

Beyond Collaboration

Strategic Restructuring of Nonprofit Organizations

Revised Edition

NCNB Funder Briefing

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THE JAMES IRVINE FOUNDATION
and the
NATIONAL CENTER FOR NONPROFIT BOARDS

By *David La Piana*

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Foreword

The James Irvine Foundation supports programs to improve the management, governance, and operations of nonprofit organizations. In this context, we undertook an exploration in 1996 to determine whether we could be helpful in supporting or encouraging “strategic restructuring” among nonprofits in California. As nonprofit organizations face mounting challenges and new opportunities occasioned by federal devolution and an increased emphasis on accountability, issues of mission, strategy, and market must be reexamined. Such assessments have already resulted in several high-profile and many lower-profile mergers among nonprofits in California. Given this reality, a study of sectoral activity in this regard seemed timely.

We are pleased to share with both other funders and nonprofit leaders the results of this inquiry on strategic restructuring, conducted by David La Piana. The study offers an analysis of restructuring efforts among nonprofits and describes several strategies that funders might develop to support further activity in this arena. Though the report is addressed to funders, many of the findings will be of interest also to nonprofit executives and board members. In the spirit of sharing lessons learned, we encourage readers to request additional copies of the report from the foundation or to pass the report along to others.

We are grateful to the many funders and nonprofit leaders in California and beyond who contributed to our inquiry, and I especially wish to thank David La Piana for his thoughtful analysis. I would also like to acknowledge the National Center for Nonprofit Boards (NCNB), which not only served as publisher of the report, but also provided additional perspective and rigor in the editorial review process. NCNB will assist in distributing the report beyond the foundation community.

We hope this report contributes to the conversation within philanthropy and the nonprofit sector on these issues, and we welcome your thoughts about how the Irvine Foundation might support nonprofit organizations as they engage in strategic restructuring activity.

Dennis A. Collins
President
The James Irvine Foundation

Preface to the Second Edition

The first edition of *Beyond Collaboration* appeared in April 1997. It was mailed to a select group of funders and others around the nation. These readers in turn recommended it to their colleagues and grantees. The first 5,000 copies disappeared quickly. Callers to The James Irvine Foundation, which distributed the report, also quickly consumed a second printing of 5,000. In mid-1997 the National Center for Nonprofit Boards added *Beyond Collaboration* to its web site (www.ncnb.org), where thousands more have read, downloaded and reproduced it. The report has found its way into registration packets at numerous conference programs, onto the shelves of nonprofit and community foundation libraries, and onto at least two university course required reading lists.

From its origins as an effort to look into the future role of mergers in the nonprofit sector, the study that became *Beyond Collaboration* grew into an investigation of the possibilities for partnering across multiple entities, using many structures. The original publication of this report marked the beginning of a heightened consideration of organizational structures, collaboration, and partnering in the sector. The state of knowledge in the field has advanced considerably since 1997, a fact reflected in the expanded reference section. We are heartened that so much attention has been drawn to these critical issues, and hope that the re-publication of *Beyond Collaboration* will spur further debate and inquiry.

Executive Summary

Strategic restructuring—including mergers, back-office consolidations, and joint ventures—is an increasingly popular option for nonprofit organizations facing stiff competition, rising community needs, and decreasing federal funds.

The James Irvine Foundation recognized the potential role funders might play as nonprofits grapple with fundamental changes in the way they operate. Thus, the foundation commissioned a study to develop an approach through which foundations might assist nonprofits in strategic restructuring. This report, intended to encourage funders to become involved in strategic restructuring, outlines that approach.

The study attempted to answer five questions:

1. How can we best define and describe the options for strategic restructuring?
2. Is the climate right for strategic restructuring? Will successful restructuring improve the functioning of nonprofits?
3. What pressures lead nonprofits to consider mergers, consolidations, and joint ventures, and what difficulties prevent bringing these efforts to fruition?
4. How can funders encourage nonprofits to undertake strategic restructuring without being perceived as applying pressure to do so?
5. What educational activities can funders promote to encourage strategic restructuring activities such as mergers, consolidations, and joint ventures?

Findings in Brief

- Many nonprofits are considering a fundamental change in organizational structure because of economic pressures such as increased competition from business, government, and other nonprofits; a shrinking supply of experienced leaders willing to remain in the sector for inadequate wages; and increasingly urgent and complex community needs.
- Those interviewed for the study suggest that a heightened interest in strategic restructuring is natural as the nonprofit sector matures, but that nonprofit leaders need assistance as they undertake significant organizational change—assistance that funders are well positioned to provide.
- Nonprofit organizations attempting to restructure through mergers, back-office consolidations, joint ventures, or fiscal sponsorships must overcome perceived threats to autonomy and board and staff members' self-interests, as well as potential culture clashes.
- Since the concept of strategic restructuring is still evolving, additional research is needed to analyze factors leading to success or failure, develop best practice guidelines, and compile and disseminate information for chief executives and board members.
- By sponsoring educational activities intended to raise overall awareness in the sector, funders can introduce nonprofit organizations to strategic restructuring options, without requiring consideration as part of a grant agreement.
- Funders can provide direct assistance to organizations involved in strategic restructuring by sponsoring workshops, training consultants, or providing direct financial support.

Introduction

Foundations are faced with an overwhelming task. Their finite resources cannot meet the unlimited needs grant seekers present, and they make up only a small fraction of the total support Americans provide to the nonprofit sector each year. Nonetheless, these funders play a critical role in developing new ideas, addressing emergent needs, initiating partnerships, and focusing the public's attention on important issues.

Economic and political pressures, competition, taxpayer revolts, and a few high-visibility scandals have all hurt the nonprofit sector. As a result, nonprofits face critical decisions about their future—and perhaps their very survival.

Funders recognize that new ideas will flow and that promising partnerships will grow only as long as the nonprofit sector is strong and vibrant. Thus, they have a vested interest in the health of the sector.

This report, based on a study commissioned by The James Irvine Foundation, reviews the challenges facing nonprofit boards and chief executives. It also examines the motivations and inhibitions that encourage or discourage these leaders in considering nontraditional alternatives such as mergers, consolidations, and joint ventures.

Frustrated by overlapping programs, service gaps, turf battles, and a lack of coordination, funders have begun to encourage, and in some cases to demand, closer collaboration between nonprofit organizations in return for new or continued funding. Unfortunately, despite some notable exceptions, this push for collaboration has led primarily to joint grant writing rather than collaborative action and sustainable partnerships: nonprofit leaders work together on the proposal, but continue to work separately after the grant is made.

Yet the need for closer coordination remains, as does a need for creative, strategic solutions in response to an accelerating economic squeeze.

The challenge confronting nonprofits is to look beyond collaboration—to build sustainable, long-term relationships that fundamentally change the way they function as organizations. Anecdotal evidence indicates that nonprofits are exploring mergers, consolidations, and joint ventures with increasing frequency. Each of these options goes beyond the current definition of collaboration. Where collaboration implies coordination of service, strategic restructuring requires changes to the corporate structure and, frequently, a change in the organization's locus of control.

These undertakings are not easily achieved. They require nonprofit leaders to yield some of their autonomy, to make themselves vulnerable, and to open their organizational cultures to outside influences. In return, these efforts have saved essential nonprofit services (if not the organizations that originally delivered them) from extinction, resulted in an improved market position, and opened the door to new opportunities.

This report may inspire funders to ask some difficult questions of their grantees. Ultimately, however, it is intended to help funders better understand the nature of strategic restructuring and the ways in which they can help their grantees develop meaningful partnerships with other nonprofits. These decisions—among the most significant nonprofit leaders face—have impacts that extend beyond the organizations involved to communities that rely on the nonprofit sector for a host of programs and services.

“A nonprofit merger or consolidation will only be successful in the long run if the leaders involved can place achieving improved community outcomes ahead of both advancing their organizational mission and maintaining organizational structures.”

—Michael Howe
Executive Director
East Bay Community Foundation

Early in 1996, The James Irvine Foundation identified a need to encourage increased integration of nonprofit organizations, thereby leading to greater efficiency and an increased chance of survival.

The Foundation commissioned this study to develop organizing principles for this effort; to investigate the attitudes of nonprofit leaders toward mergers, consolidations, and joint ventures, among other options; to develop and test ideas for promoting these arrangements; and, ultimately, to propose an approach through which the Foundation might assist nonprofits as they strategically restructure their organizations for increased effectiveness.

This report attempts to develop a fuller understanding of the range of strategic restructuring options available and the motivations, inhibitions, and environmental factors affecting nonprofit leaders' attitudes toward change. Mergers, consolidations, and joint ventures can help nonprofit organizations address structural weaknesses. This report addresses both specific strategic restructuring options and the broader ends toward which they are employed.

Ultimately, strategic restructuring should better position nonprofits to advance their missions. The quest for organizational survival in a hostile

environment should be secondary to the goal of advancing a useful social mission.

The nonprofit sector needs a keen market focus and an ethic of responsibility to mission over empire-building or organizational self-preservation. By integrating nonprofit organizations into fewer, stronger, more flexible and effective structures, resources and focus can be redirected to strengthening and advancing missions that, as Michael Howe states, result in “improved community outcomes.”

All studies, and ensuing reports, are molded by a set of assumptions. This work assumes that:

- Improved quality of service, enhanced market position or market share, political advantage, and similar strategic benefits are the most significant outcomes of successful restructuring efforts. Although a major motivator, cost reduction is seldom a short-term outcome of mergers and consolidations.
- Traditional philanthropy (the giving of grants) has a limited ability to help nonprofits through structural difficulties. Funders are called to take a more active role in guiding nonprofits as nonprofit organizational structures evolve and change.

Study Questions

The questions articulated at the study's outset and addressed in this report are:

1. How can we best define and describe the options for nonprofit strategic restructuring?
2. Is the climate right for strategic restructuring? Will successful restructuring improve the functioning of nonprofits?
3. What pressures lead nonprofits to consider mergers, consolidations, and joint ventures, and what difficulties prevent them from bringing these efforts to fruition?
4. How can funders encourage nonprofits to undertake strategic restructuring without being perceived as applying pressure to do so?
5. What educational activities can funders promote to encourage strategic restructuring activities such as mergers, consolidations, and joint ventures?

- Problems facing nonprofit organizations are—at their core—the same across all subsectors: motivating and leading board members, staff, and volunteers; earning and raising sufficient funds; managing the organization; developing and articulating a vision for the future; and continuously analyzing and acting upon environmental pressures.
- Board and staff leaders likely to benefit from strategic restructuring already possess, at a minimum, a basic level of strategic sophistication that they bring to their thinking about the organization's future. If they lack this perspective, and cannot gain it quickly, the strategic restructuring effort is doomed to failure.
- Likely nonprofit candidates for strategic restructuring are analogous to businesses with undervalued stock: the necessary elements for success are present, but the organization needs outside help to move it forward. When a business's restructuring is successful, its stock value rises dramatically. When a nonprofit's restructuring is successful, its ability to fulfill its social mission rises dramatically.

QUESTION 1

How can we best define and describe the options for nonprofit strategic restructuring?

The nonprofit sector is highly interdependent. Nonprofit organizations join trade associations and coalitions. They form shared purchasing clubs and insurance cooperatives. Professional staff members belong to guilds and advocacy organizations. This associative process builds indefinitely, creating a web of interrelationships throughout the sector. Virtually all of the organizations with which nonprofits affiliate are themselves nonprofits.

No nonprofit organization can long survive and succeed in advancing its mission while living independent of other nonprofits. Nonprofits gain information, political power, and personal and professional support from and in concert with other nonprofits. Thus, close working relationships, partnerships, and even joint ventures between nonprofit organizations are a fairly natural occurrence.

Definitions and Legal Forms

Some confusion exists when distinguishing strategic restructuring from strategic planning and reengineering. Strategic planning is an effort to define an organization's purpose and

scout a path for the years ahead; strategic restructuring is a set of options helpful in implementing the plan. "Reengineering" refers to large-scale productivity-enhancing process change, whereas "strategic restructuring" describes an evolving form of structural change.

Legally, only a merger effects change in a nonprofit's corporate status, producing a higher level of integration than any other transaction. No matter how it is implemented, a merger means a *change of control*, involving a great deal of risk and emotion. A variety of legal inventions can be employed in executing a merger or other affiliation. The most common options are described below; variations are constantly being invented and tested in the field.

Merger is the generic term for a full and final coming together of two previously separate corporations. Legally, mergers often entail one nonprofit closing (the dissolving corporation) and leaving its assets and liabilities to another nonprofit (the surviving corporation). This tactic is often employed for technical reasons. For example, if ABC and XYZ wish to merge but ABC is in debt, it may be best for XYZ to dissolve. To do otherwise could trigger a call for repayment of the debt prior to dissolution.

Although the merger may be a joining of equals, the legal partnership will preserve only one corporation. Roughly eight out of ten "mergers" are executed as dissolutions, for reasons similar to the example above and because it is simpler and less expensive. A true merger in the legal sense occurs when both nonprofits

dissolve and fold their assets and liabilities into a newly created third entity. Since this entails the creation of a new corporation and application for a new IRS tax exemption, it is usually not the method of choice.

Acquisition is the same, legally, as merger. Since nonprofits have no identifiable owners, nonprofit corporations cannot be bought or acquired. Certainly no legal maneuver among nonprofits corresponds to the acquisition of a publicly traded corporation. Nonetheless, many mergers, perhaps the majority, *feel* to participants very much like acquisitions. Use of the term is widespread, usually in reference to a merger in which one party is considerably larger or stronger than the other.

Back-Office Consolidation is an increasingly common arrangement for sharing core administrative functions among nonprofits involved in similar work. A consortium of community-based primary health care clinics provides an excellent example. As managed care is implemented and economic pressures mount, the clinics must lower costs and work together more closely. Yet each clinic serves a distinct geographic and ethnic constituency, making a merger politically inexpedient.

In this example, the clinic consolidations are far-reaching. Nonetheless, when completed, the affiliations will be “invisible” to the public and, most significantly, to the clinics’ patients. Separate corporations with separate chief executives and boards of directors will continue to exist. Behind the scenes, however, virtually every aspect of the clinics’ operations will be consolidated. Management information systems, billing, fiscal management, human resources, medical direction, capital acquisitions, and contracting will all be jointly managed. This model is one of a develop-

ing range of creative options short of merger.

Joint Venture applies to a wide range of situations. Some aspects of the above example could be described as a joint venture. So too could a programmatic collaboration between two or more nonprofits that involves no consolidation. Within the scope of this discussion, only joint ventures that materially change the character or locus of control of the nonprofit corporation are of interest.

For example, currently three nonprofits in one metropolitan area are entering the emerging field of therapeutic foster care for troubled children, an undertaking requiring capital investment and the assumption of some risk. Rather than compete for clients, foster parents, and dollars, the three nonprofits are forming a new subsidiary nonprofit membership corporation, limited to three corporate members: each of the three partner corporations. This new subsidiary will provide a vehicle for marketing, delivery, and billing of services, maximizing use of the three partners’ resources and minimizing the risk assumed by any one organization. The opportunity for shared risk and reduced competition in a new undertaking is one of the major motivators of joint venture agreements between nonprofits, as well as between nonprofit and business entities.

Fiscal Sponsorship traditionally refers to an established nonprofit serving as “middleman” for charitable funds received by a new project lacking 501(c)(3) tax status. Usually, the sponsor performs little oversight of the project, a situation that has resulted in more than a few problems. Recently, fiscal sponsorship has emerged as a more formal and intentional means to help formative nonprofit activities receive charitable

dollars, develop an organizational structure and board, manage financial and human resources, and even secure shared office space.

The Tides Center in San Francisco, Community Partners in Los Angeles, and The Fund for the City of New York are examples of organizations making fiscal sponsorship a core business, rather than simply an income-producing sideline. These centers offer an impressive array of services. They also perform an important educational function that may forestall the formation of some new separate nonprofit corporations: as their projects outgrow the sponsorship arrangement, the sponsor voluntarily assumes responsibility to inform the projects of various options for joining established nonprofit organizations as an alternative to spinning off as a new 501(c)(3).

Is the climate right for strategic restructuring? Will successful restructuring improve the functioning of nonprofits?

Key informants agreed that the specter of increased mergers and consolidations is an unavoidable if often frightening reality. The next 10 years will produce increased interest in strategic restructuring and a concomitant increase in activity. While key informants varied in their enthusiasm, they were united in their belief that “the writing is on the wall.”

This trend is not unique to the nonprofit sector—both the private and public sectors have been restructuring and consolidating for nearly a decade. Nonprofit attorney Tom Silk, a veteran of hundreds of mergers and consolidations, sees the current increased interest in merger activity as a direct result of the maturation of the sector, which grew dramatically in the 1960s and 1970s. He believes that a number of “thirty-something” nonprofits have reached a point in their life cycle where their best work is behind them, while others have achieved a level of organizational sophistication that allows consideration of complex issues such as those raised by a strategic restructuring effort.

Is it worth the effort? This study uncovered widespread anxiety and fear among nonprofit leaders. Economics are forcing a growing number of organizations to the brink of financial disaster. Yet these nonprofit leaders are not without hope. On the contrary, they hunger for solutions.

Keith Merron, in the best-seller *Riding the Wave*, argues that acknowledging that the organization faces a crisis is a necessary antecedent to committing to a major change effort. This acknowledgment seems, at last, to be emerging across the sector.

Funders can help by portraying strategic restructuring as a vehicle for organizational change; they can serve as resources—developing and disseminating information about strategic restructuring, and helping nonprofits as they implement restructuring efforts. The nonprofit sector is struggling to understand and to find a way out of its current predicament, and funders can contribute to the solution by dedicating resources and expertise.

Now, when endemic problems are rising to the surface and creative solutions are actively sought, developing new options, disseminating practical information, and offering direct assistance to the nonprofit sector are essential. The strategic restructuring effort is already under way in a halting, uncoordinated, grassroots way. Funders may wish to position themselves to shine a light into the darkness, helping the sector to find its way, and to do so through a coordinated effort that is certainly not “philanthropic business as usual.”

What pressures lead nonprofits to consider mergers, consolidations, and joint ventures, and what difficulties prevent them from bringing these efforts to fruition?

While factors specific to each organization and situation lead individual nonprofits to consider strategic restructuring, economic considerations offer a backdrop to the sector's problems as a whole. Mounting economic pressures have taken their toll on both nonprofit executives and their organizations.

Federal devolution of responsibility to state and local government (often accompanied by a decrease in allotted resources); increased competition from business, government, and other nonprofits; and two decades of taxpayer revolts have brought many nonprofits to a crisis point.

Beyond the general financial problems of the nonprofit sector, some sub-sectors face woes uniquely their own. For example, the advent of managed care is wreaking havoc with the traditional market strategies, payment structures, and contracting relationships of nonprofit health care providers, while at the same time raising competition to a fever pitch. Similarly, the end of the "Ford Era," as described by John Kreidler in his essay *Leverage Lost: The Nonprofit Arts in the Post-Ford Era*, has brought the arts sub-sector a new economic calculus after more than 30 years of reliance on large foundation funders and their leverage effect within local communities.

Compounding other economic pressures is the continued phenomenal

growth rate of the nation's nonprofit sector: as many as 30,000 new tax-exempt organizations are created each year in the United States. Many of these new organizations are providing valuable services, mobilizing community resources, and developing innovative approaches to problems. At the same time, duplication of effort, wasted resources, unnecessary competition for limited funds, and an increasing level of organizational failure are becoming endemic to the sector. Continually forming new nonprofits rather than reevaluating existing structures is contributing to and accelerating these troubling trends.

Another factor haunting the sector is the aging population of experienced nonprofit managers and staff. As baby boomers age, one seemingly inevitable consequence is a loss of what Kreidler aptly calls "discounted labor." The boomers, as they assume family responsibilities, are less able to continue to accept discounted wages. Exacerbating this problem, younger generations with real concerns for their economic well-being and future security are less willing to accept substandard wages than were the baby boomers before them. The economic stress exerted by this upward pressure in compensation, particularly among experienced staff, further erodes the sector's ability to sustain an ever-growing number of separate organizations.

"Why would we want to merge? We would lose our independence. We have our own way of doing things. We don't want to be taken over by some other group with different priorities. We would lose our identity. This will never happen while I am president."

—Spoken by the board chair of a nonprofit that dissolved six months later

"Mergers will become an increasingly prevalent means of organizational survival during the next several decades, and increased competition for declining funding and community support is the primary reason for this trend."

—Naomi Vine
Director
Laguna Art Museum

“Oversupply is not a new problem in the nonprofit sector; it is the accelerating financial squeeze that brings new urgency to the oversupply problem.”

—Rick Smith
National Executive Director
Support Centers of America

Roadblocks to Strategic Restructuring

As a result of increasing economic pressures, nonprofits of all sizes are in trouble. Merger or consolidation is seldom the first thought of leaders of a troubled organization; instead, they deplete reserves, even restricted endowments; live in expectation of the next grant; defer facilities upkeep, and reduce services and salaries; in short, they hang on and hope for a miracle.

When such weakened groups do conceive of a merger or consolidation, it is seldom wholeheartedly, and usually from the perspective of extreme financial desperation.

Strategic restructuring negotiations raise many critical issues, any one of which can threaten the outcome: the proposed name of the merged orga-

nization, chief executive self-interest, and fear of change, to name a few. Whatever the outward manifestations, resistance to strategic restructuring efforts usually stems from one of the following three themes.

Autonomy. Mergers, consolidations, and other forms of strategic restructuring can be perceived as threats to organizational and individual autonomy. In a sector where compensation is not a primary motivator, independence and autonomy are much cherished rewards. Nonprofits are often founded by, and continue to operate on, the commitment, energy, and drive of a small group of devoted leaders. Most impasses encountered in the course of strategic restructuring efforts can be traced to inadequate attention having been accorded to this emotional, and potentially explosive, issue.

Factors Contributing

Despite a challenging economic environment, many nonprofits continue to grow and thrive, providing necessary services, creating innovative solutions to social problems, excelling in their fields. Meanwhile, other nonprofits stumble and fall. The sheer tenacity of the sector shields the world from the full effects of nonprofit failures. Traditionally, nonprofits defy the “natural laws of bankruptcy.” Economic circumstances that would cause a sane businessperson to seek court protection or simply close up shop are often accepted as the normal course of events among nonprofits. For many nonprofits, delayed payroll, reduced wages, and mounting back rent are a regular part of doing business. Failure to pay required payroll taxes to the Internal Revenue Service is the most frequent cause for legal action against individual nonprofit board members nationally and, ultimately, for dissolution of nonprofit corporations.

While both thriving and troubled nonprofits can benefit from a well-conceived strategic restructuring effort,

understanding the characteristics that contribute to nonprofit organizational success is important. These characteristics help nonprofits succeed in novel, high-stakes undertakings such as strategic restructuring. Four “success factors” correlate with the ability to succeed within the current high-risk environment.

Mission. The first and most important factor in nonprofit success is a clearly defined mission that is embraced by organizational leaders, both volunteer and professional. A strong commitment to a clearly articulated mission requires much more than a written mission statement. It means that the organization’s focus on changing society as its mission mandates is a genuine, clear, daily presence and the most important element in decision-making, particularly in the consideration of major undertakings.

Flexibility. The second factor in success is flexibility. Many nonprofit organizations strive to maintain the status quo, while the world is changing with unprecedented

One way to defuse this potent issue is to ask the proponents of autonomy to detail their concerns and fears. Without interruption, argument, or rebuttal—indeed, with great and sympathetic care—they should be encouraged to articulate their worst fears for their organization, for their constituency, and for themselves. A full listing of such concerns usually reveals issues ranging from the realistic to the fantastic, from the easily solvable to the intractable. Subsequent thorough discussions of each concern can lead to compromises, cleared-up misunderstandings, and well-informed agreements to disagree. Equally important, these discussions will reveal the motivations of the parties to the negotiations and thereby begin to build mutual trust, an essential foundation for a successful outcome in any strategic restructuring process.

Self-Interest. Whether it is a board member fearing loss of attachment to a beloved organization or cause, or staff fearing loss of status or even employment, self-interest is neither inappropriate nor unethical in a non-profit context; it is a legitimate and major issue in strategic restructuring negotiations and leads to many breakdowns. Each staff person brings to the workplace psychological needs for affiliation, security, and self-esteem, as well as the practical need for continued gainful employment. Similarly, volunteer board members devote a significant amount of time because they feel a strong attachment to the organization, its cause, or both. The challenge is to identify and address participants' legitimate self-interest concerns so that they do not move underground to reemerge as sabotage.

to Nonprofit Success

rapidity. Nonprofits attempting to preserve “the way we have always done things” are struggling to hold back time—a battle that cannot be won.

Ironically, the missions of many nonprofit organizations call for social change, yet the organizations themselves are averse to change. Successful nonprofits not only embrace change, but they also anticipate or even create it. In pursuit of their missions, successful nonprofits have become more technologically sophisticated, customer-focused, and attuned to the external environment. They have learned that continuous rapid change, “learning faster than the competition,” according to Peter Senge in *The Fifth Discipline*, constitutes the ultimate competitive advantage.

Leadership. The third success factor is leadership. There is no substitute for it. The quality of both board and professional leadership varies widely among nonprofit organizations. Successful nonprofits have enterprising executives who work in harmony with supportive,

dedicated, involved boards. These executives keep their boards well informed, give both the good news and the bad, and involve their boards in the nonprofit's struggle, viewing board members as actors rather than audience in the drama of the organization's life. Over time, a successful chief executive gains the board's trust. Thus, high-risk, potentially high-reward undertakings that the chief executive supports are more likely to pass board scrutiny. “Succeed, and the board will let you take bigger risks next time,” is advice given to many new executives.

Growth. Successful nonprofits also share a desire to grow in order to deliver more and better services and increase financial stability. Strong nonprofit organizations sometimes grow by “acquiring” smaller, weaker nonprofits they believe can be revitalized by an infusion of good management. In most acquisition-type mergers the dominant party is just such a successful growth-oriented organization.

“While I agree that organizational leadership is important [to a merger’s success], my experience suggests that financial imperatives often are a stronger success factor.”

—Rick Smith
National Executive Director
Support Centers of America

Self-interest, like autonomy, is best addressed by open discussion. However, often the self-interest of one or both chief executives poses a major stumbling block to merger or consolidation. One way to address the chief executives’ concerns is to establish at the outset that each chief executive will have continued employment at the same salary level, or receive a substantial severance package.

Culture Clash. Organizational culture is a pervasive influence that is revealed by, among other things: where staff sit at the conference table for meetings, whether they wear business suits or jeans to work, the ethnic makeup of the board, the staff’s shared political beliefs, and the staff’s and the board’s respective views of one another’s roles and competency. Most nonprofit organizations have a strong organizational culture. Surviving financial insecurity and hard work, absent financial incentives, fairly requires a strong set of shared beliefs and practices.

One result of a strong organizational culture is a slightly different subjective reality from that perceived by members of the next organization. In the normal course of business this is usually not an issue, since visitors to an organization *know* they are visitors. However, during strategic restructuring, and specifically during merger negotiations, participants tend to forget this fact, to bring their own organizational culture to the negotiating table, and to expect others to share their point of view. This subtle shift in expectations occurs precisely when each organization’s most basic arrangements are being scrutinized, and its very culture is being implicitly called into question.

An understanding of these three critical issues, their interplay, and the varied ways in which they manifest themselves in the strategic restructuring process will explain most negotiation stumblings. Early identification and ongoing attention to these potential deal-breakers is essential to a successful outcome.

QUESTION 4

How can funders encourage nonprofits to undertake strategic restructuring without being perceived as applying pressure to do so?

Key informants agreed that funders must act with care to avoid the appearance of having an undue influence on nonprofits, given the reliance of nonprofits on funders for financial support. Michael O'Neill, director of the Institute for Nonprofit Organization Management at the University of San Francisco, quotes Alexis de Toqueville: "When the government speaks it is difficult to ascertain the difference between a suggestion and a command," reflecting the power that funders can wield, even inadvertently, when they "show an interest" in an area.

The consensus among key informants was that funders should promote mergers, consolidations, and joint ventures as the powerful organizational options they are, but should broaden the framework to encompass the concepts of reengineering, reinventing, and market positioning, as adapted to the nonprofit sector. From these discussions the concept of strategic restructuring emerged, broadening the focus from the promotion of specific options. Strategic restructuring addresses the need to bring change to a nonprofit in an environment that is itself rapidly changing.

Key informants reasoned that nonprofits must be encouraged to think

deeply, strategically, and realistically about their present situation and future prospects. The process should aim to assess, as objectively as possible, the organization's situation in light of its mission *and* its external environment. No organizational structure should be taken for granted. As corporate reengineering has shown, the redesign of business processes for greater productivity (and profitability) often requires abandonment of cherished but outmoded structures.

Strategic restructuring considerations are so fundamental—and their effects so far-reaching—that the organizations involved must begin with a complete reevaluation of their current strategic position. This approach also makes political sense. Most nonprofit leaders will balk at a third party's suggestion of a merger; it is an idea that must "dawn from within."

Thus, funders may wish to sponsor broad educational and awareness-raising activities for the sector, and then be ready to assist those organizations that realize that a merger, consolidation, or joint venture might be an appropriate alternative for them to consider.

"I think one of the things we really need is a broader list of options for organizations to consider, besides just mergers and consolidations . . . if you could develop more models, this would be the most significant contribution to moving organizations forward."

— Ralph Silber
Executive Director
Alameda Health Consortium

What educational activities can funders promote to encourage strategic restructuring activities such as mergers, consolidations, and joint ventures?

A funder's objective should not necessarily be to promote more frequent use of a particular option, such as merger, but rather to increase the number of options available to nonprofit leaders.

Key informants contributed a wide array of ideas concerning educational activities that funders can promote to encourage strategic restructuring. The suggestions were easily divided into three categories: research and development; documentation and dissemination; and direct assistance.

Research and Development

Key informants expressed a need for more creative thinking in this area, viewing strategic restructuring as “uncharted waters.” Now that economic necessity is forcing nonprofits to look at strategic restructuring more closely, isolated advances in practice are far ahead of the development of a body of practical scholarship on the subject.

Society is at risk of losing essential nonprofit services because of the poor financial performance and imminent economic collapse of so many of the organizations within which these activities occur. The sector needs an incubator function devoted to developing new organizational arrangements under the banner of strategic restructuring. Specifically, a successful strategy will encourage the development and dissemination of information on options for organizational change that enhance the missions of the nonprofit sector, without necessarily perpetuating its current organizational structures.

Today's nonprofit leaders glean many essential skills from practitioner-led, action-oriented research and writing (e.g., John Bryson's work on strategic planning and Hank Rosso's *Achieving Excellence in Fund Raising*). The skills taught, and more generally the broad conceptual approach to each problem conveyed in these works, spread quickly throughout the sector. For example, even among those who have not read Bryson, strategic planning is better understood because of his book *Strategic Planning for Public and Nonprofit Organizations*.

Most nonprofit management learning spreads through word-of-mouth, facilitated by the ubiquitous networks nonprofit managers maintain. This seminal activity is sorely needed in the emergent area of strategic restructuring. As happened with strategic planning, the resultant learning from a research and development effort in strategic restructuring would quickly spread from written form through word-of-mouth to benefit the wider sector. Some of the issues to be addressed by an R&D effort include:

- How to make information about mergers, consolidations, and joint ventures directly available to board members.
- How to educate chief executives on the need for a well-informed, involved board capable of making strategic restructuring and other critical decisions.
- The development of best-practice guidelines for handling each aspect of a merger (e.g., human resources and layoffs, finances, due diligence and other legal concerns, board integration, and the resolution of deal-breakers).
- Analysis of the factors leading to the success or failure of strategic

restructuring efforts and of the long-term benefits obtained from completed projects.

- A retrospective analysis of the effects of mergers on ethnic and other minority communities, social and artistic diversity, and community access to services.
- Examinations of new and emerging strategic restructuring options such as back-office consolidations, fiscal sponsorship arrangements, and joint ventures.
- Development of new concepts for effective, lean organizational structures that maximize resources available to pursue the mission, such as the “virtual corporation.”
- Exploration of the possible roles of business and government entities in nonprofit strategic restructuring efforts.

Rather than promoting one particular option, such as merger, a funder’s objective should be to increase the number, frequency of use, and development of more options.

A concentrated R&D effort represents an opportunity to field-test new ideas among entrepreneurial nonprofits and publicize the results. R&D does not require independent research or an experimental design. Many innovations are emerging from the field. The focus would be on finding promising models, studying them as they unfold, documenting the process, synthesizing the lessons learned, and then turning the results into replicable programs or policy recommendations to be considered by nonprofits and their funders.

Documentation and Dissemination

Key informants were unanimous in their belief that this area represents a

major gap in the nonprofit management literature. In order to raise the sector’s consciousness and competence in these issues, a larger body of literature is needed. Much of this effort could emerge from the R&D work described above, in partnership with practitioners and researchers. Communications aimed at scholars, board members, chief executives, constituent groups, and public and private funders are needed.

The development of this work will take many years, but it must begin now. Nonprofit managers are looking for realistic suggestions and fresh insights into new and old problems. They are relatively uninterested in theory for its own sake, but keen on practical advice and workable solutions.

The senior manager’s time is every organization’s most precious resource. Even the most thoughtful executives are “grazers” who skim widely, rather than reading in depth. Projects envisioned by key informants to expand the breadth of literature available include:

- Case studies by actual merger and consolidation participants;
- Critical reviews of successful restructuring innovations ready for replication;
- General articles in widely read periodicals;
- Scholarly articles in sectoral and subsectoral journals;
- Full-length practical yet scholarly books, such as those from Jossey-Bass; and
- A workbook format describing different restructuring options, designed around a decision tree useful for choosing the most appropriate organizational design for a given situation. (Also, this workbook could be made available online to reach a broader audience.)

“Considering the complexity of managing a successful merger . . . Direct consultation is clearly needed if a merger is to be successful. The consultants need to be well trained in nonprofit management, have knowledge of issues related to mergers, and possess mediation skills.”

—Dale Needles
Vice President
National Hispanic Scholarship Fund

These publications could be fostered through direct approaches to publishers, academic institutions, and practitioners. Small grants could support the writing and dissemination of case studies by practitioners.

Direct Assistance

Practical, immediately useful strategies are needed to encourage nonprofit leaders to consider mergers, consolidations, joint ventures, and other strategic restructuring efforts and to successfully initiate and complete the delicate, sometimes ego-bruising negotiations required to bring them to fruition. In addition to the strategies described above, which are educational in nature and medium- to long-term, an effort is needed to encourage, support, and facilitate actual changes involving specific nonprofit organizations in the field *now*.

This component of the proposed strategy includes the identification of a network of “local partners”—convener organizations with access to nonprofits in their community. Community foundations and management support organizations are likely candidates for this role. To paraphrase the old Tip O’Neill maxim: “All nonprofit politics are local.” Without geographically diverse, home-grown partners, it will be difficult to access nonprofits from many locales. Local partners would receive assistance in promoting the efforts of local nonprofits to examine their futures from a strategic restructuring perspective.

Workshops. Local partners could recruit participants and sponsor workshops to instruct nonprofit leaders about the strategic restructuring process. Workshops would cover various aspects of strategic restructuring, such as the importance of negotiation, the financial commitment involved, and the relationship be-

tween strategic restructuring and pursuit of mission. From these presentations candidates for direct assistance would emerge.

Consultation. Key informants report great variability in consultants’ skills. An unsuitable consultant can do serious damage in these sensitive negotiations. Training for consultants and a clearinghouse of experienced consultants would be useful. Local partners would identify strategic restructuring candidates for possible direct consulting assistance.

Direct Financial Support. Candidates for grants to pay for one-time expenses related to a restructuring effort, such as legal fees, could be identified by local partners. Funders can also create other financial incentives related to the new organizational structure.

Funders' Challenge

This report outlines pressures facing nonprofit organizations as resources shift and societal need intensifies. It describes the dynamics that motivate nonprofit leaders to pursue or avoid strategic arrangements with other organizations. Finally, the report highlights several ways nonprofit organizations can be encouraged to advance into the foreign territory of strategic restructuring. Some of these interventions advertise the benefits of the journey and its potential outcome. Others are designed to provide the tools—the organizational map and compass—needed by a traveler to parts unknown. Ultimately, this report is intended to stimulate funders to consider encouraging and supporting strategic restructuring by nonprofits facing turbulent times.

Funders interested in encouraging strategic restructuring may choose to build on the three types of interventions described in this report (R&D; documentation and dissemination; and direct assistance). However, this is, at best, a starting point; much more work is needed. Some questions that remain include:

- What other forms of strategic restructuring might be developed in the next few years?
- How might programmatic collaboration be enhanced by strategic restructuring?
- Is it appropriate to promote mergers and consolidations among ethnic and other minority communities that have long

struggled to build their own organizations? Will diversity be enhanced or reduced?

- What impact may an interest in strategic restructuring have on a funder's overall grantmaking programs?
- Through strategic restructuring, should nonprofits form partnerships with private businesses? with public agencies?
- What are the outcomes, both financial and programmatic, five to ten years after a strategic restructuring effort?

In conclusion, a few general recommendations are offered for funders to consider in developing an approach to strategic restructuring.

Take a Broad View of the Question. Should funders focus on promoting mergers or should they view mergers as a single option in a larger effort to renew organizational vitality in pursuit of mission? Key informants believe in a broad approach to nonprofit organizational challenges, with merger viewed as one weapon in a well-stocked arsenal. Funders should consider taking a broad view of nonprofits' problems as they relate to changes in organizational structures and the development of new partnerships. The touchstone should be the promotion of organizational change that enhances the mission: strategic restructuring.

Undertake an Integrated Effort. An integrated, comprehensive effort

to promote strategic restructuring—incorporating R&D, documentation and dissemination, and direct assistance—will maximize the funders' ability to help nonprofits as they cope with organizational change.

Establish Focus across Subsectors.

All subsectors of nonprofit activity face issues and challenges similar to those raised in this report. They apply equally to health care, the arts, human services, the environment, and other fields.

Consider the Limitations of Traditional Grantmaking.

Consider an active grantmaking approach. Many funders have discovered that organizational capacity-building grants to nonprofits facing structural weaknesses or threats are often insufficient to effect real organizational change. There are many ways to account for these failures: the nonprofit may lack clarity of purpose at the outset of the project, or it may lack the management know-how to carry it out; the organization may rely on consultants who are not adequately skilled; there may be a pattern of poor organizational follow-through; or organizational leaders may become distracted by immediate funding crises. Board members' and managers' attitudes, strong organizational cultures, and ingrained habits are difficult hurdles, but for strategic restructuring to be successful they must be overcome. Given the frequent combination of inadequate skills, external distractions, and high emotions, funders must work in new, more direct ways to promote strategic restructuring.

Implementation: *Strategic Solutions*

Since the initial publication of this report in April 1997 it has been reviewed by a growing number of funders, some of whom perceived potential value in pursuing its ideas further. In July 1997, The James Irvine Foundation was joined by The David and Lucile Packard Foundation in a unique collaboration to sponsor a year of further investigation. Complementary planning grants were made in order to implement a number of the recommendations contained in the report and, in general, to further the cause of strategic restructuring among nonprofit organizations.

At the conclusion of the planning period, in July 1998, the Irvine and Packard foundations were joined by The William and Flora Hewlett Foundation in making three-year commitments to Strategic Solutions: a concerted, time-limited effort at developing a knowledge and practice base in strategic restructuring for nonprofits.

The Strategic Solutions project is organized to develop the three core components described in this report: research and development, documentation and dissemination, and direct assistance. It also contains training and education components for funders and nonprofit management consultants. It is committed to working with a range of nonprofit organizations from different subsectors around the country and beyond.

In Strategic Solutions' three-year life it will identify, study and document innovative restructuring projects; work with local partners on educational efforts; produce books, case studies, articles, and other means of communicating what is learned; participate in university-based research projects; train a cadre of management consultants; conduct workshops and training for nonprofit leaders and funders; and initiate a small number of high-profile innovative strategic restructuring projects. Strategic Solutions has already launched, and is constantly improving, its website, which can be found at www.lapiana.org.

Strategic Solutions represents an opportunity to enhance the nonprofit sector's ability to pursue its missions through new organizational structures, some of which it might discover or invent through its research and development efforts. Strategic Solutions will not only encourage nonprofits to restructure to become stronger and better able to pursue their missions, but it will do so within a new kind of organizational partnership: active, closely involved funders working with a private consulting firm. Strategic Solutions is a project of La Piana Associates, not a new nonprofit organization. This partnership is designed for focus, flexibility and responsiveness. Thus, Strategic Solutions models the kind of strategic thinking it seeks to promote within the sector.

The following attributes, inspired by business re-engineering literature, are dynamics of successful enterprises in the current turbulent nonprofit environment. These are not abstractions: Strategic Solutions is designed to embody these characteristics:

- **Flexible**—a project rather than a program focus (nothing is permanent), extensive use of outsourced contractors and partnering with foundations, management support organizations, private consultants, etc.;
- **Small**—structured as a virtual corporation with no “offices,” minimal overhead, and outsourcing of nearly everything;
- **Market-Oriented**—a high-profile presence, aided by the retention of a publicist, and a very un-nonprofit-like emphasis on marketing, capitalizing on nonprofit leaders' increased interest in strategic restructuring, leading to earned income;
- **Entrepreneurial**—an emphasis on new project development and fee generation and a goal of becoming self-supporting through fees and project-specific grants; and
- **State-of-the-art**—no excuses for outdated technology, facilities, programs, or ideas.

Appendix B

Key Informants

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Appendix C

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