Merger Myths

Thomas A. McLaughlin   23 January 2013

As the interest in nonprofit mergers grows, so do the myths surrounding them. In the nonprofit sector, mergers carry the stigma of for-profit experiences. Considering some of the legendary train wrecks that for-profit mergers have turned out to be, this is understandable. On that basis alone many people reject them. Yet when myths dominate thinking in place of clear-eyed analysis, decision-making can get skewed. This is a good time to examine some of the more persistent ideas about mergers in the nonprofit sector.

Administrative Cost Savings

The most persistent myth about nonprofit mergers is that they will save administrative costs. Maybe. Or maybe not. Many well-meaning outsiders looking in on the nonprofit sector conclude that there are 'too many nonprofits' and that there should be a multitude of mergers in order to save money. Mostly this myth taps into everyone's shared distaste for spending more money on administrative costs than is absolutely necessary. There is no constituency for wasteful overhead spending, so it's a risk-free proposition.

But let's look at the economic realities of nonprofits and their mergers. The vast majority of nonprofit public charities have revenues barely into six figures, and the

majority rarely clear even two million dollars per year. Many pressures keep administrative spending low already, so trimming even a small slice of that amount is a nearly heroic accomplishment. Those entertaining a merger with the primary idea of achieving major administrative savings will almost certainly be disappointed.

More important, any merger whose chief goal is to achieve, for example, $20,000 in administrative savings is quickly going to seem like cruel and unusual punishment to those trying to make it happen. At some point they'll likely stop, look around, and ask each other 'Are we doing all this just to save $20,000?' Better to have a lofty strategic goal and be realistic about administrative savings.

It is more likely that any savings will show up as more bang for the same buck. Only when one of the entities is much larger than the other, and has far more established and efficient administrative systems, will there likely be any significant administrative savings.

Massive job cut fear

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The second most pervasive myth about nonprofit mergers is that they lead to massive job losses. This fear is largely a carryover from mergers in the for-profit sector and the simplistic media coverage they usually get. Investors

generally approve of mergers but they dislike the resulting dip in stock prices they tend to bring. CEOs need to produce a quick offset to the additional cost of the merger, and the fastest way to do that is to lay off staff. The real heart of a merger is pretty unglamorous stuff, but the local television news reporter gets a ready-made, instantly understandable story, and that becomes the lead. Interestingly, it may be the announcement itself that they're counting on to achieve the effect. One study tracked layoff announcements from the Wall Street Journal and calculated that if all of the announced job cuts had actually happened, the unemployment rate would have been 50%.

In the nonprofit sector there is nothing comparable to investor pressure so there is no inherent pressure to cut jobs. There may be incidental job losses, but any major level of job loss that occurs during a nonprofit merger was probably going to happen anyway. In fact, a merger may actually reduce some of those losses if it promotes more efficient service delivery models.

Loss of identity

Of all the merger myths in this sector, this is one of the least well-understood. For practical purposes, 'identity' means 'brand', and managing brands is one thing that the nonprofit sector is just beginning to master. In the days when the prevailing nonprofit model was one-corporation-one-site-one-brand, this may have been a legitimate fear.

But many nonprofits are learning that it is possible and sometimes even desirable to have multiple brands under the same roof. It is important to understand that the decision to merge corporate structures is not the same thing as the decision to merge brands.

Let's figure out the structure first

Once the initial exploratory discussions are over, many board members and some CEOs want to jump right into a discussion about a desirable corporate structure. Big mistake. Form should follow function. Decide what you want the merger to accomplish and be clear about your shared assessments and desires. Only then is it worth having a discussion about structure.

Shhhh. Don't tell anyone

For-profit mergers are done in secrecy out of necessity. Large amounts of money are often made or lost on swings in stock prices, and there are laws and regulations governing what merger planners are allowed to say. Premature disclosures can sink a deal, and unauthorized outsiders (and insiders) are always willing to try to cash in on a tip.

Nonprofit mergers may well have to start out in secrecy for vaguely similar reasons. No nonprofit wants potentially damaging rumors to scare off donors or unnecessarily alarm government funders. And the wrong kind of

disclosure can create unnecessary staff anxiety.

But if the best nonprofit mergers are decided from the top down, they must be implemented from the bottom up. Owning the company in a for-profit context confers now-hear-this authority, but in the nonprofit sector authority is diffuse and employee buy-in and good will are essential for implementation.

Nonprofits can often manage the message effectively to external stakeholders such as donors and even the media. Without the lost-jobs hype, nonprofit mergers take on less urgency for most media outlets. Even today, when the mainstream media picks up on stories about nonprofit mergers, the treatment tends to paint nonprofits as a monolithic industry, with specific mergers used as illustrations of broad trends rather than as the story itself.

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Ironically, this tends to be a self-fulfilling myth. If they do not clearly understand the implications of their financial condition, many struggling nonprofits tend to hold on longer than they should. By the time they are finally ready to consider the idea it may be too late to salvage the programs.

The result is that the first wave of mergers in a given area

does tend to involve stronger organizations taking over weaker ones, so that becomes the prevailing imagery. But combining a problem-plagued organization with another, healthier organization just produces a larger organization with a lot more problems to solve. The most constructive use of mergers is not to rescue organizations in trouble – which might be done in other ways – but to strengthen community capacity by building nonprofit organizational strength.

The increase in mergers is a product of the economic downturn

Although it is logical to associate the increase in merger activity with the economic downturn, the fact is that many nonprofit resources are currently locked in outdated corporate structures and aging program models. While the downturn is making mergers seem like a logical choice, it is only a catalyzing agent for trends that were already under way.

In the end, mergers are simply another leadership tool. Reflexive loyalty to unneeded corporate structures or to program models in need of innovation is not a virtue. Time to lighten the baggage of mythology.

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