Grant Thornton

The State of the Not-for-Profit Sector in 2017

Fourth annual report

Article excerpt:
In Focus: Associations and Membership Organizations
Turning to M&A for Sustainability and Growth

Find and share the full report:
The State of the Not-for-Profit Sector in 2017
at grantthornton.com/2017

Introduction

Leaders of not-for-profit organizations have new opportunities, technologies and analytical tools to help their organizations thrive. They now have more information at hand to make better-informed decisions, new technologies to exploit, and potential transformative initiatives to undertake in programmatic and administrative execution.

Leaders are likewise dealing with rising challenges in identifying new revenue sources and funding, cost containment, workforce changes, regulatory requirements, and finding ways to mitigate or at least respond to organizational risks.

This is a time of great potential for reaching and serving a more diverse constituency, collaborating with other organizations and private industry, and using technology more strategically. Innovative thinking will be vital to successfully moving into the future.

In this, our fourth annual *State of the Not-for-Profit Sector* report, we offer you our experience-based viewpoints and approaches that point the way to decision-making that will sustain organizations, positioning them for long-term success. While we will continue throughout the course of this year to provide webcasts, training and articles of interest to leaders in the not-for-profit sector, the editorial purpose of this publication is to cover the trends and issues we expect to emerge in 2017. As a leader in this sector, we believe it is our responsibility to give back to this community we serve by providing these valuable insights.

Within these pages, you will find our guidance and proposed solutions regarding important developments, challenges and opportunities facing not-for-profit leadership, with specific features for each of the key sectors our industry practice comprises — associations and membership organizations, foundations, Jewish and Israeli organizations, museums and cultural institutions, religious organizations, and social service organizations (we cover our seventh sector, higher education, in a separate publication, *The State of Higher Education in 2017*; see grantthornton.com/highered2017).

The articles in this report stem from knowledge gained through our professionals' direct interactions with their clients. Rather than theoretical pieces, they are the result of practical, hands-on experience gained by more than 400 Grant Thornton LLP professionals serving approximately 900 eminent not-for-profit clients. These insights are intended to be used by you — board members, executives, management, and other leaders and stakeholders in the not-for-profit sector.

Our Not-for-Profit and Higher Education practices are committed to helping "organizations that do good" fulfill their missions. We understand that enhancing quality, protecting reputation and maintaining operational sustainability are all essential to organizations' ability to achieve success and further their cause. Our not-for-profit experience is deep, and we offer it to assist nonprofit leadership with the challenges and opportunities addressed in this report.

On behalf of the partners and professionals of Grant Thornton's Not-for-Profit and Higher Education practices, I am pleased to present *The State of the Not-for-Profit Sector in 2017*. We hope that you find this to be a valuable resource. As always, we welcome your feedback and are available to assist management teams and boards in addressing the challenges discussed in this report, or any other issues you may be facing.

Mark Oster
National Managing Partner
Not-for-Profit and Higher Education Practices
mark.oster@us.gt.com

Watch Mark's introduction to the report.

In Focus: Associations and Membership Organizations Turning to M&A for Sustainability and Growth

Jeffrey Su, Managing Director, Audit Services, Not-for-Profit and Higher Education Practices
Bridget Roche, Director, Tax Services, Not-for-Profit and Higher Education Practices

Myriad challenges — both internal and external — are converging to not only stymie association growth, but also threaten sustainability.

According to executives surveyed by Marketing General Incorporated, the biggest challenge for association leadership is effectively communicating membership value and benefits in a way that drives retention and growth.[1] Associations also face increasing competition to their traditional business model from online and social networking communities that offer opportunities to virtually engage with others, as well as from sources offering online education or training. Finally, changing demographics are resulting in declining memberships with baby boomers retiring and a preference for online engagement by the younger membership joining association ranks.

As a direct result of these challenges, the majority of associations responding to the survey reported a decrease (26%) in renewal rates over the past year. To survive, many have felt forced to offer more member benefits and services. But this presents financial challenges that jeopardize long-term financial viability. With an uncertain return on investment for these efforts, an association could consider a new direction — mergers or acquisitions — to achieve financial stability and growth.

M&A can close gaps and open opportunities

A viable strategy to fortify your association's position, purpose and brand in the marketplace can be via a merger or acquisition. To clarify the distinction between these two approaches, a merger is where two entities combine to form a new entity, generally to decrease competition and increase operational efficiency, and an acquisition is where one entity (target company) is subsumed into another entity (acquiring company) which can provide instant growth and expansion for the acquiring organization. A merger or acquisition can be domestic or international and can be between a not-for-profit and a for-profit entity. An option for some associations is an internal M&A — a merger of chapters to consolidate duplicative administrative and programmatic functions.

M&A can expand the member group beyond the current membership, add member services, enhance technology, and deepen knowledge and experience of association staff. It can further serve to overcome competition through consolidation of similar associations within the same industry or profession, reduce costs through synergies gained, and provide additional access to new members and population. Just as importantly, your association's reputation and brand can be enhanced.

With an uncertain return on investment in efforts to offer more member benefits and services, an association could consider a new direction — mergers or acquisitions — to achieve financial stability and growth.

1 Wasserman, Adina. "2016 Membership Marketing Benchmarking Report," Marketing General Incorporated, June 22, 2016.

Exploring benefits of M&A can focus on strengthening existing revenue streams, bringing in new revenue sources, or gaining additional infrastructure for income-producing conferences and events. For organizations seeking global expansion, targeting international associations with a similar membership base is a great way to expand without incurring the expense of creating the growth organically.

Market research is essential to gauge changing member needs and preferences of current and potential members, and it is an essential prerequisite to M&A. Based on research outcomes, you will be able to determine if a new affiliation can provide the membership solutions your association doesn't have the resources to offer.

Conduct wide-ranging tax and financial due diligence

Substantial due diligence is always necessary, but it must be especially comprehensive when transactions involve private organizations for which little information is publicly available. While strategic fit, constituents, employee/management issues, major contracts, litigation, and anticipated nonroutine expenses such as IT upgrades must be included in the due diligence process, go beyond the obvious aspects to address some nuanced financial considerations. Engage outside advisers to ensure an efficient and beneficial process.

Because intangible assets — including trade name, content, member relationships, goodwill and internally developed technology — are commonly acquired, it is imperative to involve valuation specialists for realistic assessments of these assets.

Not-for-profit tax and M&A specialists can identify potential deal hazards and their effects, and assist with ideal tax structuring, the target entity's structure verification (e.g., S-corporation election), and modeling of initial estimated tax costs of the target and the target's shareholders versus the benefit to the acquiring association.

Synergies and expanded services resulting from M&A

The Institute of Electrical and Electronics Engineers Inc. (IEEE), a global nonprofit technical professional organization with 420,000 members in over 160 countries, acquired GlobalSpec, a global for-profit source of engineering and technical news, data and analytics in April 2016. This acquisition of an industry information source increased the offerings to IEEE's members and boosted the association's brand through improvement of its emerging position in research analytics. In describing the value of the acquisition, IEEE President Barry Shoop said, "We are committed to our mission of advancing technology for humanity, and we believe the synergistic benefits created through this acquisition — across content, standards, and communities — will better serve the needs of our members, professions, and customers."[1]

The merger of two nonprofit retail industry associations — the Association for Retail Environments, a North American association for retail suppliers, and Point of Purchase Advertising International, a global association with more than 1,400 member companies in 60 countries — was rebranded in June 2016 as Shop! This merger resulted in a new association that provides expanded services, including research, education and networking to over 2,000 member companies worldwide. CEO Steven Weiss described the value of the new association: "After a thorough vetting process that included numerous focus groups and input from many of our members, our Association is proud to announce this new name and immediately begin our renewed focus to advance retail environments and experiences through our programs, events and publications."[2]

1 IEEE. "IEEE Acquires GlobalSpec and the Engineering360 Platform from IHS to Create Powerful New Resource for the Global Engineering Community," April 29, 2016.

2 "Introducing 'Shop!' – new name for A.R.E. | POPAI The New Association," PR Newswire, June 29, 2016.

When M&A involves a for-profit entity and/or entities with international or multistate local jurisdictions, associations should also consider transfer pricing tax implications. For instance, if the M&A involves a for-profit entity, there are additional considerations for pricing of such items as intercompany expenses, management fees and due to/due from loans. In a scenario in which a U.S. not-for-profit organization plans to acquire a Mexican not-for-profit organization, and the U.S. acquirer expects to purchase database services from its Mexican target, the U.S. acquirer must understand the requirements of the transfer pricing rules, which cover such issues as beneficial exchange rates. Instead of pricing the services at cost, it might be necessary for the Mexican target to include a markup fee to represent an average profit margin that matches the margin it receives from other buyers of its database services. The U.S. acquirer and the Mexican subsidiary would need a management services agreement to ensure that the acquirer maintains a relationship that meets the required arm's-length standards that it has with other service providers. By confirming that the prices it is charged represent fair market value, the U.S. acquirer complies with Organisation for Economic Co-operation and Development guidelines.

As part of due diligence, transfer pricing policies should be reviewed and revised as necessary to assure that there are minimal or no gaps between stated business and tax objectives, and to minimize the burdens and risks of noncompliance. An effective review of transfer pricing includes assessment of cross charges that might result — such as sharing employees, or payment from an acquiring entity to a target for services or physical goods — and management contracts that might be needed between the acquiring entity and the target. Include SALT considerations, as well as international value-added taxes, in the upfront cost analysis, and see that there has been proper registration and filing of sales, income, property and employment taxes.

With an open mind about collaboration and well-grounded due diligence, a formalized M&A strategy can help an association sustain and grow to further its mission, expand membership, reach across jurisdictions and even continents, broaden revenue streams through added depth and breadth of offerings, generate efficiencies, and ultimately better position itself for long-term success.

About Grant Thornton LLP

We want to hear from you
Please take this quick survey and tell us what you thought of this content.

GrantThornton

Connect with us

grantthornton.com

@grantthorntonus

linkd.in/grantthorntonus