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Community Investments Vol. 10, Issue 4 Mergers and Acquisitions in the Nonprofit World

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One can't pick up a newspaper these days without reading about the latest bank mega-merger or acquisition. Fierce with competition for bank customers, financial institutions constantly seek ways to expand product lines while creating efficiencies that result in cost-savings to the institution. Recent years demonstrate that merger deals can be smart and strategic moves in the game of market share and long-term corporate survival.

Executive directors of community-based nonprofits understand better than anybody the challenge of "doing more with less." For years, local grass-roots organizations have been at the core of successful community development initiatives, and this will likely continue into the future. However, as we will learn from the following article, mergers in the nonprofit world are beginning to occur with greater frequency. While a merger deal may not be on the immediate horizon, its benefits in the longer term may make it a business strategy worthy of consideration.

Banking, commercial real estate, the insurance industry. . .you name it. Mergers and acquisitions (M&As) have become the hottest business trend of the 90's. The persistent bull market and steady rise in stock prices has fueled much of the merger-mania experienced during the last several years.

In fact, M&As are one of the key growth strategies for companies in the private sector seeking to expand their markets and influence.

One of the obvious advantages of a private-sector merger is increased shareholder return. Less obvious, however, are other significant benefits that contribute to a company's bottom line; we'll discuss some of them later in this article. And, while M&As may seem applicable only to the private sector, many of the same advantages exist for their counterparts in the nonprofit world.

In the private sector, merging with or acquiring another company can make dollars and sense for a number of reasons:

1) Most M&A deals are paid for with shares of stock from the acquiring or "surviving" company; the higher its stock price, the more capital the company has to fund the purchase of other companies.
2) Company products and/or markets may be complementary or supplementary, thereby suggesting that the combined companies could fit well together. In such cases, the new "whole" might be viewed as greater than the sum of the original parts. If this is the marketplace perception, then the share price of the new company would likely increase, creating additional capital for future expansion.
3) The new company might also be better positioned to serve an expanded market, which is particularly important in highly competitive and fast-growing industries.
4) Significant cost savings might be created through the elimination of duplicative overhead and support services (accounting and back-room operations, for example), overlapping store, branch or service-delivery locations, and the reduction of personnel at various levels of the corporate structure.
5) All of the aforementioned activities could result in increased efficiencies and an enhanced ability to market the company's products.

Combined as elements of a long-term business strategy, these considerations are solid reasons for a private enterprise to consider a merger proposal. They are also critical factors in the financial and organizational survival of nonprofit entities as well.

Differences undoubtedly exist between the structure and operation of private-sector businesses and nonprofit organizations, particularly the manner in which each generates capital. Unlike corporate capital generated from stock proceeds, nonprofit capital is generated from philanthropic sources, public sector contributions, service delivery revenue and/or member contributions. However, this doesn't alter the fact that nonprofits are also businesses and, as such, can benefit greatly from astute business decisions which may include a potential M&A with another nonprofit organization.

If the missions and visions of two nonprofits are complementary, the combination of the two could create a new and improved organization that enjoys greater cost efficiencies and long-term potential. Furthermore, potential funders would likely be more inclined to participate in an organization that is perceived to be larger, more cost efficient, and ultimately, more effective.

A Case In Point

The following is the story of two Neighborhood Housing Service (NHS) programs that served two low-income neighborhoods in Orange County. In late 1997 and 1998, the authors (hereafter "we") helped facilitate the merger of these two NHS programs that will now serve all of Orange County. This case study illustrates many of the advantages of M&A activity outlined above.

Pre-Merger Status

For nearly 20 years, there have been two NHS programs in Orange County, home to more than 2 1/2 million people. The La Habra NHS and Santa Ana NHS were both formed in the late 1970's. They share similar origins, including a common connection with the same national intermediary, Neighborhood Reinvestment (NR). Both served predominately low-income Latino neighborhoods within a large, affluent, and politically conservative county.

Even with such striking similarities, the two programs differed in fundamental ways. The La Habra program enjoyed continuous organizational and financial stability since its founding, including an executive director with a 17-year tenure. The Santa Ana program, while strongly supported by neighborhood residents, suffered organizational and financial setbacks, difficulty in delivering program services, and problems in retaining an executive director. Beginning in June 1996, the La Habra executive director and other staff were hired under contract by Santa Ana to provide temporary leadership until a permanent solution could be found. Organizational assessments conducted by Neighborhood Reinvestment ultimately determined that the Santa Ana program was not financially viable in the long term.

In December 1997, we were engaged by La Habra NHS to help determine the optimal relationship between the two NHS programs and to explore ideas for resolving the situation. After a series of meetings with representatives of both organizations, we found that Board members and staff alike were anxious for a solution. But they were also concerned that a merger of the two organizations would dilute the benefits of local programs, leavning partnerships between residents, government and businesses diminished. Furthermore, Board members from La Habra NHS had grave concerns about the financial liability of consolidating. Their counterparts in Santa Ana were apprehensive about becoming a "step child" of the stronger La Habra program.

Externally, there was strong support for a countywide organization that could help revitalize a variety of low-and moderate-income neighborhoods by working with local residents, businesses, and the public sector. In contrast to neighboring Los Angeles County, there were relatively few organizations addressing affordable housing and community development needs within Orange County. Funders were enthusiastic about the possibility of reaching the lower-income communities in the County, including Santa Ana and surrounding cities.

Based on this research, our recommendation to both Boards was to create a new, countywide NHS by merging the two organizations, and slowly expand its programs into new communities as funds became available. Like mergers and acquisitions in the private sector, this one made sense for several reasons:

- the mission, products and markets of the two NHS programs were complementary and similar;
- both Boards and their respective staffs shared similar values, orientation and experiences through their connection to Neighborhood Reinvestment;
- a countywide NHS would be positioned to serve the unmet community revitalization and affordable housing needs of a larger market;
- significant cost savings would be created through the elimination of duplicative overhead and support services (administration, fundraising, accounting, program staff); and
- resources to support such an effort seemed available.

The key challenge was how to create a new, countywide program while preserving the existing programs and local presence of the two original organizations.

Planning Support

Neighborhood Reinvestment recognized the potential for M&A replication elsewhere in its network of more than 170 affiliates, and was strongly supportive of the planning effort. In addition to providing financial assistance for our study, NR staff participated in key meetings and retreats throughout the process.

The Fannie Mae Foundation funded a large portion of the planning effort. Other corporate sponsors such as the Enterprise Foundation, Wells Fargo, and Bank of America supported the merger effort based on NHS' excellent track record and reputation in the community.

The Planning Process

The next step involved the creation of a countywide Task Force to plan for the expanded organization. With the help of NHS staff, a 21-member Task Force was recruited that included members of both Boards, representatives of other Orange County housing programs, potential funders, and participating jurisdictions. Neighborhood Reinvestment staff attended all meetings and served in an ex-officio advisory capacity.

The purpose of the Task Force was to create a detailed plan for the expanded organization, including resolution of the issues identified by both organizations. After review, the plan would be submitted to both Boards and the members of each organization for approval. Some of the issues addressed were:

- the mission and vision for the expanded organization;
- the governance structure of the new organization, including composition of a new Board of Directors and Advisory Committee;
- necessary staffing and facilities;
- budgets for the initial year(s) of operation as a combined and expanded program;

- an identification of potential funding sources and a fundraising plan;
- a determination of the initial housing programs which would be offered;
- a marketing and outreach plan for the new organization; and,
- other details of the transition process, including a timetable for its implementation.

Legal counsel was provided by Orrick, Herrington & Sutcliffe, a San Francisco-based firm under contract with La Habra NHS. The attorneys worked closely with us throughout the merger process, providing legal guidance on organizational options and preparation of required legal documents.

The Results

The merger was completed in August 1998 following the presentation of Task Force recommendations to both Boards of Directors and members of La Habra and Santa Ana NHS organizations. In September 1998, "Neighborhood Housing Services of Orange County, Inc." (NHS OC) became a reality.

With its new mission and vision, the Board of Directors and staff are genuinely excited about the possibilities that lie ahead. There is a new 21-member Board of Directors comprised of representatives of the La Habra and Santa Ana programs and a number of new members. In addition, there are two Advisory Boards representing "chapters" and overseeing local programs in the two original communities. As new communities are added, Advisory Boards and chapters will be created to retain the neighborhood planning and oversight function that makes the NHS model so strong. Program expansion will begin with the creation of a "Homeownership Center" which will serve low-and moderate-income clients from all over Orange County. In addition to its existing facilities, NHS OC will locate its administrative and program staff, as well as the Homeownership Center in a

new facility that is centrally located in the County. A two-year budget has been prepared, along with a fundraising plan campaign which has already begun to raise money from lending institutions, foundations and other funders.

Through a careful examination of the issues, members of two local NHS programs were able to look beyond their immediate horizons and see the greater potential presented by a larger and more comprehensive program. NHS OC has been carefully structured to retain the present program strengths while expanding to serve more neighborhoods and people in need. Other non-profit organizations may learn from the NHS OC experience, and are welcome to consider it as a model for replication.

Considering a Merger Deal?
If so, ask yourself these key questions:

1) Are our missions similar, and do our activities significantly complement or supplement each other?
2) Can the market for our services be better served by a larger organization?
3) What cost savings can be anticipated from the potential combination of two organizations?
4) Can we make the case to both our respective Board members and our funders that this makes sense? Will they be supportive?
5) In the final analysis, do the potential advantages of a merger and acquisition significantly outweigh the disadvantages?

For additional information on the NHS OC merger or other community development initiatives, please contact Kathy Kenny at (415) 826-2547 or John Trauth at (415) 332-4346.

About the Authors


John R. Trauth has been working in the affordable housing field since 1972.


Kathy Kenny has over 15 years experience in community development, affordable housing and program design. For over 10 years, they were the team responsible for many of the nationally recognized programs of the Development Fund, a nonprofit organization dedicated to the development of innovative financing programs for community development. Working closely with the Federal Reserve Bank of San Francisco, they helped create financing programs for community reinvestment in seven states totaling $650 million, including the California Community Reinvestment Corporation (CCRC), the California Economic Development Lending Initiative (CEDLI), and California Resources and Training (CARAT). As consultants, they have developed affordable housing strategies for cities and have jointly conducted numerous strategic planning efforts and organizational start-ups. John Trauth was instrumental in the creation of BRIDGE Housing Corporation and Southern California Housing Development Corporation, two highly successful nonprofit housing development corporations. Kathy Kenny currently serves as a planning consultant to the Council on Foundations, several California foundations,

nonprofit community development organizations, and the Federal Reserve Bank of San Francisco.