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No Exit: The Case for Nonprofit Holding Companies

Applying the structure of a holding company to the nonprofit and social enterprise sectors could help both small, high-potential organizations and larger anchor organizations flourish.

By Andrew Stern | Mar. 31, 2016

Many of the nonprofits and social enterprises celebrated around the world have exactly what social change funders are seeking: a proven model that delivers impact with a defined product or service.

But then they hit a wall. After 5-15 years of good work, many outgrow their early funding without reaching a sustainable earned income model or access to larger government funding. They're stuck in what my colleague Alice Gugelev and I call the "social capital chasm." (See our article "What's Your Endgame? (http://ssir.org/articles/entry/whats_your_endgame) ") At this point, many organizations struggle to maintain their operations, let alone grow. Many go through leadership transitions and lose their most charismatic fundraiser: the founder.

What if these high-potential organizations didn't have to go through this complicated, risky growth process—at least not on their own? What if a nonprofit or social enterprise that safely crossed the chasm could "acquire" them, in effect realizing the concept of a nonprofit holding company structure by joining programmatic, leadership, and decision-making forces with the smaller organization?

The Art of the Acquisition

Silicon Valley would be littered with similar failing businesses if private companies had to navigate this investment chasm on their own. After 5-10 years of operations, most small and growing businesses in the United States are acquired for their product, service, or intellectual property, and then benefit from the acquiring company's tremendous resources, support, and, most importantly, growth experience. In 2014—one of the best years on record for initial public offerings (IPOs)—74 percent of venture-backed US firms that successfully exited, or cashed out their initial investments in building their companies, did so through corporate acquisitions (http://pitchbook.com/news/reports/1q-2015-us-venture-industry-report) , with approximately 13 percent through next-stage buyouts and 13 percent through IPOs.

Thanks to acquisitions, most successful for-profit businesses never really have to go it alone. The few companies that do grow independently and survive become the platforms that integrate other businesses. These so-called "unicorns" have something that's seemingly very difficult for other businesses to replicate: a unique combination of governance, leadership, management, and access to capital to grow and invest in core operations.

In contrast, nonprofit organizations and social enterprises are almost never acquired and rarely merge with other organizations. It's unrealistic to think that successful nonprofits will grow and thrive forever, as long as they're doing good work and have some decent funding. They face a variety of constraints—most notably a lack of equity, which constrains long-term ownership, limits access to capital, and prevents reasonable exits for early leaders and funders. These barriers also limit the development of a real "social capital market" with, for example, Series A through D funding (http://www.investopedia.com/articles/personal-finance/102015/series-b-c-funding-what-it-all-means-and-how-it-works.asp) , or private equity buyouts (http://www.investopedia.com/terms/b/buyout.asp) .

These barriers have shaped the current landscape for early-stage nonprofit and social enterprises: a collection of great programs slowly losing their early founders and funders, or at risk of collapsing.

Putting the Nonprofit Sector's "Unicorns" to Work

So what can we do about this? One solution may be to follow the lead of the business sector, and have startup and middle-stage organizations partner with "nonprofit unicorns"—ones that have successfully transitioned leadership, and defied the usual size and scale constraints of social capital markets and the sector—to aggregate programs and break through. Potential unicorns might include nonprofits such as Partners in Health, Room to Read, or mothers2mothers.

The value of such a model could be significant. It would give established nonprofit unicorns—organizations that have built management and operational bases strong enough to support multiple programs—the ability to grow or scale newly acquired programs faster and with fewer resources than the nonprofit partner could manage alone. It would give the other organizations longer-term sustainability and more widely adopted uptake of their program, service, or approach.

Often acquisitions look more like one large NGO gobbling up a small nonprofit that's at risk of bankruptcy, rather than a true partnership. But a nonprofit holding company structure is different; it makes the most of each component's strengths and harnesses the best of small organizations in a way that scales impact even further. This conceptualization of the structure would overcome some of the barriers to nonprofit mergers that authors from Bridgespan have documented well (http://ssir.org/articles/entry/why_nonprofit_mergers_continue_to_lag) , including the desire for programs to preserve elements of their brand, leadership, and governance, even if acquired.

Pathway to a Nonprofit Holding Company

The preliminary pathway to this nonprofit holding company structure—outlined below and to be tested further—seeks programmatic, cultural, and leadership alignment before greater operational alignment.

1. Identify the nonprofit unicorn, or anchor partner. The anchor partner should be a credible, leading organization in the nonprofit sector, with a strong operating platform and a clear, strategic rationale for why expanding programs to include new organizations would improve its services to clients.

2. Start with a programmatic partnership. The anchor partner and joining organization(s) should first partner together on programmatic work, either at one site or in one country, to identify how their programs can find synergies to better serve clients, beneficiaries, or partners, and to understand how their teams might work together.

3. Migrate to a joint leadership and decision-making model. In one site or country, the anchor partner and joining organizations should start combining the management of programs under a joint leadership team—with shared planning, budgeting, and decision-making—and pursue shared funding together. The joint team should establish clear milestones to monitor and understand when and how to advance the partnership toward the full holding company structure.

4. Create a full holding company. Once the programs and leadership teams are aligned, the holding company structure can start taking shape. The organizations should consolidate back-office and other operations, wind down redundant legal entities, and combine fundraising efforts. They should, however, also maintain distinctly branded programs and define leadership roles: Leadership teams from joining organizations should become directors of programs (either as units within the holding company, or fully integrated management teams) and part of a holding company-wide management committee, and the joining organization board should continue as a program advisory board (with a few board members becoming members of the holding company board).

Better Together

Of course, creating such a holding company wouldn't be easy. Just like in the for-profit sector, many mergers and acquisitions fail without the right leadership, strategy, culture, and other important ingredients in the mix.

But the benefits could make it worthwhile—and not just for nonprofits and social enterprises. This structure would also allow funders to more efficiently allocate capital toward a more robust and sustainable nonprofit sector. To facilitate this shift, funders shouldn't just celebrate startups and entrepreneurial nonprofit founders; they should also celebrate the (albeit less glamorous) exits and nonprofit CEOs who are able to manage large, well-run organizations. They can also speak with their money—through financial support, they can help manage transitions and incentivize organizations to join the holding company structure.

A staged pathway to a holding company structure can mitigate some of the difficulty and risk, while allowing organizations to preserve the elements of their brand, leadership, and governance that were so critical to their original success. Drafting the blueprint for a stronger global organization may just be the first step toward building a stronger nonprofit sector.

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