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Why M&A May Help Nonprofits

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Insight

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Many philanthropic groups don't seek advice from investment bankers. That's too bad, because mergers and acquisitions may offer real solutions

Strategic alliances and mergers among nonprofits, while increasing, are infrequent relative to the number of nonprofits that might benefit. Why are these combinations, so common in Corporate America, so rare in the nonprofit sector? One reason is the disconnect between the nonprofit and corporate worlds. I would venture that many nonprofit leaders don't know what an investment banker is or does. And while many nonprofit board members know about investment banking, they don't see a connection to the nonprofit sector. As a result, the financial advisory services provided by investment bankers to Corporate America are not regularly sought by, or made available to, nonprofit organizations.

And that's unfortunate, because these services—including the handling of mergers, acquisitions, and other strategic alliances, as well as raising and managing capital—could often be useful to nonprofits, which are under increasing pressure to raise their level of fiduciary responsibility.

STRENGTH IN COMBINING. The obstacles to a merger go beyond just a disconnect, however. After all, there is no market mechanism to value and drive a merger between nonprofits—no shareholders demanding a handsome premium for their shares, no institutional investors driving a transaction to maximize value.

Without these drivers, nonprofit boards and staff tend to focus on their uniqueness rather than the benefits of combination. Because a merger is more likely to happen between nonprofits with complementary programs than with competing programs, a merger isn't an obvious option.

It also may seem that a merger is a less than ideal solution. To a nonprofit staff or board member, "merger" often connotes layoff or downsizing. Care for the welfare of the staff is a deeply ingrained and laudable aim of many nonprofit boards. The results of a merger—possible efficiencies and economies of scale—are therefore not welcome outcomes.

NO ROOM FOR AMATEURS. Nonprofit staff and board are focused on mission fulfillment with little spare resources to devote to the burdens of working through a combination, and the immediate cost savings may not be realized. The nonprofit may have to spend money at first (for severance, advisers, building and equipment rationalization, systems integration, etc.) to realize cost savings in the long run. The nonprofit may be just too fragile to survive the usually lengthy process of combination. Also, the process is generally too complicated for amateurs to consummate.

And granted, many nonprofits aren't good candidates for merger. They provide a needed service to a community for a relatively modest general and administrative cost structure and have adequate, reliable program funding.

So, why should a nonprofit board consider a merger or strategic alliance when there are all these obstacles—some of them quite legitimate? Because the best way to preserve the name, reputation, mission, and programs may be to affiliate with a stronger entity. Specific reasons could include the need for experienced leadership, a compelling cost-saving metric, more possibilities for growth, the preservation of quality programs, and enhanced fund-raising potential.

Why M&A May Help Nonprofits (continued)

SPIN-OFF OPTION. While fundamental structural change in the relationship of one nonprofit to another is rare, it's fairly common for a nonprofit to shut down a program that no longer meets its mission. The orphaned program's fate will be liquidation unless it can find a new home in another nonprofit or be structured into a stand-alone organization.

But because the orphan program might appear to contribute little in the way of tangible value to any potential new owner and because many organizations have a "not invented here" attitude, it's a challenge to locate the right "home" for the orphan program. Often overlooked are the values the program brings in terms of its name, program content, fund-raising contacts, staff expertise, location, and ability to grow and diversify the programs offered by the acquirer. So such a spin-off can be done. And that's one way in which an investment banker can be useful.

One of my clients is a program with both social-service and educational content that was abandoned by a major urban university. As the investment banker for the program, I explored creating a stand-alone 501(c) (3). However, this was not possible as the program depended on the university to provide working capital and could not finance itself from an independent source. This program was successfully acquired by another university with a mission closely aligned to serving urban youth and teaching others how to do this.

The process of finding a new home for the program will sound very familiar to those experienced in the sale of a subsidiary or division in the corporate world. We developed a list of potential strategic partners, gained access to these potential partners at the highest level of management, presented the program and its key staff to the decision-maker, worked with the acquirer's staff by providing additional materials and answering questions, structured the alliance, negotiated a letter of intent, and assisted in transitioning operations (programmatic, fiscal, and human resources).

NO PLACE FOR ARROGANCE. As noted in this example, the investment banker to a nonprofit must possess the skills to present the client favorably, design the structure, conduct due diligence, draft and negotiate the terms of the combination, and close the deal. The banker must also bring skills to the client that are different from those the corporate client needs. Those skills include patience with a staff already distracted by program delivery pressures, understanding of the nonprofit's need to ceaselessly raise money to meet operating expenses, and persistence in the face of a more deliberate pace of decision-making by a volunteer board. Most important, however, is respect for the staff and boards who tirelessly contribute so much of their time and talent to help others.

The banker must abandon arrogance and preconceived notions about the skills in the sector and must share the passion of the client for doing good works. The investment banker for the nonprofit organization will, upon completion of a successful affiliation, experience satisfaction beyond measure.

Lamb, president and CEO of Lamb Advisors (www.lambadvisors.com), has more than 35 years of Wall Street, corporate, and nonprofit experience addressing financially complex and critical strategic issues. Prior to establishing Lamb Advisors, Lamb spent 20 years at the investment bank Lazard Freres & Co.