White Paper #2

Emerging Nonprofit Partnership Models: Two Alternatives to Traditional Merger

Summary

Merger of nonprofit organizations has historically faced several obstacles, including concerns about loss of autonomy and limited understanding of a range of potential partnership alternatives. In this paper we detail two emerging partnership models nonprofits may consider, to promote efficiency, mission impact and financial sustainability: *Consolidation with Local Autonomy*, and *Strategic Alliance of Independent Organizations*. We compare the relative merits of these models and contrast both with the *Common Merger*.

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Overview

The combination of two or more organizations is a well-established practice in the nonprofit world. While specific motivations for merger vary by situation, the benefits generally include:

- Enhanced effectiveness in achieving mission outcomes
- Improved operational efficiency, and/or
- Stronger financial health and stability.

Despite the familiarity of merger as a shared organizational strategy and its clear upside returns, the concept faces obstacles unique to the sector.

First, unlike most for-profit companies, public charities and other nonprofits cannot, by law, be purchased by another entity.[1] Motives and potential obstacles may be complex, and a good business proposition is not enough to ensure consolidation. Additionally, merger ("the M-word") has long been stigmatized in nonprofit culture. The perception of inequity, loss of autonomy, loss of employment and a range of other real or supposed downsides has derailed many would-be mergers, often before negotiations could begin. The stigma may be receding, but merger remains a topic fraught with baggage among competing nonprofits.

There is yet another latent hurdle. General knowledge of the range of partnership options available to nonprofits is limited. Practical solutions to negotiation challenges may not be introduced, simply because they are unknown or not intuitively obvious to the partners.

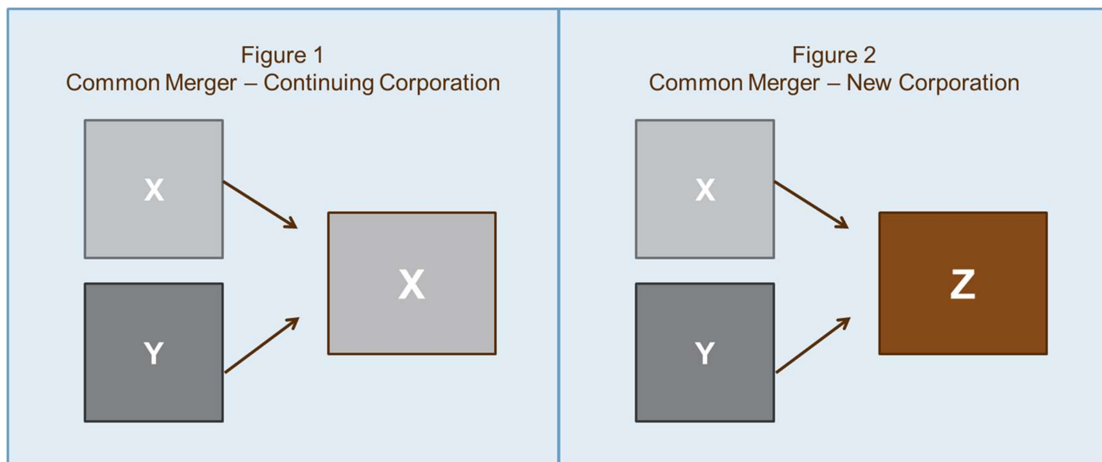
In this paper we detail two creative alternatives that can help nonprofits surmount the obstacles to consolidation. These models can broaden the partnership discussion, promote organizational effectiveness and further the goals of all partners.

First, we'll review the most familiar form of structural partnership.

The Common Merger

In the *Common Merger* of nonprofits, one organization is incorporated into another. Figure 1, on page two, illustrates this event. X represents one of the two partners, usually the larger of the two. In this model, X is the continuing post-consolidation corporation. At the time the merger is consummated, Y ceases to exist as a legal entity and X becomes the sum total of both partners. While post-merger X's legal status with the state and federal governments stays the same, its staffing, methods of operating and/or name may change. The model is flexible, and the negotiation process can address many permutations, such as retention of program brand identities and the establishment of functional divisions within the merged entity.

[1] Nonprofit corporations do not have commoditized equity that can be sold as an asset. They are essentially owned by the people of the state of incorporation.



A slight variation of this model is reflected in Figure 2. Here, the continuing organization is a new corporate entity. This version has all of the flexibility inherent in Figure 1, and may have practical legal or structural advantages in particular negotiations.

The *Common Merger* is straightforward and efficient, and among the simplest partnership models with regard to governance. The upsides are clear and direct. It can also be scaled to involve multiple organizations, either simultaneously or sequentially. But this model does not effectively address all situations, and one or more of the partners may risk losing essential features of programs or community engagement. Further, the *Common Merger* is not easily reversible if the results are poor.

The Alternatives

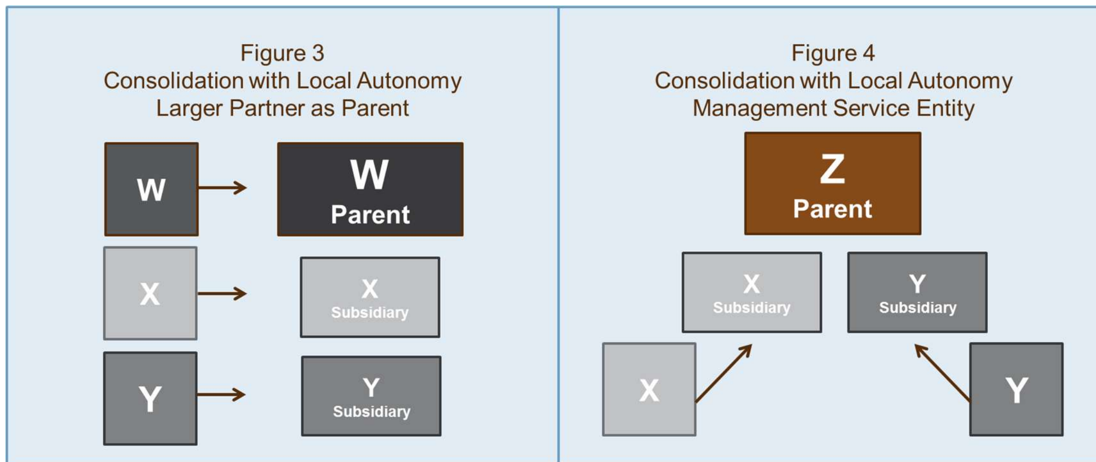
Two alternative partnership models offer strategic benefits to nonprofits that may not embrace or consider traditional merger. We summarize each here.

Consolidation with Local Autonomy

In this model, two or more nonprofits consolidate strategy and operational functions while retaining separate corporate status. The organizations are structurally integrated through one of two governance mechanisms.[2] In essence, a parent organization conducts shared functions and controls coordinated activities. However, the locally autonomous entities may play significant roles in governance of the parent, bringing a holistic dimension to the partnership.

Figure 3, on page three, illustrates this concept. Here, W is a nonprofit with ample administrative and management capacity. X and Y are smaller entities that consolidate under the governance of W, effectively becoming subsidiaries. (Note that this model can apply to two or more organizations; we've used three to show scalability.) In this case, W, X and Y may deliver similar services to distinct, adjacent geographical areas,

[2] The linkage may occur through a membership parent-subsidiary organization structure and/or bylaws allocation of board seat appointment rights.



or may offer complementary, synergistic services in overlapping regions. Nonprofits X and Y have separate boards. However, they are not fiscal entities—W manages the finances of the organizational family, which has a single budget and payroll. Within W's operating budget, X and Y are departments, and all staff are employees of W. The board of W has fiduciary responsibility.

The boards of X and Y oversee programmatic functions and relationships unique to their local domains, and may also play important roles in local fundraising. Organization W has the authority to appoint some or all board members of X and Y, but the boards may have significant overlap. The board of W may be structured to reflect a balanced representation of local entities and at-large representatives.

In the model depicted in Figure 3, W is a provider of programmatic services *in addition to* serving as the parent of the consolidated "family." Figure 4 represents a structural variation, in which a new organization, Z, solely provides family leadership and management services. Z does not operate program—only the local entities do this. The models in both Figures 3 and 4 are scalable. The number of locally autonomous organizations can increase to the extent that management capacity allows efficient operation.

In both variations of this model, two major benefits accrue to the organizational family: improved economies of scale and coordinated strategy.

Economies of scale can yield greater operational capacity, in part by allowing more specialization and better compensation of staff positions. A more skilled staff can lead to improved program delivery, revenue development productivity. Spreading overhead across a wider base can increase overall cost-efficiency. The result, in principle, is enhanced mission impact and improved financial results. Coordinated strategy can ensure that the separate constituents, (the organizational family members), are formally unified, and corporate integration ensures a level of stability.

Consolidation with Local Autonomy delivers many of the benefits of merger, while retaining influence of the domains within the organizational family. It can benefit nonprofits for which distinct geographic or programmatic identity is essential to collective success. In addition, and in contrast to the *Common Merger*, the continuation of separate corporations allows the potential for modification or even reversal of consolidation, should that be deemed necessary in the future.[3]

As a multi-dimensional organizational model, *Consolidation with Local Autonomy* brings with it more complex political structures and processes. These elements add layers to administration and governance, and create potential challenges building consensus around organizational strategy. To the extent the consensus-building process supports effective coordinated strategy, the gains may justify the added costs. Choosing this structure requires careful thought in establishing an operational and governance framework.

Examples of *Consolidation with Local Autonomy* include: American Red Cross; Amnesty International; NatureBridge; Berkshire Community Land Trust; Washington State Public Schools; and the United States of America.

Strategic Alliance of Independent Organizations

Another alternative to *Common Merger* integrates organizations without consolidation into a unified corporate structure. *Strategic Alliance of Independent Organizations* is a flexible emerging approach to partnership that delivers several of the key benefits of merger without surrendering organizational sovereignty.

Strategic alliance is a formal agreement between two or more parties to pursue a set of specific long-range objectives. It's commonly practiced in the business sector, where companies find common cause central to each party's goals. The model includes some combination of:

- Service integration
- Shared operational functions
- Combined marketing
- Joint strategy development.

In the business sector the broad goals of strategic alliance are to improve market share and/or financial bottom lines of participating partners. Interestingly, such alliances often bring competitors together, as they find mutual interests. Examples include travel service alliances (the Star Alliance), trade associations (Alliance of Motion Picture and Television Producers), joint advocacy efforts (National Restaurant

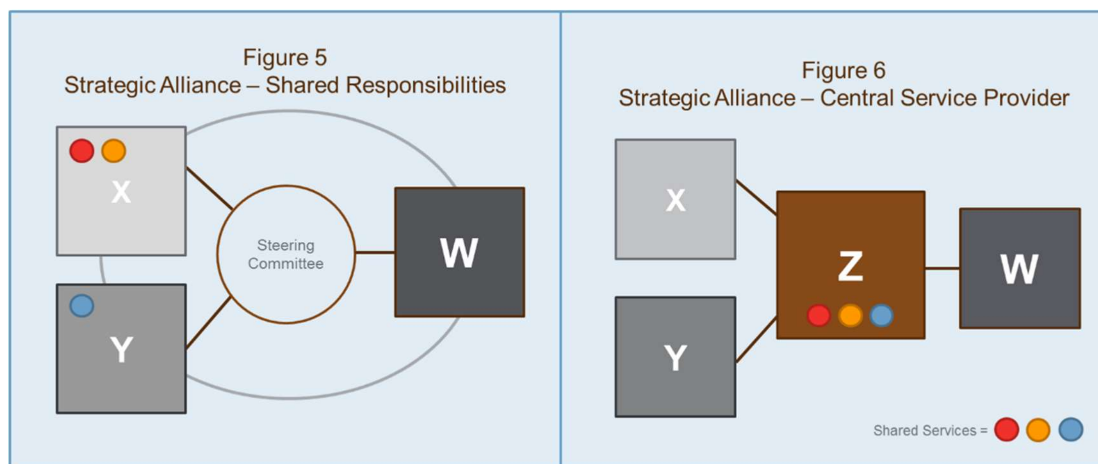
[3] Withdrawal of one or more entities from the consolidated partnership would require consensus and action of both the parent and subsidiary boards. The subsidiary would have an intact board, but would need to re-establish its fiscal resources, management and staffing following such a separation.

Association) and vertically integrated packages of complementary products or services (Dell, Intel and Microsoft).

In the nonprofit sector the goals of strategic alliance overlap those of businesses, but may be more diverse, including:

- Improved programmatic outcomes
- Greater operational scale and efficiencies
- Expanded constituencies or brand awareness
- Improved financial bottom line.

Strategic Alliance of Independent Organizations is distinguished from more basic collaboration in three ways: First, the objectives of the alliance align with the partners' overall organizational strategies (as the name suggests). Second, the investments and commitments of the partners are deeper and longer-term. Third, the alliance is established through a detailed formal agreement, which outlines roles, responsibilities, decision-making mechanisms, financial terms and other obligations.



Figures 5 and 6 illustrate this model. In Figure 5, three organizations are equal parties to a strategic alliance. (This model can apply to two or more nonprofits.) As independent entities, W, X and Y are bound together by a formal agreement, which defines cooperation in three shared services. The services represented by red and orange circles are housed in organization X, which has capacity to perform these functions for the partnership. The third shared service, represented by a blue circle, is housed in organization Y. These services may be performed by existing or dedicated staff, and the agreement defines cost- and revenue-sharing. The circle in the center represents a governing body, a steering committee, comprised of partner representatives. This committee makes key decisions for the alliance, including approval of strategy, allocation of resources and resolution of conflicts.

Figure 6 is a variation of the model. Here, a dedicated entity, Z (an independent nonprofit), is established to manage and operate the affairs of the alliance. The governing body here is not a steering committee, but the board of the central coordinating entity. Money is not exchanged directly between the partners in this variation, but rather between individual partners and the central organization.

Note that the Figure 5 variation has limited scalability and fits a partnership with relatively few members and/or limited resources. The Figure 6 variation is more scalable, and requires more centralized resources, personnel and operational systems.

Examples of *Strategic Alliance of Independent Organizations* in the nonprofit sector include:

- Administrative consolidation (Community Service Partners, Inc.)
- Linked public outreach and sales (Balboa Park zoo and cultural organizations)
- Advocacy partnership (ACTION, Minnesota Environmental Partnership, Washington Low-Income Housing Alliance, CalNonprofits)
- Regional strategic integration (The Deschutes Partnership, ChangeScale, Bay Area Consortium of Community Land Trusts)
- Shared staff/facility infrastructure (Central Valley Coalition for Human Services; Ordway Center for Performing Arts and partners)
- Affiliated nonprofit networks with common services—unified branding (United Way, Planned Parenthood), individual branding (Feeding America, Land Trust Alliance).

These alliances were designed to produce greater mission impact, operational efficiency, public awareness, financial resources and/or fiscal health.[4]

Strategic Alliance of Independent Organizations can be preferable to merger or consolidation when the shared activity of partners is limited to a particular interest or service, or when maintaining local control of a nonprofit is required by political or economic factors. In an alliance, nonprofits can achieve some benefits of scale without losing community governance. The relative benefits of this model may also be limited, and thoughtful analysis can help determine which model offers greatest potential impact.

[4] Strategic alliances may also involve a nonprofit and corporation(s) and/or government agencies, and there are numerous examples of cross-sector partnerships. This article looks exclusively at alliances among independent nonprofits.

Ensuring a Successful Partnership

Nonprofits interested in exploring the impact of structural partnerships should identify and vet a range of structural alternatives. The models discussed here have relative strengths and weaknesses, depending on specific situations, goals and priorities.

In addition to ensuring organizational relationships are strongly rooted in mutual trust, nonprofits should consider three key factors in evaluating partnership options:

- Structural fit
- Cultural compatibility
- Business model strength.

The chosen structure should address current needs of the partners and support long-term success of the partnership. Organizational cultures can have substantial, and sometimes subtle differences; participants should be proactive in defining a desirable shared culture as well as a program for aligning leadership, staff and stakeholders. The partnership's collective business model should be robust and sustainable. Feasibility analysis can explore these topics in depth.

Finally, every structural partnership should be guided by a detailed integration plan that details the steps that will guide the union through a successful launch.

Nonprofits and the communities they serve can benefit from structural integration. A growing body of evidence links defined partnership strategies with organizational success. Conversely, organizations that adopt a "go it alone" strategy often struggle to achieve sustainability and mission effectiveness.

The alternatives summarized here can broaden the dialogue between nonprofits and introduce options for high-impact partnerships in the sector.