Strategic Restructuring

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What are some common types of Strategic Restructuring?

Strategic restructuring occurs when two or more independent organizations establish an ongoing relationship to increase the administrative efficiency and/or further the programmatic mission of one or more of the participating organizations through shared, transferred, or combined services, resources, or programs. Strategic restructuring ranges from alliances like jointly managed programs to organizational integrations, like full-scale mergers.

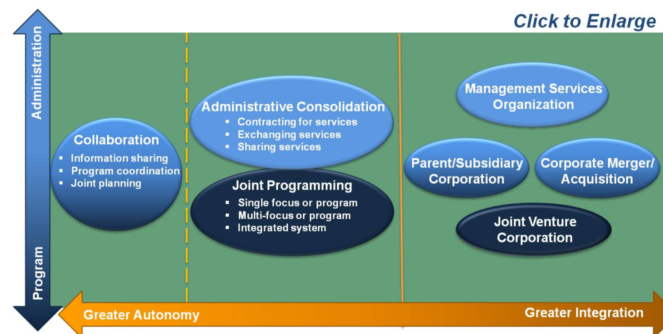
A strategic alliance includes:

- Commitment to continue, for the foreseeable future to share/consolidate administrative functions and/or programmatic services,
- Shared or transferred decision-making power, and
- Some type of formal agreement, contract, or Memorandum of Understanding (MOU).
- However, it does not involve any change to the corporate structure of the participating organizations.

An integration is a strategic restructuring that:

- involves changes to corporate control and/or structure, and
- may involve the creation and/or dissolution of one or more organizations.

The Partnership Matrix



The specific types of strategic alliances include:

1. Administrative Consolidation

An administrative consolidation is a restructuring that includes the sharing, exchanging, or contracting of administrative functions to increase the administrative efficiency of one or more of the organizations involved. Such functions include accounting, human resources, information systems, marketing, and purchasing, among others.

For example, a consortium of community-based primary health care clinics consolidated their financial and information management functions while each clinic continued to serve a distinct geographic and ethnic constituency, and to maintain a separate board of directors and management.

Publications

Article: Good facilitation, great results

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Models of Strategic Restructuring Case Study: Crittenton Women's Union Merger

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Article: Language Matters

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Article: Don't Neglect Investing Your Message

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Client Testimonial

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- Gregg Behr, Executive Director, The Grable Foundation

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2. Joint Programming

Joint programming is a restructuring that includes the joint launching and managing of one or more programs to further the programmatic mission of the participating organizations.

For example, a domestic violence shelter and a rape crisis services organization got together to form and manage a domestic violence offenders program, while continuing to operate their existing organizations and programs independently.

3. Joint Earned Income

Joint earned income is a revenue generation activity that occurs when two or more organizations jointly create an earned income activity. This could include: a combined capital campaign or social entrepreneurial ventures.

4. Joint Advocacy

A Joint advocacy effort occurs when two or more organizations combine their advocacy efforts either on a single issue/time-limited basis or for ongoing advocacy campaigns.

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Four specific types of integrations include:

1. Management Service Organization

A management service organization (MSO) is an integration that includes the creation of a new organization in order to integrate administrative functions, and thus to increase the administrative efficiency of participating organizations.

For example, two mental health centers in Illinois created and jointly govern an MSO that provides administrative support to both organizations, while still allowing both to maintain complete programmatic independence. Through the MSO, the two organizations share a controller, a director of management information systems, a director of revenue development, a director of managed care, and all other financial staff.

2. Joint Venture Corporation

A joint venture corporation is an integration that includes the creation of a new organization to further a specific administrative or programmatic end of two or more organizations. Partner organizations share governance of the new organization.

For example, a child welfare organization in the Midwest initiated a joint venture whose mission is to develop and service client tracking software for human service organizations. The five partners all sit on the joint venture corporation's board, and together have been able to provide the community with a much-needed resource.

3. Parent-Subsidiary Structure

A parent-subsidiary structure is an integration that combines some of the partners' administrative functions and programmatic services. The goal is to increase the administrative efficiency and program quality of one or more organizations through the creation of a new organization(s) or designation of an existing organization(s) ("parent") to oversee administrative functions and programmatic services of other organization(s) ("subsidiary"). Although the visibility and identity of the original organizations often remain intact in a parent-subsidiary relationship, some organizations involved in such restructurings consolidate to the point where they look and function much like a merged organization.

For example, a Boys and Girls Club and a YMCA in Maine formed a parent-subsidiary structure that functions much like a merger, but allows both partners to maintain their corporate structures, and thus their original endowments. Two multipurpose mental health agencies in Ohio, on the other hand, formed a parent-subsidiary structure that preserved more of each organization's programmatic autonomy, while allowing the partners to pursue some programmatic goals together, and providing improved administrative support and financial stability to the subsidiary.

Parent-subsidiary structures are most often utilized when two organizations desire a merger, but cannot accomplish it immediately due to the non-transferability of a license/certification or contract. A parent-subsidiary structure can be put in place until the transferability issues are resolved and the organizations may then proceed with merger.

4. Merger or Acquisition

A merger or acquisition is an integration that includes the integration of all programmatic and administrative functions to increase the administrative efficiency and program impact of one or more organizations. Note: FASB (Financial Accounting Standards Board) requires an “accounting” determination of either a merger or acquisition described below.

A **merger** occurs when two or more organizations are dissolved into a newly created corporation that includes some or all of the resources, administrative infrastructure and programs of the original organizations.

An **acquisition** occurs when one corporation is dissolved (acquired corporation) with all activities and resources transferred into the surviving (acquirer) corporation. The selection of an acquisition form of consolidation does not limit the identity/branding, governance or leadership options of the participating organizations. However the selection of an acquisition form of consolidation does impact the booking of assets within the surviving corporation as outlined by FASB Statement No. 164. An acquisition may also involve formation of a new entity where one participating entity has obtained control of the nonprofit activities or businesses of all participating entities (e.g., by appointing significantly more of the governing board of the newly formed entity, retaining its bylaws and policies, etc.).

Asset Liquidation/Transfer

Asset liquidation occurs when an organization is no longer able to sustain its services. Liquidating organization settles all of its liabilities, closes its nonprofit corporation and then transfers its remaining assets to another nonprofit organization of similar mission. Organizations in this situation need to obtain legal services to help determine the appropriate path to asset liquidation and debt resolution. Asset transfer occurs when an organization determines it cannot or chooses not to continue with a program/service or capital asset. The goal is to transfer these programs/services and/or capital to another organization. Assets and liabilities related to the specific program/services need to be assessed for appropriate disposition, along with appropriate compensation.

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Other Frequently Asked Questions

What is the difference between a merger and a joint venture?

In a merger, two (or more) separate corporations (organizations) come together to form one legal entity. There are several legal ways to implement a merger, but regardless of how it is done, the result is one corporation (organization), not the two (or more) that existed previously.

This is not the case with a joint venture. Two (or more) organizations can establish a joint venture — project, program, organization, etc. — together, and jointly administer and govern it, while still maintaining their own organizational autonomy. With a joint venture, the partnering corporations (organizations) remain separate.

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What is the difference between a Joint Venture and a Parent/Subsidiary structure? Can a 501(c)(3) organization strategically restructure with subordinates (adopt identical mission statement) and still gain the support from the grantees; collaboration or strategic restructuring?

A joint venture is an alliance in which the primary focus is the sharing of both programmatic and administrative capacities between two or more independent organizations--often around a specific initiative or project. This type of alliance involves a commitment to continue for the foreseeable future, shared or transferred decision-making power, and some type of formal agreement (it need not be a legal contract.)

When a joint venture leads to the establishment of a new organization, that new organization is often set up as a subsidiary of the founding organization(s). The parent/subsidiary model implies that the parent organization(s) have some degree of control over the governance of the subsidiary organization - the subsidiary is not completely independent. The parent may appoint the board of the subsidiary, or representatives from the founding (parent) organizations(s) may make up the board in its entirety. The

subsidiary organization can be set up as a membership corporation, with the parent(s) as sole member(s).

Parent/subsidiary structures can form as a result of other motivations as well. Sometimes a single organization wants to pursue an activity outside of its own organizational structure, but still maintain overall control over that activity. This can also lead to the establishment of a parent/subsidiary relationship. An example might be a large nonprofit with very solid administrative abilities and excess capacity. It might decide to set up a separate organization to provide administrative services to other nonprofits - an MSO, in other words. It could do this on its own, or in partnership with one or more other organizations. In either case, it would set itself up as the parent - perhaps along with its partners, perhaps not - and the new corporation, the mission of which is to provide administrative services to other nonprofits, as the subsidiary.

There are also times when two organizations wish to merge, but some legal or financial reason makes a legal merger unwise. They may choose to set themselves up as parent and subsidiary instead.

It is possible to restructure with subsidiaries or other organizations with identical mission statements, and still gain the support of funders, donors, and clients. Yes, it is possible. This is a question every organization should ask itself as part of the initial assessment process, however. If the strategic restructuring effort is being pursued for the right reasons, i.e. is mission-driven and will allow the organizations to pursue their missions in a more efficient, effective manner, it will most likely be supported by the constituents. You will need to communicate the rationale and benefits clearly, however, and be ready to answer questions and address concerns throughout the process.

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What is the difference between fiscal sponsor relationship and parent/subsidiary relationship?

Fiscal sponsorship is when an organization with 501(c)3 status allows an organization, group, or individual that does not have a 501(c)3 to operate some or all of its activities under the umbrella of its 501(c)3. Most often the sponsored organization, group, or individual wants to receive financial support from a private foundation or government entity, or tax-deductible donations from individuals or corporations.

A parent-subsidiary structure is an integration of organizations that combines some of the partners' administrative functions and programmatic services. The goal is to increase the administrative efficiency and program quality of one or more organizations through the creation of a new organization or designation of an existing organization ("parent") to oversee administrative functions and programmatic services of another organization ("subsidiary"). Although the visibility and identity of the original organizations often remain intact in a parent-subsidiary relationship, some organizations involved in such restructurings consolidate to the point where they look and function much like a merged organization.

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In a parent-subsidiary restructuring, does one entity lose their 501(C)(3) status?

No, both parties can continue to be tax exempt. Parent-subsidiary only refers to the governance structure. The "subsidiary" makes the "parent" its only member, thus giving it control of key functions, such as electing its board.

For more information on parent-subsidiaries, you may want to review our national research study, which includes 2 profiles of p-s case studies. It can be downloaded from **http://www.lapiana.org/research/nationalstudy.html**.

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Can an organization be part of a parent /subsidiary relationsip with out having the parent being in control of its board?

The parent organization, as the sole member of the subsidiary organization, elects the subsidiary's board at the latter's annual meeting. When electing the board, the parent has, essentially, four choices:

1. It may elect its own entire board as the subsidiary board.
2. It may elect a subset of its board to serve as the subsidiary's board if it wishes the subsidiary to have a smaller board.
3. It may choose a group of non-board members - for example, its senior managers - to serve as the subsidiary's board.
4. It may elect some representatives by either method 2 or 3 above, and then allow that core

board to freely choose some number of additional board members. (In this case, it is important that every board member, however recruited, understands that the parent organization's board ultimately elects him or her.)

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What is the difference between an affiliate organization and a chapter?

There are no hard-and-fast definitions for these terms in the nonprofit sector, and different nonprofits use the terms differently. If you were to look them up in a dictionary you would find that "chapter" means local branch of some association and "affiliate" mean a subsidiary or subordinate organization that is affiliated with another organization . In practice, one organization's relationship with its "chapters" might look very much like a second organization's relationship with its "affiliates" – and/or very different from a third organization's relationship with its "chapters." In general, however, we have found that "chapters" tend be a bit more centrally controlled or regulated than "affiliates."

The key attributes of such relationships include the degree of local autonomy enjoyed by the affiliates/chapters, and the types of services provided by the national organization to its affiliates/chapters. In addition, there are differences with regard to governance structures; the degree to which national organizations set standards for and regulate their affiliates/chapters; how funds, fees and financial accountability are distributed between the entities; and what happens when affiliates/chapters cease to be affiliates/chapters.

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When an organization begins the process of setting up or chartering chapters, what type of agreement should be established between the founding organization and the chapter(s)? Is it a common practice for a central or founding organization to charge fees of the chapters? What is the advantage or disadvantage of a non-profit public benefit organization 501(C)(3) filing for a group ruling?

It is quite common, and certainly advisable, for an organization that is setting up chapters (also known as affiliates, members, councils, sites, or franchised areas) to implement a formal agreement with those chapters. This type of agreement is often known as an affiliation agreement. It defines the relationship, identifies what type and level of control or influence each party has on the other, and offers protection for mutual assets, such as the name (if it is shared) or reputation. Some organizations structure their agreements in two parts - the chapters' responsibilities and commitments to the central/founding organization, and the central/founding organization's responsibilities and commitments to the chapters. You do not need to set up a Parent/Subsidiary structure to implement this type of relationship, though some organizations may do that. More commonly, the affiliation agreement defines and provides the accountability in the relationship. Each party is expected to abide by the terms of the agreement, and there is typically a section in it that defines some sort of periodic evaluation, review, or "check in" process to ensure that this is the case, and that the common goals and mission are being best served.

The fee structure you describe is also common in this type of arrangement. We have done some research on this, and found that the most common means of charging dues or fees is through a percent of revenue, percent of expenses, or percent of overall budget formula. We have seen numbers ranging from 0.5% to 10% here, though understand that there are organizations that charge more than this. In return for these fees, the central/founding organization is providing the value inherent in its name, reputation, and marketing efforts, as well as some level of support or assistance to its chapters or affiliates. Some organizations decrease the percentage charged as the revenue of the chapter goes up - an effect opposite to that of the progressive income tax in the United States. Others charge a flat fee, though this works better if all of the chapters or affiliates are around the same size. If not, fairness issues could arise.

According to the IRS, a central organization that is tax exempt under IRC 501(c) may obtain recognition of exemption, on a group basis, for subordinate organizations that are under its general supervision or control. The purpose of the group exemption is to relieve subordinate organizations from filing their own exemption applications. To be included in the group exemption letter, each subordinate organization must authorize the central organization in writing. After the initial exception is granted, a central organization may file, in addition to its own annual information return, a group return on behalf of two or more of its subordinate organizations covered by a group exemption letter, as long as certain conditions are met. These conditions relate to issues of supervision and control, each organization's fiscal year, information flow between the central organization and the subordinates, etc. Group rulings and group filings can make the work of the subordinate organizations somewhat less onerous, but they do require the subordinate organizations to be under the "general supervision or control" of the central organization. Such control would have to go beyond an affiliation agreement, and involve some sort of legal parent/subsidiary structure. More information on group rulings can be found on the IRS web

page, at **http://www.irs.ustreas.gov/prod/bus_info/tax_pro/irmpart/section/27772.html**

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Have you ever come across the situation of a non-profit acquiring a for-profit S-Corporation? We are in negotiations now to do so. Any advice? Things to watch out for? Legal issues?

Nonprofit organizations are not prohibited from acquiring for-profit entities. This is in fact simpler than a situation in which a business wishes to acquire a nonprofit. As with any major transaction, care and thought must be used to protect the organization's interests. Things to watch out for include:

1. Are there any relationships between individuals connected with the two parties to the transaction (e.g. a nonprofit board or staff member who works for the for-profit company, is an investor in it, is related to someone at it, etc.)? Ideally you want this transaction to be between two completely unrelated entities. If it is not, you have a potential conflict of interest that needs to be openly addressed by the nonprofit's board, prior to any deal being made.
2. Is the purchase price fair? Nonprofit boards have a responsibility not to make wild acquisitions or to enter high-risk ventures with their tax-exempt revenues.
3. Have you performed due diligence? Do you know what you are buying, and any downsides to the transaction?
4. Be aware that, depending upon the type of business being acquired, it may subject the nonprofit to Unrelated Business Income Tax (UBIT). Any activity that is not directly related to the nonprofit's exempt purpose opens up the possibility of UBIT.
5. Consult an attorney before executing any agreements. Legal advice is required to ensure that you are protecting the organization's assets and reputation, and are aware of all of the tax implications of your particular transaction.

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