Managing Mergers and Consolidations

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The merger of organizations historically has occurred primarily in the business sector. However, in recent years there has been a proliferation of merger activity in the nonprofit community. As a restructuring strategy, the merger has become an increasingly important vehicle for nonprofit organizations in dealing with changing environmental conditions. This chapter explores six theoretical perspectives to explain why organizations come together, or merge. These perspectives suggest conditions that lead organizations to consider merger and, as such, provide leaders in nonprofit organizations with tools for assessing the appropriateness of merger as a strategv for restructuring.

DEFINITION OF MERGER

Merger is a form of restructuring wherebv one or more organizations is completely absorbed by another organization whose corporate existence is preserved. The body being absorbed dissolves and loses its corporate existence (Yankev & Singer, 1991). The American Hospital Association (989) defined *merger* as a statutorily defined corporate transaction, in which two similar corporations come together permanently, leaving a single survivor corporation. Assets do not have to be transferred, because this happens by operation of law, and the surviving corporation owns all the assets and liabilities of both parties.

NOTE: Darlyne Bailey, dean of the Mandel School of Applied Social Sciences at Case Western Reserve University, and research associate Kelly McNally-Koney have done extensive work in adapting- the perspectives on collaboration identified in this chapter to address conditions in nonprofit organizations. In our discussion of nonprofit mergers as a particular form of collaboration, we have borrowed from their adaptation and express our appreciation to them for their contribution to our effort.

REASONS FOR MERGER

Several reasons that contribute to a nonprofit organization's decision to merge have been identified (Grahm, 1986; Greater New York Fund/United Way, 1981; Plimpton, 1989;Yankey & Singer, 1991):

- greater organizational efficiency and cost reduction through economies of scale, such as combined management functions and physical facilities, reduced staffing levels, increased technology, and increased purchasing power
- increased effectiveness of client services (two organizations combined may provide a more comprehensive array of services in a single setting)
- greater financial stability through such factors as an increased or more reliable base of funding
- greater organizational stability through a partner that has strong leadership and management
- increased market power by gaining control over pricing of services
- increased geographic market share resulting in greater access to both the population served and more funders
- enhanced community image and credibility by absorbing an agency or program with a poor reputation into an agency with a good reputation
- increased power and prestige for the organization, executives, and board members
- reduced competitive fundraising by combined resources.

Although these reasons may appear situation specific, they may be generalized to other settings. Indeed, the six merger perspectives that follow provide order to these reasons and theoretical structure to thinking about the conditions that lead nonprofit organizations to merge.

CONDITIONS LEADINGTO NONPROFITS COMING TOGETHER

Why do organizations merge? Some researchers have argued that environmental conditions lead organizations to pursue collaborative strategies includeing merger (Emery & Trist, 1965; Gray, 1985; Wood & Gray, 1991). Wood and Gray described how those conditions inform the merger process. They idenfied six theoretical perspectives as collaborative strategies addressing environmental conditions and complex problems that lead organizations to come together: (1) resource dependence, (2) institutional or negotiated order, (3) microeconomics, (4) political, (5) strategic management-social ecology, and (6) corporate social performance-institutional economics.

Resource Dependence Perspective

The resource dependence perspective suggests that organizations need resources such as infrastructure (administrative capacity), funding stability, and technology (management information systems, financial management systems) to accomplish goals, if not simply to survive. Organizations unable to access resources on their own look to agents in the environment for those resources to "secure organizational survival" (Galaskiewicz, 1983, P. 282). If funding stability is critical to an organization's survival and that stability cannot be accomplished by that organization alone, it looks to other organizations to provide that stability.

A turbulent environment in which the resource dependence perspective has explanatory power is one in which an organization lacks resources, and this deficiency places the organization's mission in jeopardy. The serious absence of resources leads organizations to consider dramatic strategies, such as merger, to ensure the continuation of their mission. The pooling of resources through mercer strengthens that mission for the future.

What would a merger look like that came about because each partner needed resources that could be provided by the other? O'Brien and Collier (1991) presented a resource dependence case study involving the merger of two Portland, Oregon, social services agencies: a long-established, traditional family services organization and a relatively young grassroots organization. In this case, the family services agency provided several key resources critical to the success of the grassroots organization. First, the grassroots agency lacked the administrative capacity to manage the service provided; administration was provided through an advisory council and not professional staff. Second, the agency suffered from a lack of income co support program operations. The authors described income flow as "erratic" and the agency as struggling with chronic financial problems." In contrast, the family services agency identified growth as a critical strategic imperative. Growth, seen as increased service volume, was a needed resource for the family services agency. The importance of growth was further described as extending "operations into a new geographical area of the community" (P. 23).

Conditions of resource need defined the coming together of these two agencies. Merger worked as a strategy because each of the partners in the merger brought a resource the other needed. The grassroots organization brought the increase in business and geographic expansion desired by the family services agency. The family services agency brought the administrative support and stable finances needed by the grassroots agency. The resolution of each agency's resource needs through merger responds to the turbulence in the environment and positions the new agency for future growth.

Managers who consider the future in terms of the organization's dependence on resources might ask these questions:

- What are the critical resources the organization needs to survive?
- How critical are these resources? Today? Over the long term?
- Is there an organization from which I can acquire those resources without sacrificing those things that are most important (mission, values, strategic direction)?
- What is the possible range of places from which my organization can acquire needed resources?

Institutional or Negotiated-Order Perspective

The institutional or negotiated-order perspective identifies the role institutional legitimacy plays in defining organizational success and, consequently, organizational behavior. That is, the greater an organization's perceived legitimacv in its environment, the greater the organization's success. As such, if "legitimacy is the primary resource sought or at risk" (Wood & Gray, 1991, p. 157), an organization pursues strategies that bolster its institutional legitimacv. Such strategies could include merger or other kinds of collaboration. The process by which institutional legitimacy (or other environmentally defined problems) is accomplished is through a negotiated strategy with communitv partners.

A turbulent environment in which the institutional perspective has explanatory power is one in which the criteria by which social legitimacy is measured chances dramatically. For example, when funders chance expectations for funded agencies, the institutional credibility of each funded agency is placed at risk. In such situations, organizations may pursue collaborative strategies that rebuild their credibility and meet the new funding requirements. In such situations, the environment forces organizations to look outside themselves for solutions that enable them to be successful over the long term. Mergers may result from organizational realization that institutional legitimacy is a requirement for survival and may not be accomplished without merger. The merger creates a new order that responds to the environment. That new order is a negotiated one.

What would a merger look like that came about because of each partner's need for institutional legitimacy? Legitimacy is conferred by institutions. With nonprofits, their funders, both public and private, frequently are the legitimacy-conferring institutions. Changes in the expectations of funders can destabilize the environment within which nonprofit organizations operate altering funder-organization relationships that have been in place. Imagine a case in which a public funder of mental health services changes the administrative reporting requirements for funded agencies. The changes involve adding new administrative functions that provide information that analyzes and describes the service provided by funded agencies. The new administrative services require infrastructure that many of the small, currently funded agencies lack. However, without the capacity to meet the new administrative requirements, funded agencies lose the legitimacy they have established with the funder.

What options do small agencies have in this case? One option might be for two or more of the smaller agencies to consider merger. How would merger increase institutional legitimacy, The combining of two (or more) similar agencies could accomplish economies of scale (efficiencies), which could be reallocated to create the administrative capacities needed to be competitive. With increased administrative capacity, the new organizations formed from the merger would be able to maintain the reputation each agency held with the funder previously and enhance institutional legitimacy through the demonstration of new capacity to meet the funders' administrative requirements.

Managers who consider the oryaniza6on's future in terms of its legitimacy might ask these questions:

- What are the institutional requirements for long-term success (as defined by key funders or other stakeholders)?
- What are the other sources in the community from which the organization can acquire those institutional requirements?
- Do those organizations share the organization's mission and values?
- What organizations are perceived favorably by institutional forces?
- Are funders directing me to any particular organization or kind of organization?

Microeconomics Perspective

The microeconomics perspective emphasizes accomplishment of economies of scale that may not be accomplished by one organization alone. A turbulent environment in which the microeconomics perspective has strong explanatory power is one in which funder expectations of an organization dramatically increase such that infrastructure becomes critical to success. In such a situation, a small organization would view its lack of infrastructure as inhibiting and ,would consider merger with another organization as a strategy to make management more efficient. Through meeting funder requirements that would be too costly to develop on its own, merger is viewed as a strategy that can eliminate inefficiency and accomplish long-term organizational success.

What would a merger look like that came about because of a need for efficiency? It is not difficult to apply the case study associated with institutional legitimacy to the macroeconomic perspective. Imagine that the same funder of mental health services adjusted its provider expectations so that more serious volume was expected at a lower reimbursement rate. How would agencies in an environment made turbulent by that reality respond?

One could easily imagine merger. Perhaps in this situation larger agencies might merge with smaller agencies, rather than small agencies merging with each other as described in the institutional perspective. The difference is that the environment presents a problem that requires as a solution sufficient efficiency so that service can be provided at a lower reimbursement rate without operating at a deficit. How would efficiency be accomplished', To operate a balanced budget and provide more for less requires significant increase in service volume. Merger is an important, and perhaps the only, strategy to increase service volume. The small agency, with its limited base, could not compete without a dramatic increase in volume. A large agency with a significant base on which to build could accomplish the needed volume by adding the service provided by the smaller agency. Merger would force administrative efficiencies within the two agencies (shared functions would be eliminated in the merger) and would provide the capacity to increase volume to remain competitive with the new reimbursement rates. A turbulent interorganizational environment defined by inefficiency could lead to merger as a key survival strategy.

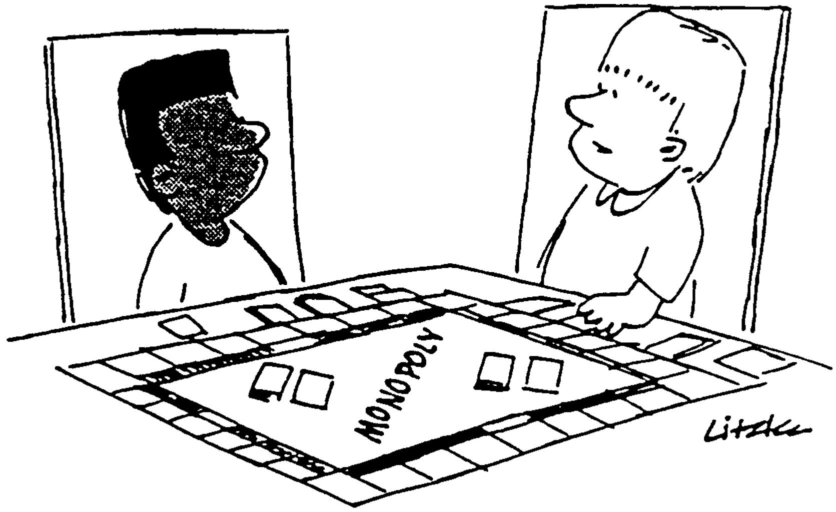
Managers who consider the organization's future in terms of economies of scale may ask these questions:

- Where are the functional areas in which my operation is least efficient?
- What are the inefficient areas that have been identified for me by funders or other key community stakeholders?
- Are there organizations that share my organization's mission from which I can gain needed efficiencies?
- Are those organizations weak in places that my organization is strong?

Political Perspective

The political perspective emphasizes the acquisition and maintenance of power as the reason organizations come together. Organizations can increase their power through shared access to resources and the withholding of needed resources from other organizations. The perspective is relational, explaining, both how and why organizations come together.

A turbulent environment in which the political perspective has explanatory power is one in which many active interests vie for predominance. The forces with sufficient power dominate discussions regarding resource use and



"It isn't your 'desire' to buy Park Place or Boardwalk that concerns me. . . . It's your 'motivation.'"

establish rules that enable the accomplishment of goals they support. As policy makers develop new requirements, previous certainties are made uncertain, , and organizational futures become unclear. In such situations, organizations that share a common interest in a particular outcome may pursue various forms of working together, including merger. From the political perspective, mergers may Guarantee an outcome that saves the interest of the merging organizations at the expense of ocher organizations in the sector.

What would a merger look like that resulted from power dynamics defined by a political perspective- Consider the environmental realities defined in the examples for macroeconomic and institutional or negotiated-order perspectives. A public funder of mental health services informs a community of 30 funded agencies (large and small) that it is changing its expectations to include additional administrative requirements and increased service volume at lower reimbursement rates. These new realities reflect a turbulent environment indeed for chose funded agencies.

One can easily imagine power dynamics forcing mercer between funded agencies. In the context described, small agencies, lacking in administrative capacity, do not have resources to create that capacity. In addition, the limited agency size does not allow the generation of sufficient service volume to break even with the new reimbursement rate. Given the new requirements, that agency is in a politically weak position. In contrast, the agency that is the largest provider of mental health services in the community with a well-developed administrative infrastructure has the capacity to meet the new administrative requirements. Service volume could be increased through merger. The large agency has a variety of merger strategies it can pursue, which leverage its position of power. The large agency, may seek to force small agencies to merge on the basis of the latter's long-term inability to compete. Another option might be to pursue merger with medium-sized or other agencies as a strategy that isolates smaller agencies, vulnerable to defunding because they lack capacity. Should this happen, the larger agency can leverage its political advantage to assume the lost business of the smaller agency. Political explanations of merger ultimately allow organizations in positions of power to use that power to their advantage in response to the turbulence affecting the interorganizational environment.

Managers who consider the organization's future in tern-is of maximizing power may ask these questions:

- What kinds of organizations can maximize the organization's power in the community?
- If my organization lacks power, what like-minded organization can benefit from linkage with my organization (and increase its power and standing in the community?
- What is required for organizations to have power in the future?
- How can that power be achieved?
- What organizations are well positioned to have power in the future?

Strategic Management-Social Ecology

The strategic management-social ecology perspective emphasizes collaborative action as a means "to support the positive gains of competitive advantage" (Wood & Gray, 1991, p. 156) not only by providing access to resources, but also by strengthening the collaborating organizations in the marketplace.

A turbulent environment in which the strategic management-social ecology perspective has explanatory power is one in which organizations must respond to the requirements of their environment to increase their competitive advantage. For example, funders may move from funding stand-alone services to integrated services or continuum of care. That movement is turbulent by definition because it creates problems for organizations that may not be solved by any organization alone. A long-term strategy would be to achieve competitive advantage through mercer with an organization that provides complementary services or establishes the continuum of care required by funders.

What would a merger look like that could be explained in terms of the strategic management perspectives Return once again to the situation of agencies funded to provide mental health services. If the chanced expectations of that funder are modified once again, the strategic management perspective provides an explanation for merger between organizations. In this case, assume that the funder of mental health services has changed requirements to include not only additional administrative infrastructure, but also the capacity to provide a broad range of community mental health services. The strategic management perspective emphasizes maximizing strategic advantage. In an environment made turbulent by the requirements identified above, the way to maximize strategic advantage is to identify a strategy that enables an agency both to meet the additional administrative requirements and to provide a broad range of services. Two medium-sized agencies would merge for strategic advantage if together they could meet these requirements. A merger would occur if the service complement created by the merger reflected the needed broad range of services and if the coming together of the two agencies allowed reallocation of resources to create needed administrative infrastructure. A strategic management explanation of merger allows organizations to see and seize advantage in turbulence. That advantage is accomplished through merger.

Managers who consider the organization's future in terms of strategic advantage may ask these questions:

- What are the requirements of the competitive organization of the future?
- Does my organization have the capacity to achieve competitive advantage on its own, as presently configured?
- If not, what mission-compatible organization can most enhance most organizations competitive advantage?

Corporate Social Performance-Institutional Economics

The corporate social performance-institutional economics perspective emphasizes an organization's role and responsibility in solving social problems. It describes how responsibility and risk are shared among the various players who have a stake in the issue or problem.

A turbulent environment in which the corporate social performance-institutional economics perspective has strong explanatory power is one in which a new phenomenon emerges. In such a situation, the community would look to the nonprofit sector to address the problem. Examples of such phenomena would include the emergence of youth gangs or new forms of drug use. The emergence of HIV/AIDS in the early 1980s is also a good example. Addressing such problems often requires the coming together of service providers that have expertise in areas related to the new phenomenon. Successful development of a solution to that problem may best be accomplished through the mercer of the related organizations.

What would a merger look like that was explainable in terms of the social performance perspective-- We may expand on the reference above to services to people affected by HIV/AIDS. In the early 1980s, when AIDS was first identified and diagnosed, an AIDS-specific service infrastructure did not exist. The community looked to the nonprofit sector to develop a response to the social services needs of those affected by the illness. One immediate response was the proliferation of grassroots organizations that addressed different aspects of the social services needs presented by people affected by HIV/AIDS: prevention, housing, counseling, nursing care, and so on. The service infrastructure that developed was fragmented, and AIDS services were provided for different purposes in different organizations throughout the community. A social services delivery structure was needed to offer services that reflected the community goal of an HIV/AIDS service infrastructure. Community pressure could lead providers of different HIV/AIDS services to merge to accomplish that goal.

Managers who consider the organization's future in terms of better solving a community problem may ask these questions:

- What does the community need to solve this problem?
- How can my organization add value in solving this (new) community Problem?

CONCLUSION

The six perspectives discussed in this chapter explain reasons for organizations coming together and, at the same time, provide tools for developing those relationships. Given an understanding of the environment and an organization's strategic direction, potential merger relationships may be identified. As an organization approaches a potential relationship with another organization (either as initiator or reactor), knowledge of the environment and organizational need may determine which (or what combination) of explanatory perspectives is operative. For example, knowledge that the funding environment is shifting from one that encourages many community service providers to one that supports a few corporate service providers may lead a small organization supported by that funder to understand its position in terms of political theory. On receiving an inquiry regarding merger from a larger provider, the smaller provider is likely to see power dynamics as operative and look to political theory for guidance regarding how to maximize that organization's position given environmental conditions. Other situations could be explained in terms of negotiated order or pure resource dependence, each of which would lend itself to a particular set of merger development strategies.

Understanding the reasons that lead organizations to come together is a critical element in strategic planning (see chapter 21). Effective nonprofit leaders must have the capacity to identify through strategic planning processes those issues that challenge their organization's long-term success. Nonprofit organizations face many potential challenges today, including insufficient resources, lack of institutional credibility, and inefficiency in operations. Leaders experiencing or anticipating these challenges in their organizations must be aware of merger as a tool to address those challenges.

Merger is a wise strategy when the management problem presented, given all other considerations, may best be addressed by the coming together of two or more organizations. The explanations provided by the theories described in this chapter provide a framework for how merger may address certain kinds of management problems effectively.

SKILLS-APPLICATION EXERCISE

Identify a nonprofit organization you are involved with and develop answers to the following questions:

- What impact would increased power have on my organization? What are my options for increasing my power' If merger is an option, what characteristics in a merger partner should I identify to increase my power in the community?

- What resources does my organization lack? How important are these resources to my long-term survival? What is the possible range of places from which I can acquire these needed resources?

- What is required of my organization to be competitive in the future? Can my organization meet those requirements on its own? Do we have a defined strategy? Is it cost-effective? What are my strategic options?

- How do key funders and other stakeholders view my organizations Are we perceived as having credibility? What do they require for the long-term success of the organizations What characteristics in a mercer partner should I identify to increase my credibility and legitimacy with funders and stakeholders?

- What are the potential changes in community values that may affect my organizations What might the community ask of my organization to meet these changes in values?

- In what functional areas is my organization least efficient? What are the inefficient areas that have been identified for me by funders or other

Stakeholders? What characteristics in a merger partner should I identify to increase my organization's efficiency?

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