What Happens When Nonprofits Consolidate

(Either Partially Or All The Way)?

A new survey offers insights into strategic restructuring and how to make them a success.

BY AMELIA KOHM

The nonprofit landscape has shifted, and strategic restructuring is a crucial part of the new reality. Although many nonprofits are keenly interested in such partnerships, they are hard-pressed to find models other than corporate mergers, which do little to illuminate their own efforts.

Consolidating with a children's theatre attracted school groups to the Kentucky Center for the Arts facility—just one benefit of the partnership.

THE CHANGING NONPROFIT LANDSCAPE

▮ The number of active 501(c)(3) charitable organizations increased by 57 percent in eight years, between 1989 and 1997. *(National Center for Charitable Statistics, The Urban Institute)*

▮ A survey of 137 nonprofit executive directors in the San Francisco area found that although their average tenure was 5.95 years, the majority had served as executive directors for five or fewer years. Nearly two-thirds reported that their current executive directorship was their first. Only one in four wanted their next job to be that of an executive director. *(Support Center for Nonprofit Management/NDC)*

▮ Community-based nonprofit organizations play a pivotal role in recent efforts to devolve public responsibilities to lower levels of government and other sectors. A study of 124 nonprofits in Cuyahoga County, Ohio, found that smaller nonprofits—particularly community-based and faith-based organizations—lacked the service capacity, economies of scale, revenue flows, and trained staff to meet the expectations of government contracts. *(Cleveland State University)*

▮ In 1998, no fewer than 30 states were considering managed care strategies in their funding of child welfare services. Many are also considering such strategies in the mental health area, signaling an emergence of market forces in these industries. *(Chapin Hall Center for Children)*

To shed light on the subject, a team from the Chapin Hall Center for Children, a policy research center at the University of Chicago, and Strategic Solutions, a California-based project of La Piana Associates, Inc., asked 192 nonprofits nationwide to share their strategic restructuring experiences. Here's what they learned.

What Sorts of Partnerships Are Nonprofits Forming?

The survey uncovered valuable information about the types of partnerships nonprofits are undertaking. Drawing on survey data, the team identified six types of strategic restructuring partnerships, which can be organized into two primary types: alliances and integrations. (See the partnership matrix in Figure 1.)

Alliances

An alliance is a commitment to share or transfer decision-making power. It involves a formal agreement but no change to the organizations' corporate structure. Alliances include:

- **Administrative consolidations:** the sharing, exchanging, or contracting of administrative functions to increase the administrative efficiency of one or more organizations.
- **Joint programs:** the joint launching and managing of one or more programs to further the programmatic mission of participating organizations.

Integrations

An integration involves changes to corporate control or structure, including the creation or dissolution of one or more organizations. The integration category includes the following:

- **Management service organization (MSO):** the creation of a new organization to conduct a range of administrative functions and thus increase the efficiency of participating organizations.
- **Joint venture:** the creation of a new organization to further a specific administrative or programmatic end of two or more organizations. Partner organizations share governance of the new organization.
- **Parent-subsidiary structure:** the creation of a new (or designation of an existing) organization (called the parent) to oversee administrative functions and programmatic services of one or more other organizations (called subsidiaries). Sometimes the organizations keep their identities; in other cases, they look and function much like a merged organization.
- **Merger:** the integration of all programmatic and administrative functions to increase the administrative efficiency and program quality of one or more organizations. Mergers occur when one or more organizations dissolve and become part of another organization's structure or when two or more organizations dissolve and establish a new structure that includes some or all of the resources and programs of the original organizations.

What Kinds of Nonprofits Are Restructuring?

The survey revealed the following information about the responding organizations:

- Very young and very old organizations were less likely to be involved in strategic restructuring.

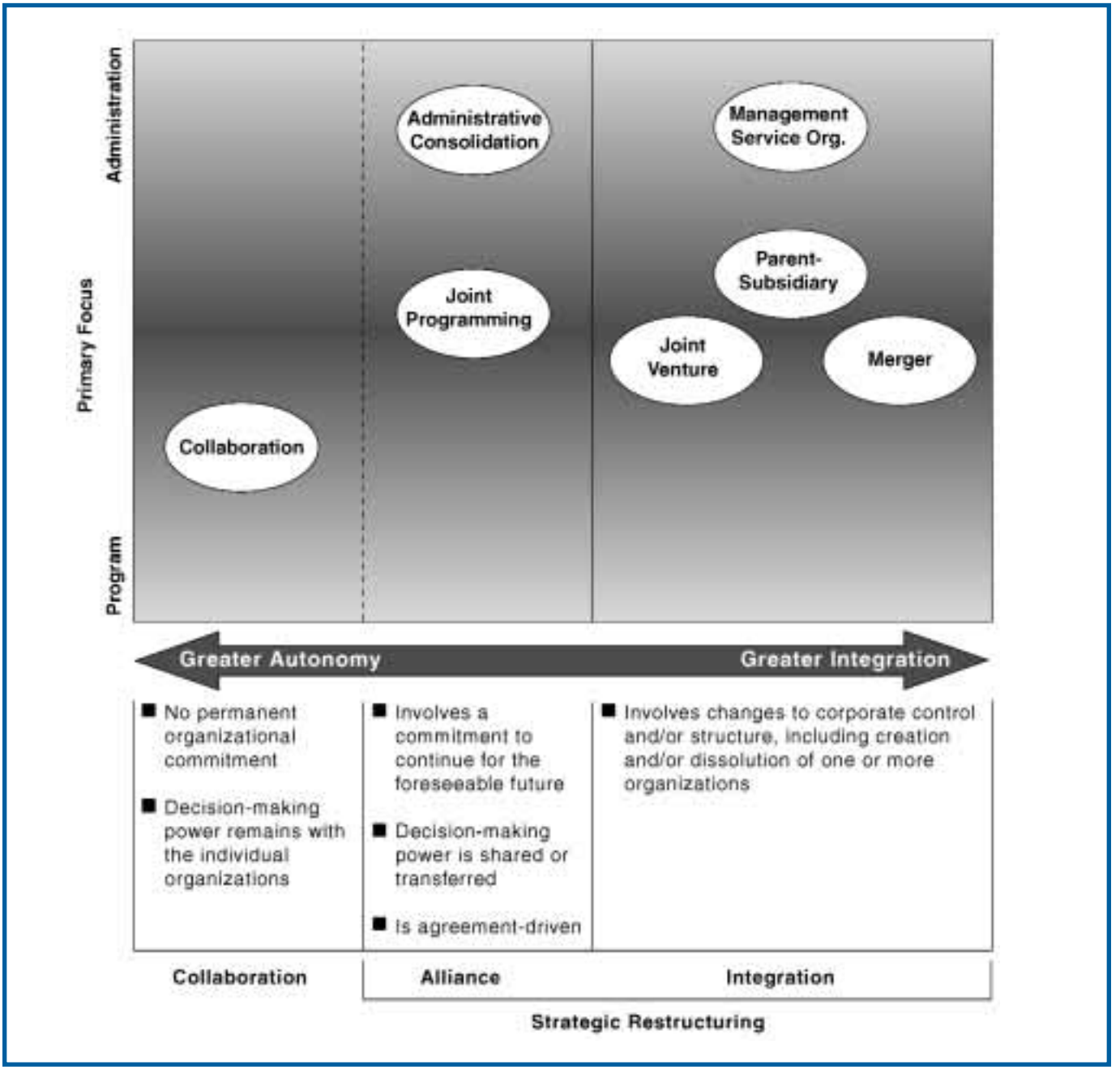

Figure 1. PARTNERSHIP MATRIX

■ Respondents involved in integrations were more likely than those involved in alliances to be focused on human services, to have large budgets, to have active boards, and to be located in urban communities.

■ Respondents involved in alliances were more likely than those involved in integrations to be focused on arts and culture, to have small budgets, to have fairly inactive boards, and to be located in rural communities.

■ Integrations usually involved fewer organizations than alliances did.

Why Are Nonprofits Choosing Strategic Restructuring?

Survey results provided insights about why nonprofits decide to restructure:

■ Competition is a key factor. Some service areas are growing crowded with competing organizations. Nonprofits are responding by cooperating or merging.

■ Most respondents entered into strategic restructuring to improve the quality of what they do rather than

because of threats of closure or pressure from funders. In other words, they are approaching strategic restructuring as a result of forecasting and planning.

What Are the Benefits of Strategic Restructuring?

The most common benefits respondents reported from their restructuring experiences were:

- increased programmatic collaborations with partner organizations, leading to higher-quality programs
- increased services
- increased administrative capacity and quality
- increased market share.

What Are the Problems?

Most respondents reported very positive strategic restructuring experiences without many problems. Most said they realized their goals for the partnership. Integrations presented more challenges than alliances, but the problems weren't judged to be serious.[1]

In rating 13 potential problems, less than 37 percent of respondents identified any one problem as significant. The most common challenges were:

- conflicting organizational cultures
- the adjustment of staff to new roles
- the difficulty of building trust among organizations
- autonomy concerns.

What Contributes to Success?

The most important success factors, according to respondents, were:

- a staff or board member who championed the partnership
- positive past experiences with partnering with other organizations
- board encouragement
- organizational risk taking and growth orientation.

Strategic Restructuring in Action: Two Profiles

Stage One and Kentucky Center for the Arts, Administrative Consolidation Profile

A financial crisis that threatened the survival of Stage One, a children's theatre in Louisville, Kentucky, was the spark that led to an administrative consolidation with Kentucky Center for the Arts (KCA), a larger organization that could provide Stage One with administrative support and oversight. KCA books traveling companies and provides theatre space for five resident performing groups, including Stage One.

Under the terms of a management agreement, Stage One exchanged control for resources. Stage One paid KCA a management fee, which KCA used to hire Stage One's artistic and managing director. In this way, KCA gained oversight authority.

KCA began to sublet office space to Stage One, provide maintenance and security, and oversee Stage One's financial systems. It let Stage One use its accounting and phone systems and offered a wide range of technical assistance including computer support and human resources advice. In addition, Stage One paid KCA $25,000 for access to its marketing department resources.

Assured of KCA's backing, funders lent their support to Stage One. At first Stage One's board and producing director, Moses Goldberg, were uncomfortable with the degree of control they had ceded. They worried about KCA's power to fire Stage One's director, but this was an aspect of the agreement upon which funders insisted. Goldberg ultimately was satisfied with the arrangement. He felt it provided fiscal oversight but no "program invasion" and allowed "breathing space" for Stage One to get back on its feet. In one year Stage One raised enough funds to erase its debt.

Michael Hardy, KCA's president, believes KCA gained a good deal of credibility from the partnership. To fulfill its mission of serving all Kentuckians, KCA needed to serve children. Without Stage One, KCA would have a hard time maintaining high-quality programs for young audiences, says Hardy. "And the school buses parked outside the facility on weekdays is great PR for us—it shows that we are using the facility to its maximum benefit, not only during evening hours."

Goldberg continues to be on KCA's payroll, but the two organizations have begun to negotiate an affiliation agreement rather than a management agreement. And because funders no longer seem to need the assurance of KCA's oversight, Goldberg and Hardy see the relationship moving toward one limited to Stage One contracting with KCA for various types of administrative support.

How the relationship will evolve remains unclear. Hardy wonders whether the partnership will diminish as Stage One needs less support, or whether it will persist as a way to maintain its healthy functioning. Goldberg thinks that the infrastructure support is critical to Stage One's survival and should continue. "There's no way we could replace the technical assistance, equipment, or space at the same cost. We benefit from the economies of scale of a larger organization." Stage One plans to take advantage of its current security and stable finances by building a cash reserve equal to 25 percent of its annual budget, and then an endowment to insulate it from crises and funders' concerns.

The funders nearly broke into applause at the news.

Talbert House and Core Behavioral Health Centers, Parent-Subsidiary Profile

How can an organization ensure that it rides the next wave of policy changes and funding reductions instead of being overtaken by it? This question was on the minds of board and staff at Talbert House and Core Behavioral Health Centers in 1997 when they began to discuss a partnership. Similar in mission but not size, the Cincinnati-based organizations both had experience with mergers but were interested in a more flexible relationship that would leave the two organizations intact. They eventually formed a parent-subsidiary relationship.

With multiple sites throughout Greater Cincinnati, Talbert House provides services in mental health, community corrections, and substance abuse. A strategic planning process convinced Talbert's board that, to attract the talent required to win government contracts and keep costs down, it should expand. Thus the pursuit of mergers, collaborations, and alliances became part of Talbert's long-term plan.

Core Behavioral Health Centers, the result of a 1993 merger, offers a range of mental health services with a focus on adults and families in the western part of the county. By the mid-1990s, several Core board members believed that the next round of mergers would occur in the human services field. "We wanted to ally with the strongest organization and do it next to be ahead of the pack, so that we were in a position to choose our partner," recalls Stuart Schloss of the Core board. Additionally, Paul Guggenheim, Core's executive director, was concerned that the agency was too reliant on a few funders and thought a partnership could help diversify the revenue base.

In January 1997, a board member from each agency met and signed an agreement to explore a partnership. A committee of management staff and two board members from each organization was formed.

Early in the discussions, the group developed a mission statement for the potential partnership: "To create a behavioral health entity for Hamilton County/Greater Cincinnati that would reduce cost and increase quality for all our clients, especially those on the west side of Hamlin County." Whenever they hit a rough spot or apparent impasse, they returned to the mission. "It got us through about 10 tough decisions, and we didn't need a consultant," notes Neil Tilow, Core's president.

Most of the concerns came from the Core side. They worried that Talbert would swallow them up. Talbert's main concern was the potential strain on its management staff.

After rejecting a full merger—because of Core's concerns about losing its community orientation and relationship with funders—the group decided on a parent-subsidiary structure. This structure established Core as a membership organization with Talbert as its only member. As its member, the Talbert board appointed the Core board with the understanding that for the first five years, current members would occupy a majority of board seats. In addition, three Core board members joined Talbert's board. Board member Julie Shifman stresses that, under the agreement, the Talbert board doesn't oversee any of Core's operations. "That's their board's responsibility."

Determining the structure and governance was easy, according to Shifman; the hard part was hammering out a management agreement. After much discussion, they decided that Core's executive director and five executive managers would work for Talbert and be contracted in part or in full back to Core. The current contract amounts to 10 percent of Core's budget, although the amount and percentages of staff time are negotiated on an annual basis. Under the agreement, Guggenheim reports to Tilow, but only the Core board has the authority to fire him.

A key aspect of the agreement was its duration. "We established a five-year honeymoon to quell fears," says Schloss. "We wanted to be sure that it wasn't too easy to pull away but also allow for an exit strategy," adds Shifman.

Although the agreement spelled out the broad structure, there were, and continue to be, many details to work out. For example, the Core board didn't want to cede control of their personnel policy to Talbert. After much negotiation, Tilow says he put his foot down: "I didn't think it could succeed if people were working side by side with different vacations, tuition reimbursement, etc. Such things represent the basic culture of an organization."

Tilow and Guggenheim met with their boards, staffs, and funders to explain the partnership. The funders nearly broke into applause at the news. Many felt they were

Survey respondents emphasized *how to be* more than *what to do.*

paying nonprofits too much for overhead expenses and were thrilled to hear how the partnership would help the organizations economize.

Several economies of scale have already been realized. For example, the organizations saved $100,000 in the first year of the partnership by purchasing insurance together. Size has also had a psychological effect on the staff. Dottie Crosby, a supervisor for Core, says she feels more secure working in a larger entity and believes there will be more opportunities for advancement.

However, the adjustment hasn't been easy for everyone. Some Talbert staff feel they've sold out by incorporating Core programs and policies, and some Core staff feel they've been bought out. Memos and meetings designed to address these concerns can do only so much to allay staff worries, says Tilow. He believes it's only when employees have concrete benefits, like increases in pension and life insurance benefits, that their concerns subside.

Several other organizations have expressed interest in affiliating with Talbert–an indication of the success of its partnership with Core, in Tilow's opinion. The parent-subsidiary structure lets Talbert make consolidations gradually, when opportunities come along. However, the end point of these gradual consolidations is not clear. Most of those interviewed think that Talbert and Core will eventually merge, but Tilow feels that this is not a foregone conclusion and that the current arrangement's flexibility is a major benefit.

What Conclusions Can We Draw?

The language of courtship and marriage often colors the descriptions of those involved in strategic restructuring. Organizational structure may seem the least romantic of topics, but the impetus by which two people—sometimes gradually, sometimes suddenly—link their fates does provide a useful analogy. Trust, common goals, compatibility, flexibility, sacrifice, and, ultimately, a leap of faith move both people and organizations toward union.

Looking closely at the reflections of study participants, it seems that most of their strategic restructurings began because of at least two out of three factors:

- **a sudden interruption in the status quo**—such as a departure of a director, a fiscal crisis, or a significant funding opportunity—that requires or propels an organization to make a significant change
- **forward-thinking individuals** (usually executive directors) who shepherd a strategic restructuring idea through opposition, sometimes working to promote and sometimes working against their own self-interest
- **a climate**—real, perceived, or predicted—that calls for a different way of doing business, such as reductions in public grants or contracts or the implementation of managed care policies.[2]

Because most respondents had less than five years of experience with strategic restructuring, they can't be characterized as experts on what helps partnerships endure. However, in general, survey respondents emphasized *how to be* more than *what to do*. Rather than specifying the types of agreeements, consultants, or planning processes to adopt, they stressed the importance of being forthright, flexible, and focused on the big picture.

The primary hurdles in the strategic restructuring process seem to be organizational or individual ego issues. Although strategic restructuring certainly doesn't call for absolute selflessness, sacrifices in the pursuit of common goals appear to be critical. Here the marriage analogy applies quite well. As the saying goes, "Marriage is when two people become as one; the trouble starts when they try to decide which one." ■

Footnotes

[1] Because the sample was entirely self-selected, it is likely that it represents more successful strategic restructuring experiences than unsuccessful ones because those who have experienced great difficulties or failures may be less likely to participate in these types of surveys.

[2] For more on a climate conducive to strategic restructuring, see "Consolidation: A Nonprofit Success Story," "Teaming Up for Successful Programs," and "Keys to a Successful Nonprofit Merger" in *Profiles in Excellence: Leadership Series*, available from the Society's Resource Center, 800-424-7367, www.snpo.org

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