Merging Wisely: Best Practices for Structuring Successful Non-Profit Mergers

By Lewis Horowitz and Julia Abelev

A merger in the non-profit world is no less complicated than the merger of a for-profit corporation. But the metrics of success are different. Values-based organizations structured around achieving a mission—as opposed to bottom lines—may need to think even harder about whether a merger aligns with their goals, clients, and world view.

The dynamics of bringing donors, board members, and employees onto the same page is the greatest challenge faced by non-profits seeking to merge or acquire. This article shares some wisdom borne from the experience of our firm and others to provide non-profits with a roadmap for how to get from pitching the idea to the donors to successfully merging organizations. For each stage of the merger process, we provide best practices so your organization will be well-armed to think several steps ahead—to a bright future post-merger.

The stages of the non-profit merger are generally: 1) Pre-Merger Negotiations; 2) Merger Agreement; 3) Due Diligence; 4) Approvals; and 5) Closing & Integration.

Stage 1: Pre-Merger Negotiations

The pre-merger negotiations phase sets the stage for the entire merger. At this point, the parties must develop the values critical for the negotiations, agree on a means of formalizing their desire to move forward, and assemble a team whose task is to shepherd the merger.

i. Values Consensus

The start of any merger process begins with the most important discussion of all: developing a common values-based goal that both corporations can rally around. The importance of this cannot be overstated. "When organizations were able to identify potential mutual gains that could be realized in the merger there was a statistically greater likelihood that staff would integrate well into the new organization." [i]

ii. Memorializing a Memorandum of Understanding

Once the parties are on the same values page, they should draft a brief document (akin to a Letter of Intent or Memorandum of Understanding) memorializing the framework for the deal, disclosure schedules, and confidentiality requirements.

iii. Assembling the Merger Team

At this stage, many experts recommend putting together a dream team to manage the merger. In addition to board members and various stakeholders, there are three other types of people that could be of value at this stage:

Merger Consultant. The 2012 MAP report cited above found in its study sample that 86% of the mergers it studied included a merger consultant. They were found to add value as experts, facilitate discussions, and sometimes take on highly specialized roles like interim executive directors.[ii]

Joint Merger Committee. The benefits of a Joint Merger Committee include creating a smaller decision-making group, ensuring both boards have representatives always communicating, and maximizing technical skill already available on the boards.[iii] Several articles and studies have concluded that a task force or committee focused on the merger minimizes procedural mistakes and the escalation of tensions. It is also worth considering adding a special Staff Merger Team to ensure proper staff integration and investment.[iv]

Lawyers. Joint defense/representations agreements are common in this space to reduce costs; however, joint representation—much like in any other context—should be approached with caution, especially if the law firm chosen typically represents one of the merger entities.

Stage 2: Merger Agreement

The strength of the Merger Agreement depends on the thought that goes into its foundation. The parties should engage all relevant stakeholders when drafting the terms and try to preempt possible issue areas to minimize disagreements down the line.

i. Building Stakeholder Support

Before any serious drafting may occur, it is crucial to begin reaching out to stakeholders and generating buy-in. MAP for Nonprofits identifies four stakeholder groups of particular importance: 1) executive staff champions; 2) board members; 3) clients, consumers, and funders (treated as one group of external stakeholders); and 4) the non-profits' staff members.

First, studies indicate that having internal leadership on board with the transaction has a potent effect on steering the process along. A key leader with a vision becomes the executive champion—the one who pushes along the agenda and keeps morale high.

Second, a unified board front is fundamental. Each merging corporation's board has independent authority to approve or reject the merger. The board takes on a particularly active role by laying all of the merger groundwork. If there are any rifts on the board or disgruntled members, the process will hit logjams each step of the way.

Third, early and frequent communication with customers, clients, and funders ensures that everyone is on board as the Merger Agreement and formal contracts take shape. Customers and clients should feel comfortable with the surviving corporation and its ability to continue the services they have come to expect. Each board should sit down with major funders and get substantive buy-in from each—essentially pledges to financially support the new entity. Throughout this process of outreach, it is important to think of those shadow stakeholders whose interests will fundamentally affect the success of a merger, such as well-connected community members, committed volunteers, and government officials.

Fourth, staff members should be brought on board early to give them a sense of ownership in the merger process. "[I]nvolvement of non-administrative staff prior to merger are all associated with a significant number of positive outcomes following merger. Specifically: financial stability, service quality and/or expansion, organizational reputation, and the alignment of staffing with client needs."[v] The staff members need to feel that their interests matter. "Whether a merger results in reassigning roles, creating graceful exits, or developing new leadership positions in the merged entity, crafting a plan for senior staff that the staff itself considers fair and in the organization's best interests is a critical step if the parties are to actually tie the knot." [vi]

ii. Drafting the Merger Agreement: Issues to Consider

Once all of the right parties are invested in the merger, the actual drafting of the Merger Agreement can happen. Here is a list of considerations (beyond what is required by state statutes) that should inform the drafting of the Agreement. These include:

1. **Brand Stewardship:** Select the merged entity's brand based on the emotional and financial strength of each merging company's brand. This may involve dropping one of the brands, creating a public brand partnership, or creating a new amalgam brand.

2. **Mission/Vision:** Much like what was discussed in the earlier sections, the parties need to have an honest conversation about why the merger is taking place, who it serves, and what the larger goals of the new organization should be. Reaching a consensus on this will inform the rest of the transaction.

3. **Timeline:** The parties need to be realistic about how long negotiations may take, with the exactly timeline depending on how much legwork the organizations have already done and the relative complexity of the parties. If organizations are smaller and/or on tight budgets, the merger could take place surprisingly quickly.

4. **Board Structure & Executive Leadership:** Crucial questions remain about board, leadership, and programming. A common approach, is combining the boards and allowing for attrition to eventually get the board to the right size over a few years.

5. **Transfer of Liabilities & Contracts:** It is crucial to discuss which liabilities and contracts will transfer—and which will be closed out before the merger finalizes. Consider all possible sources of liability, including contracts, employees, pending court cases, etc.

6. **Transfer of Funds & Budget:** This is where keeping the funders in the loop is critical. According to the Stanford Social Innovation Review, funders can be responsible for "codifying and sharing know-how on all forms of alliances, connecting grantees that could become more than the sum of their parts, and providing financial support for the due diligence and integration costs." Importantly, funders should pledge up front that they will maintain their donations after the merger. If government funders are the main source, it is important to check with the sponsoring organization to make sure no grants are put at risk by a merger.

7. **Administrative/Overhead Escalation:** Non-profits are accustomed to lean operations, but a merger will produce increased need for sophisticated administrative and support staff. "The newly merged organization . . . because it's typically larger, may have to professionalize systems that could just 'get by' before."[vii] This includes thinking about accounting, human resources, physical relocations, and who will fill the new roles.

8. **Programmatic Planning:** Because each non-profit has built a brand and a mission with strong emotive backing, it may be difficult to let go of redundant or unnecessary programs. Such discussions should begin early, especially if staff reductions or cultural shifts are required.

9. **Define the Merger Process:** This includes more than just timelines but also authority transitions, phase out and phase in periods, financial deadlines, amending procedures, etc. MAP found that several merging entities felt that such front-end planning and preemption saved all parties much hassle when disputes or timing concerns arose.[viii]

With all of the above factors in play and memorialized, due diligence can begin.

Stage 3: Due Diligence

Conducting thorough due diligence not only shields the non-profit from an unhappy merger but also protects individual boards members. "Courts have held that that the members of the board of directors of a corporation that recommends a merger to shareholders or members can be personally and individually responsible if untoward results occur from the merger and the board members had failed to closely examine the merger partners in advance. Due diligence is thus an insurance policy for each governing board involved in the merger." [ix]

Each corporation should conduct independent as well as joint due diligence in order to maximize information. The categories of exchanged information include corporate documents, financial materials, fundraising records, third-party contracts, and personnel records. The timing of the due diligence is just as important as the substance of the exchange: phase the due diligence and make sure highly sensitive information (i.e., donor lists) is not exchanged too early in the process.

Stage 4: Approvals

The actual legal enactment of the merger follows the state law requirements for approval. Note that third-parties may have to approve a merger, such government entities, funders or donors with restrictions, banks, and insurance companies.

Stage 5: Closing & Integration

The closing itself is rarely an issue. State law dictates the required filings. The larger concern is what to do after closing: the process of integrating staff, programs, and boards. The integration process consists of two parts: 1) cultural integration; and 2) board/member integration.[x]

The best way to address each type of integration concern is to ensure that there is constant communication with staff, a clear mission from the beginning of the merger process, and several opportunities for continued discussions during the first few years—allowing for systems changes when needed. If the steps laid out in the earlier sections are followed, the integration should be smoother due to opportunities for staff and stakeholders to interact repeatedly in forums designed for such impactful conversations.

Concluding Thoughts

The moving pieces in a non-profit merger require looking several steps ahead at every point, always balancing the interests of the board, donors, and staff. With proper planning, a non-profit merger can be an invaluable tool for increasing an organization's social impact and finances. But only if the two corporations follow best practices, align their visions early, and check-in frequently. The above steps will empower a non-profit in merging wisely and building a new future.

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[i] MAP for Nonprofits, "Synopsis: Success Factors in Nonprofit Mergers," at p.10 (July 2012) (hereafter MAP 2012), available online at http://www.wilder.org/Wilder-Research/Publications/Studies/Nonprofit%20Mergers/Synopsis%20-%20Success%20Factors%20in%20Nonprofit%20Mergers.pdf.

[ii] Ellis Carter, "Mechanics of a Nonprofit Merger," CharityLawyer: Daily Dose of Nonprofit Law (Feb. 10, 2012), available online at http://charitylawyerblog.com/2012/02/10/mechanics-of-a-nonprofit-merger/.

[iii] Ellis Carter, "Collaboration Case Study—Successful Merger," CharityLawyer: Daily Dose of Nonprofit Law (Nov. 13, 2009), available online at http://charitylawyerblog.com/2009/11/13/collaboration-case-study-%e2%80%93-successful-merger/.

[iv] MAP for Nonprofits, "What do we know about nonprofit mergers? Findings from a literature review, focus group, and key informant interviews," at p.29 (March 2011) (hereafter MAP 2011), available online at http://www.mapfornonprofits.org/wp-content/uploads/2013/10/What-do-we-know-about-nonprofit-mergers.pdf.

[v] MAP 2012, supra note 1, at 12.

[vi] Katie Smith Milway, et al., "Why Nonprofit Mergers Continue to Lag," Stanford Social Innovation Review (Spring 2014), available online at http://ssir.org/articles/entry/why_nonprofit_mergers_continue_to_lag.

[vii] Alfredo Vergara-Lobo, et al., "The M Word: A Board Member's Guide to Mergers: How, Why & Why Not to Merge Nonprofit Organizations," CompassPoint (2005) (hereafter CompassPoint), available online at http://conservationtools-production.s3.amazonaws.com/library_item_files/1153/1053/445_mwordfinal2005.pdf?AWSAccessKeyId=AKIAIQFJLILYGVDR4AMQ&Expires=1466388484&Signature=W1bVyfVmT%2BOvcDIbGtWMHJgnCyQ%3D.

[viii] MAP 2011, supra note 4, at 35.

[ix] Jerald A. Jacobs, "All About Mergers of Nonprofit Organizations," Pillsbury Winthrop Shaw Pittman LLP (July 2008), available online at http://www.pillsburylaw.com/publications/all-about-mergers-of-nonprofit-organizations.

[x] MAP 2011, supra note 4, at 33.