarily about saving money, but rather it is a way for organizations to produce a greater long-term return on investment for donors and the community.

2 PROMOTE MERGER CONSIDERATION BUT DON'T OVERSTEP. Funders are often in a unique position to see clear opportunities for mergers among their grantees, and with other nonprofits. While funders should avoid a heavy-handed approach that might inappropriately encourage mergers where they are not a good fit, they can nonetheless encourage grantees to learn more about mergers, convene potential partners to consider the opportunity, and even (in limited cases) provide incentives for merger pursuit.

3 CONSIDER PROVIDING DIRECT FINANCIAL SUPPORT. As noted earlier, merging can be expensive and nonprofits typically underestimate the costs associated with integration. Organizations will benefit from financial assistance both to pay for one-time expenses, such as legal fees and consulting, as well as to help pay for the resources and time needed to fully integrate.

4 RECOGNIZE THAT INTEGRATION EFFORTS TAKE TIME. As one nonprofit leader noted, organizations cannot be expected to emerge fully formed. Organizations need time to completely operationalize all of the changes before the benefits of merging can be realized.

5 CONTINUE TO PROVIDE SUPPORT POST-MERGER. Some funders see a merger as an opportunity to reduce funding and support for the newly-formed organization. However, merged organizations are typically bigger and more complex and will often require more management and enhanced infrastructure. While a merged organization is often best-positioned to produce a greater return on investment over time, they will continue to need support to grow and thrive—particularly during the first few years after integration.

RESEARCH METHODOLOGY

Mission Capital conducted in-depth interviews with the leadership of 12 Central Texas nonprofit organizations identified by Mission Capital and the Texas Secretary of State's office as having been involved in a merger during the past 10 years. These interviews were conducted between February-April of 2013. In most cases, separate interviews were conducted with two leaders from each organization, typically the executive directors and/or board chairs. This allowed for a comparison of responses and provided different perspectives on the merger process and outcomes.

A total of 22 interviews were conducted. These interviews were recorded and transcribed. To analyze the qualitative information from respondents, the researcher developed a coding scheme by identifying reoccurring ideas, creating overarching categories, and then coding participants' responses based on those categories.

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AMOA-Arthouse – Austin Museum of Art, Arthouse at the Jones Center

Austin Habitat for Humanity – Austin Habitat for Humanity, PeopleTrust

BookSpring – Capital Area Reach Out & Read, Reading is Fundamental

Catholic Charities of Central Texas – Catholic Charities, Marywood Children and Family Services

DePelchin Children's Center – DePelchin Children's Center, Caring Family Network

Easter Seals Central Texas – Easter Seals Central Texas, United Cerebral Palsy of Texas

Faith in Action-Senior Access – Faith in Action Caregivers-Pflugerville, Faith in Action Caregivers-Round Rock

Girl Scouts of Central Texas – Lone Star (Austin), Bluebonnet (Waco), El Camino (San Angelo), Heart of Texas (Brownwood)

Khabele School – Khabele School, Primavera Montessori

Planned Parenthood-Greater Texas – Planned Parenthood Austin, Planned Parenthood Waco, Planned Parenthood North Texas

United Way of Williamson County – Georgetown United Way, United Way of Greater Williamson County

LifeWorks – Kids Exchange, Literacy Austin[14]

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[14] We spoke with the Executive Director of LifeWorks about the original merger that created LifeWorks as well as about two organizations that LifeWorks has acquired since 2003, Kids Exchange and Literacy Austin,

APPENDIX: MISSION CAPITAL'S STRATEGIC COLLABORATION CONTINUUM

COMMUNICATION
- Share ideas
- Share information
- **Example:** Leaders of two nonprofits meet regularly to discuss community needs or program effectiveness.

COOPERATION
- Share goals
- Limited joint activities
- **Example:** Two nonprofits with similar clientele refer clients to each other for complementary services.

COLLABORATION
- Shared means to achieve goals
- Significant joint activities
- **Example:** Two or more nonprofits offer a program or sponsor an event with the same mission and purpose.

SHARED SERVICES
- Share resources formally
- Joint formal operations, programming, or ventures
- **Example:** Nonprofits jointly fund a shared accountant, grant writer, etc.

MERGER
- Formal combination of two or more entities
- **Example:** Two or more nonprofits formally and legally merge into a single 501(c)(3) nonprofit corporation.

** Adapted from Peter Drucker's Meeting the Collaboration Challenge.*

THREE TYPES OF MERGERS

1. OUTRIGHT MERGER

This occurs when two or more nonprofits combine all aspects of their operations and programs into a single 501(c)(3) organization. It may involve relatively equal partners or be comprised of organizations with significantly differing assets. In cases where one partner has considerably greater assets, the merger may be defined as an acquisition. How the merger is viewed, "merger among equals" or "acquisition," often as implications for branding, who will be the executive director, board composition, marketing, communications and organizational culture.

2. ASSETS TRANSFER

In this type of merger the assets of one organization are transferred or given to other organization. Assets can be physical (buildings, equipment, etc.), human resources, or programs/services.

3. PARENT/SUBSIDIARY STRUCTURE

In this merger, one organization becomes a subsidiary or member of the other organization. Typically the organizations retain separate 501(c)(3) statuses, while the administrative functions and programmatic services are at least partially combined. This structure is often employed when a fully integrated merger may not initially be possible due to licensure or contract issues or as a way to mitigate risk. Once these issues are resolved organizations often choose to proceed with an outright merger.

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