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Mergers: Scandalous Nonsense or Strategic Alliance?

Just say the word "merger" in a room of School Heads and a cacophony of competing beliefs fills the room like some odious vapor. However, there is mounting, research-based evidence to suggest that mergers in the nonprofit sector create more robust, impactful, and efficient mission-driven organizations.[1] ISM's experience is that nonprofit Boards and Heads have difficulty discussing mergers because the strategy is frequently associated with leadership failure, financial distress, and operational chaos. Add to those fears professional and volunteer leaders' investment of time, talent, and treasure, and strategic thinking all too often takes a backseat to immoderate organizational goals that never materialize. It has been said that passion blinds. Perhaps it's time for some private schools to consider the strategic advantages of a merger.

Certainly financial distress and leadership vacuums top the list of initial drivers to consider mergers. But these are not strategic reasons to consider merging two or more private schools. Ultimately, the decision to merge must produce a new, mission-consumed, effective, cost-efficient organization with expanded reach.

From a strategic financial standpoint, a core driver for a merger would normally be an enhanced economy-of-scale, i.e., higher student-staff and student-teacher ratios (thus, an organization with more tuition-paying students per staff member and per teacher). This, in turn, feeds ISM Stability Markers No. 1 and No. 4, a higher percent-coverage of operations expense with hard income (No. 4),[2] yielding a heightened ability to build reserves and reduce indebtedness (No. 1).[3]

Merged private schools can attract seasoned executive leaders and savvy Board members because the new entity is more substantial, with the potential to reach deeply into the market served. Mergers can also eliminate competition for enrollment and fundraising dollars. They can streamline the business, operations, advancement, and marketing functions, and reduce the number of professionals required while becoming more attractive to a savvy professional talent pool. Reducing the number of business and operations personnel can have a powerful impact in that more resources for academic and cocurricular programs can be allocated. These strategic goals are not merely necessary. They must become so powerful and compelling that current leadership allows something new and better to emerge in exchange for laying aside what was. Private schools do not merge such that one school survives and the other partner dies. They join because two or more schools understand that something different, better, and new is necessary, and all parties are willing to lay aside the former schools. We do not recommend take-overs as a wise course for independent schools. Schools are values-rich institutions. A school's entire constituent base—Board members, faculty, administration, parents, students, donors, and alumni—makes connections to our schools because we help them live and fulfill their values. The complexity of values makes mergers in the traditional sense difficult to impossible to manage. Therefore, conversations about mergers must shift from what each participating school currently is to what could be, and the focus must be on creating a new school, a new legal entity. Successful mergers start with visionary thinking, not saving a fiscal catastrophe.

We do not mean to imply that all schools considering a merger must be in excellent financial and operational condition. We can look at corporate mergers in the United States and easily see examples of fiscally vulnerable, even bankrupt, companies merging and coming out stronger. The American Airlines and US Air merger is such an example. But private schools are not mere mergers of assets. Certainly, there is an asset component. But, more important, the education of young minds, the impact on the next generation of leaders, the kinsmanship of values—these are the components of private school missions, and they must be the centerpiece as merger discussions begin.

The first stage of a merger is the consideration stage. This stage is where lay and professional leaders, from all sides, talk about something new. This stage is informal—it's discussion- and meeting-prone. This is not the time to discuss entrenched or challenging positions. That derails the conversation. This is the time to be creative, to envision what is possible, to dream big. Once it's clear that all parties are serious, it's time to develop a one-page written agreement. It should state that all discussions are confidential, that no commitments have been made, and each party handles their expenses as it relates to this exploration. At this point, fully apprise each Board of the conversations.

Next, it's time to locate experts who can help you navigate the complex merger process. Typically, a consultant with private school expertise, an attorney, and a CPA are the minimum to retain. The consultant:

- is essential to ongoing conversations;
- helps each school remain ordered, and helps eliminate the inevitable sense of competition that arises as the discussions develop; and
- helps keep personalities in check, while maintaining a determined focus on the merger benefits and managing the entire process.

The second merger phase involves planning—this is where the serious work begins and where the new organization is designed. This requires an ad hoc group, usually senior Trustees or recent past Board members, from all parties. Senior staff members also become engaged during this phase. As the work develops, form subcommittees for things such as governance, mission-statement creation, curriculum, program development, naming the new school, and so forth. During this phase, compromise is essential. Each team should list a few, most important issues. The guiding consultant helps achieve as many of these as possible.

Among the most challenging decisions for a new school creation is Board composition, who will lead the Board, who will be School Head, and the new school's name. As an example of the expertise required to navigate these sticky situations, let's examine Board composition. The initial Board might comprise an equal number of Trustees from each merging school. However, sometimes the founding Board needs to be larger than ideal to allow for an agreeable transition. That can easily be accommodated and fixed through attrition over the first few years of the new school's operation. This is a short-term compromise with little downside, but can ease the natural fear of being consumed by a competitor. This compromise is often necessary to create a new school from the existing ones.

Once it becomes clear there is not only a desire to create a new school, but there is also a workable and exciting plan, a formal merger proposal is written and we enter the final stage of the merger. This document begins the legal process and is intense and expensive. The legal and financial due diligence of this phase requires attorneys and accountants. A full inventory of each parties' legal status, contracts, pending lawsuits, assets, and liabilities is required. The reports generated in this phase become essential to each Trustee in approving the final decision to merge. Due diligence is supremely important because courts often hold Board members personally responsible for failing to examine potential merging partners thoroughly. This does not mean that merging partners must be fiscally solvent, but Boards must completely understand their merging partner(s) and demonstrate why merging with the chosen partner(s) is a wise course. This phase ends with a formal merger agreement approved by all Boards. The official merger agreement contains all the details of governance, leadership, name, new bylaws, the new 501(c)(3), and so forth. Once this work is complete—and this stage is protracted—the merging Boards vote to dissolve the existing corporations and the new school opens.

Mergers are complex, values-laden transactions. While no individuals will profit from mergers in the nonprofit sector, leaders' overwhelming sense of pride and mission must be put aside so something better can serve multiple generations. Private schools must remain fiscally and operationally stable. Strategic mergers can create healthy private schools for many communities where too much competition weakens operational excellence. *I&P*

[1] Haider, Donald; Katherine Cooper; Reyhaneh Maktoufi. (2020). *Mergers as a Strategy for Success: 2016 Report from the Metropolitan Chicago Nonprofit Merger Research Report.* chicagonpmergerstudy.org

[2] See "Calculating Your School's Score on ISM Stability Marker No. 4: Hard Income," *Ideas & Perspectives*, 43-13-51.

[3] See "ISM Stability Marker No. 1 Revisited: Cash Reserves, Debt, and Endowment," *I&P*, 42-16-61.