

Social Services Agencies in New York City: When Financial and Operating Risks Make Saying No to a Merger the Best Strategy – for Now

Challenge

Facing a range of financial pressures, including shrinking federal funding and mounting cash flow problems, a small social services agency in New York City brought the idea of a partnership to a larger, more broadly based agency serving the same community. The central idea was for the larger agency to take over the contracts of the smaller nonprofit. A merger would allow a dominant service provider to emerge, able to secure additional private and federal funding, expand community services, and cut redundant costs. For the larger agency the combination presented a major strategic opportunity to expand one of its smaller service lines. Yet, there were significant challenges. The larger agency would be assuming the accumulated deficits for the current contract year from the smaller organization. The smaller agency also appeared resistant to cost-cutting. Most important: A merger could threaten the financial health of the acquiring agency.

All mergers face cultural, financial, and strategic challenges. Careful up-front analysis is vital to making an informed decision on whether to proceed – or risk seeing the best-intentioned combinations unravel.

A key question emerged: Would the long-term strategic benefits of a merger be overwhelmed by the financial risks of taking on the new agency's obligations?

Our Work

Fiscal Management Associates was engaged by the larger agency to determine the risks and rewards of a merger. FMA worked with the executive directors and senior financial management of both agencies to help them understand the impact of a merger on the long-term sustainability of the merged organization. Early on, FMA identified critical areas of concern for our client. The size of the accumulated contract deficits the larger agency would assume was problematic. Add to that, we had questions about the smaller agency's ability to meet its payables, generate new funds, and create a balanced budget.

For the deal to make strategic and financial sense, a number of hurdles needed clearing. FMA prepared a going-forward plan for the smaller agency focused both on cutting costs, through reduced salaries, benefits, and staff, and boosting revenues by increasing fees, holding fund-raising events, and targeting foundations for additional funding. FMA also cautioned both organizations that the larger agency may need to step in to assume the budgeting tasks to reduce potential liabilities.

Results

The larger agency decided to put the deal on hold, based on the risks we identified. FMA provided the larger agency's board with the framework to fully assess the implications of a merger on its own health and strategy. On balance, the decision to say "no" to the merger was more important than gaining potential competitive advantages over other social service agencies – at least for now. If the combination is to proceed, the smaller agency must strengthen its financial condition by the end of its fiscal year. All mergers face cultural, financial, and strategic challenges. Careful up-front analysis is vital to making an informed decision on whether to proceed – or risk seeing the best-intentioned combinations unravel.

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