

Comment on William M. Rohe and Rachel G. Bratt's "Failures, Downsizings, and Mergers among Community Development Corporations": Merger Does Not Mean Failure

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Abstract

In response to the article by Rohe and Bratt in which mergers among community development corporations (CDCs) were viewed as one type of response to organizational "failures," this comment makes the case that many nonprofit mergers arise from a variety of motivations other than organizational crisis. Mergers are increasingly strategic partnerships in which two or more nonprofits seek mutual advantages, such as a larger market share, better access to capital, and other longer-term goals.

Mergers are most successful when relatively strong organizations analyze their circumstances and determine that they can best advance their missions through working together. A merger has limited utility in saving an organization in crisis. Rather, it is a tool for advancing the missions of different organizations by combining their strengths. The relationship is best entered into freely, after a great deal of consideration, and with reasonable expectations for both the work ahead and the potential payoff.

Keywords: Community development corporations; Nonprofit organizations; Urban policy

Introduction

In their article, Rohe and Bratt explore three eponymous responses of struggling community development corporations (CDCs) to extremely difficult circumstances. It is indeed a safe bet that organizational failures leading to closure—or to significant downsizing (defined by the authors as a substantial 40 percent reduction in operations)—are usually the result of either very poor performance or a dramatic, unanticipated shift in the external environment or perhaps both. Merger with another nonprofit organization, however, is a different type of activity.

Although it is true that a merger may result from one or more CDCs experiencing serious challenges such as those identified by Rohe and Bratt, recent research and practice indicate a much bigger phenomenon. Nonprofit mergers arise from a variety of motivations beyond organizational crisis, and nonprofit partnerships come in a wide array of strategic options. In this essay, I will review the lessons of a decade of consulting on and research into nonprofit mergers and alliances,

including the results of a landmark national study of strategic restructuring (Kohm, La Piana, and Gowdy 2000) among nonprofits from many fields.¹ This study was completed through Strategic Solutions, a grant-funded project of La Piana Associates, Inc., a consulting firm serving the nonprofit and philanthropic sectors.² This comment will also draw on my personal experience in facilitating more than 60 nonprofit mergers over the past 11 years.

Snapshot of the national study

The national study on strategic restructuring (Kohm, La Piana, and Gowdy 2000) consisted of an online survey administered in 1999. We advertised widely to attract survey respondents who self-identified as being involved in some sort of partnership with another nonprofit. These organizations independently completed the online survey, and we then reviewed their responses to identify “usable” cases to be included in our study. The survey garnered 192 responses that met our study definition of an integration or an alliance.³ These survey results were then vetted during interviews with 20 national philanthropic and nonprofit leaders. Also, we conducted a random survey of 400 nonprofits that had budgets exceeding \$200,000 and were located in either Cleveland or San Francisco. A notable result of this random survey was that 24 percent of the 262 responding organizations had experience with some form of partnership.

Evolution of a field

When I first began facilitating mergers as a consultant to nonprofits a decade ago, most of the mergers could be characterized as fitting a

¹ Organizations participating in the national study (*Strategic Restructuring: Findings from a Study of Integrations and Alliances among Nonprofit Social Service and Cultural Organizations in the United States*) included approximately 73 percent in human services, 18 percent in arts and culture, and 9 percent from other fields. Geographically, 50 percent were located in an urban community, 23 percent were suburban, 9 percent were rural, and 19 percent had multiple locations cutting across these designations.

² Strategic Solutions, operated by La Piana Associates, Inc., is a five-year effort to study nonprofit strategic restructuring (mergers and other forms of alliances) and to make the findings available to the sector. It is funded through grants from the David and Lucile Packard Foundation, the James Irvine Foundation, and the William and Flora Hewlett Foundation. Information is available from the Strategic Solutions Web site <<http://www.lapiana.org>>.

³ Of these, 45 percent were alliances and 55 percent were integrations.

“weak-joins-strong” model. In a typical scenario of the time, a very troubled nonprofit sought refuge in the greater strength of another nonprofit in its field or community. Unfortunately, many of these partnerships did not work out as nonprofit leaders had planned.

Typically, the weaker party expected the stronger one to bail it out of financial, and perhaps legal, trouble, the worst of which might not have been fully disclosed before the deal was consummated. The stronger party, reviewing its partner’s operations and present difficulties, might determine that the current cost structure was unsustainable and decide to reduce staffing and programs. These reductions would in turn trigger a backlash by supporters of the weaker partner, including current and former staff and board members. Accusations of “raiding the coffers” and of “not caring about the community” would ensue, and the conflict would often play out in the local press, damaging both parties’ reputations and prospects for future fund-raising.

Usually, however, the planned reductions were entirely necessary. In fact, they were most often no more than the steps the board and management of the weaker party should have undertaken on their own, months or even years earlier. Yet given the lasting ill will and the tremendous distraction of the transition and conflict, these mergers generally could not be considered successful.

By the mid-1990s, a new set of circumstances seemed to be emerging. The weak-joins-strong mergers became less common and were replaced by strategic partnerships in which two or more nonprofits sought mutual advantages, such as a larger market share, better access to capital, and other longer-term goals related to growth.

Motivations for strategic restructuring

In our 1999 survey, we asked respondents to identify the reasons they had considered strategic restructuring (Kohm, La Piana, and Gowdy 2000). Their most frequent responses were as follows:

1. An internal decision to increase the efficiency of the organization (83 percent)
2. Increased competition for funding (60 percent)
3. Increased overhead (47 percent)
4. Pressure from funders (30 percent)

It is interesting to note that pressure from funders was mentioned in only 30 percent of our cases. Rohe and Bratt reported it as a significant motivator in both of the mergers they studied. In my experience, such pressure can only go so far. That is, it can bring parties to the negotiating table, and it can even cause them to merge, but it cannot make them want to work together. Thus, funder-driven partnerships often result in an “unconsummated merger,” in which the parties are legally joined but largely continue to function separately. This is not a situation that produces the hoped-for synergy of a true merger.

Reviewing our consulting experience, we have observed a variety of additional motivations for strategic restructuring. These include economic challenges such as increased competition, an opportunistic or growth-oriented management, leadership challenges (principally the difficulty of hiring and retaining a competent executive director at the salary many nonprofits can afford), and a tired board of directors in need of relief. These motivations may represent the weakness of one party or the complementary strengths of two. For example, if one group has a strong board but has been unable to attract a good executive, while another has an executive-led organization with a weak board, it could be a winning match. Depending on which attributes are joined, the merger could produce a stronger entity or a greatly weaker one.

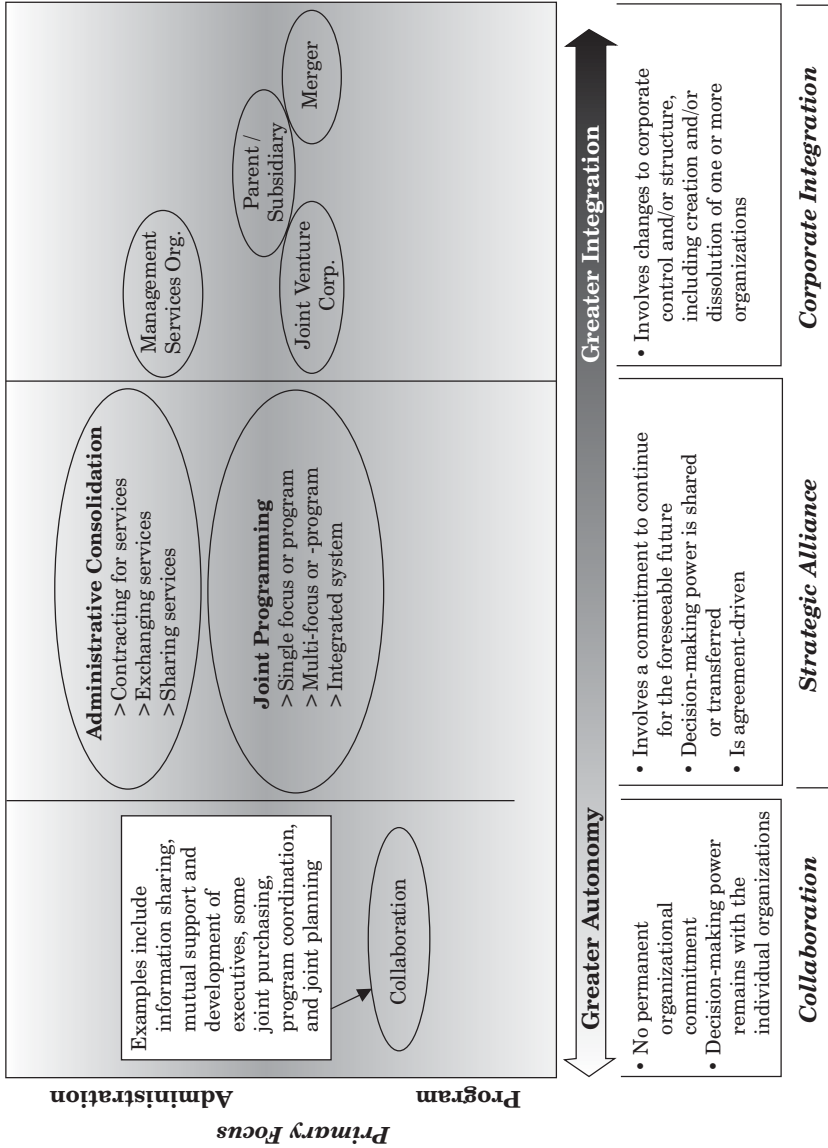
A range of options

In the 1997 monograph *Beyond Collaboration* (La Piana 1997), I coined the term “strategic restructuring” to describe a broad continuum of partnerships we were observing in the nonprofit sector. These partnerships involved shared, transferred, or combined services, resources, or programs and included merger as only one end of the spectrum. The partnership matrix (figure 1) portrays a schematic of these options, described in more detail later.⁴

The partnership matrix depicts three types of relationships among nonprofits. Collaboration is characterized by a relatively low level of commitment on the part of the nonprofits involved. An example might be a CDC making space available once a week for another nonprofit to conduct blood pressure screenings for residents. No money changes hands, and if either party wishes to stop the arrangement, a phone call is all that is required. Collaborations are quite common and genuine in the

⁴ For a fuller description of the partnership matrix, see either La Piana 2000, page 6, or the Strategic Solutions Web site <<http://www.lapiana.org/defined/matrix.html>>.

Figure 1. The Partnership Matrix



Source: La Piana 1997.

nonprofit world, although during the past decade, an increasing number were inspired or mandated by funders with mixed results.⁵

The center section of the partnership matrix displays a variety of options for strategic alliances. These are typically guided by a written agreement between the parties, are intended to be enduring, and may involve a financial arrangement. An example here would be a group of CDCs deciding that one of them will provide accounting and bookkeeping services for the others. A contract is drawn up specifying services and compensation, and the arrangement is intended to last for the foreseeable future. Aside from the specific area covered by the agreement, however, the CDCs remain entirely independent of one another.

The right side of the partnership matrix portrays corporate integrations, which are partnerships that include changes to corporate control and/or structure, including the creation or dissolution of one or more organizations. There are two basic subtypes of this form of strategic restructuring. The first includes joint ventures and management service organizations (MSOs), in which core organizations remain independent but significant operations are combined, usually within a new nonprofit structure controlled by the partners. The second subtype, mergers and parent-subsidiary arrangements, combines control of the entire scope of the organizations involved.

To better understand an MSO, let's revisit the earlier example, in which a group of CDCs wished to share accounting services. Rather than choosing one of them to provide the desired services, the group could instead decide to create a new and separate organization to provide administrative services for everybody. This separate entity—an MSO—would be controlled by the partnering CDCs, but they themselves would remain independent. If, however, the CDCs decided to combine not only accounting and other administrative services, but their boards, management, and programs as well, then they would have chosen a merger.

Making a merger work

Once two or more nonprofits decide to consider a potential merger, it can be a long and painful undertaking, as Rohe and Bratt's respondents reported, fraught with opportunities for discord and, ultimately, frustrating failure. One can easily read between the lines of the

⁵ For a fuller discussion of collaboration, see *Real Collaboration: A Guide for Grant-makers* (La Piana 2001), a monograph commissioned by the Ford Foundation.

Portland case study, with its last-minute changes in the players, to get a feeling for the complexity and difficulty of these negotiations. The Portland experience is not uncommon.

A model process that leads the negotiating parties to a decision based on good, solid, mission-related reasons—but is not intended to guarantee a merger agreement—is described in detail in La Piana (2000).⁶ Briefly, the process works as follows:

Step 1: Board authorization and resolution

The boards of each organization must separately discuss the possibility of a merger and approve entering negotiations. This step is absolutely critical before beginning serious talks. Board authorization is a small hurdle, and if the boards cannot get over it, then they are likely to be wasting their time in actual negotiations. The board resolution also forestalls the situation where a party becomes unhappy at the negotiating table and suddenly claims that its board never intended for a merger to be discussed (which happens more often than one might think). The model resolution commits the board to a process, but not the outcome. It usually contains a confidentiality clause: The organizations must agree how disclosures of sensitive or proprietary information will be treated if the negotiations do not result in a merger.

Step 2: The joint negotiations committee

The committee that will negotiate a possible merger should represent the diversity of opinions on each of the boards and include the paid executive of each organization. Other staff should serve the negotiations committee with information and resources, but not be actual members. Staff members have a vested interest in the outcome of the negotiations; after all, their jobs are involved. Negotiations should always be board-led.

Step 3: Agenda development

At the first meeting of the negotiating committee, following a brief orientation on the history and priorities of the parties, the negotiators should facilitate the committee in a brainstorming process to list all the issues they feel must be resolved before a merger decision. These

⁶ Available from the Amherst Wilder Foundation at <<http://www.wilder.org>>.

typically include the following sorts of issues: governance, human resources, programs, finance, capital, and communications.

Step 4: Negotiation of issues

The negotiating committee will need several meetings to complete its work, with time in between for research, testing ideas with constituents, and keeping their respective boards informed. At each meeting, the committee should work through the list of issues and record its agreements in a cumulative “minutes” document. The negotiations process typically requires 4 to 6 months of steady effort to complete.

Step 5: Due diligence

In the nonprofit context, due diligence is an attempt to determine, to the extent limited resources allow, the financial condition of each of the parties. Typical areas for examination include financial history and plans, any restrictions on activities imposed by donors or organizational charters, and the existence or threat of any lawsuits. This process is usually undertaken midway through the negotiations, when it appears that the deal is likely to go through, so as not to expend time and money unnecessarily.⁷

Step 6: Decision making

Once the committee has negotiated all issues to its satisfaction, it should be able to come to a consensus on whether it feels a merger is in the best interest of the parties. Each organization’s committee representatives should caucus and then cast a single vote for or against the merger. If both (or all) parties to the negotiations committee approve the merger, then on the basis of all the points resolved through the negotiating process, the committee recommends it to the full boards for their consideration. The boards must then formally approve or reject it.

⁷ This process is a significant departure from the due diligence processes undertaken by public corporations. It is one of many basic differences between corporate and nonprofit mergers.

Step 7: Implementation planning

Many mergers make it all the way through approval and legal implementation, but fail to achieve the results the organizations sought. Occasionally, it may be a case of a bad match—but more often, integration of the partners is incomplete, leaving separate organizational cultures and a lack of agreement on mission among board and staff. To avoid this scenario, implementation planning should start early, and execution should begin as soon as the boards act to approve the agreement.

Factors leading to success

Given the difficulty in first negotiating and then executing a successful merger, we asked respondents in the national study what they found to be key to their partnership's success. Their most frequent responses were as follows:

1. Having a staff/board member champion the alliance (80 percent)
2. Positive past experiences with collaboration (74 percent)
3. Board support/encouragement (73 percent)
4. Organizational risk-taking/growth orientation (70 percent)
5. Positive board-executive relations (64 percent)

The most striking response was the overwhelming identification of a champion, who works to keep everyone else focused on the mission, even during the most difficult moments in the process. Further, organizations that had successfully worked with others in the past seemed to feel that this helped them in their new, deeper partnership. A large majority also thought it was essential to have an organizational orientation favorable to growth and change, which means that it is open to the risks inherent in a merger.

From our consulting experience, I would suggest these additional factors:

1. In a merger, as in any other nonprofit endeavor, an organization that is keenly focused on its mission is more likely to navigate the difficult journey successfully. Mission is the compass that must guide all decision making.

2. It is also important to have a flexible approach to pursuing the organization's mission. Think of this flexibility as knowing the difference between the organization's mission and the work it does to carry out that mission. The work of a CDC may be to develop housing, but its mission is something bigger. Because it is rare that two merging entities will have exactly the same portfolio of programs, it is important for merging partners to be able to see alternative ways of pursuing their mission.
3. It is difficult for a divided nonprofit to attend to the task of making a merger happen. Therefore, a key success factor is that neither partner is in an immediate crisis or is plagued by factional infighting.
4. Unless the parties are clear about what they are trying to accomplish through a merger, it is unlikely that they will succeed. Before entering into negotiations, it is important to know what each party hopes to achieve. These statements can then serve as a guide to the negotiators.

CDCs must consider an additional set of challenges when undertaking a possible merger. CDCs are most often place-based, that is, they are firmly rooted in a locality, usually a neighborhood. When two CDCs offering similar or complementary services to the same neighborhood merge, the reaction of local constituents is likely to be supportive. If, however, CDCs from two different neighborhoods in the same city decide to merge, they are likely to encounter some resistance from constituents who will be concerned with the possible loss of their organization. Early, forthright discussion of the benefits and drawbacks of a potential merger across neighborhood lines is essential to the positive engagement of constituents. The CDCs must make a case both for the synergy of the merger (greater efficiency, better fund-raising, the possibility of more or larger projects), and the protections that will ensure neighborhood responsiveness (board composition, honoring of funding restrictions, and so on).

Recommendations

On the basis of the research and consulting experience discussed earlier, I offer the following recommendations to CDCs and their funders:

1. CDCs should consider mergers and the entire range of strategic restructuring options as tools to be used if and when they are needed. Just as a competent leader must understand strategic

planning and fund-raising, so too must he or she know how and when to execute a partnership with another entity.

2. Funders should provide educational opportunities through which CDC leaders can learn more about the options presented by strategic restructuring. This should be done without forcing the CDCs into partnerships they do not want.
3. Funders and CDCs alike should recognize that mergers are complex undertakings requiring specific skills and knowledge. When considering a merger or other form of partnership, CDCs should engage consultants, attend workshops, and use online and printed resources to increase their knowledge and the likelihood of success.

Conclusion

Mergers are most successful when two or more relatively strong organizations analyze their circumstances and determine that they can best advance their missions by working together. A merger has limited utility in saving an organization in crisis, and forced mergers—the shotgun marriages of the nonprofit world—usually result in resentment and dysfunction, even when the parties actually agree to merge.

Rather, a merger should be viewed as a tool for advancing the missions of different organizations by combining their strengths. They are best entered into freely, after a great deal of consideration, and with reasonable expectations for both the work ahead and the potential payoff.

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