The Center on Philanthropy & Public Policy

WHY DO NONPROFITS MERGE?

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Introduction

As the nonprofit sector has grown and become increasingly recognized as a significant component of a three-sector economy, there has been a heightened interest in applying business principles to an array of issues of nonprofit strategy and management. This is particularly challenging for nonprofit organizations that are distinctive from public and for-profit agencies not only in their legal form, but in the nature of their services, the heterogeneity of their missions and objectives, and their funding streams.

Some nonprofit organizations have maintained a distinct legal form, but have increasingly come to resemble either a public agency or a for-profit firm, as they have become heavily, if not exclusively, reliant on public funds or fees for service, respectively. In these instances, the standard application of public or business management principles will be easily transferred to the strategy and management challenges that these types of organizations face. However, the more interesting question is how management principles apply to those nonprofit organizations that have qualities that make them distinctive – with missions of broad public purpose and substantial philanthropic support.

Such nonprofit organizations are confronted with important strategic choices in an increasingly competitive funding environment. The growth rate in the number of nonprofit organizations far exceeds the growth of philanthropic dollars. Thus nonprofits in search of public funding face increasing competition from their nonprofit counterparts. Nonprofits that seek out commercial activities or begin to charge fees for services may also encounter competition from business firms. This competition has been amplified by governments who have reduced barriers to for-profit entry into new service arenas such as social services. For the nonprofit organization facing such an environment, there is an increased threat to its mission and its survival. One potentially effective response to this changing environment is for two or more like-minded nonprofit organizations to merge and create a new organization better positioned to adapt, respond, and succeed under changing market conditions.

In this paper we examine the factors that lead nonprofit organizations with a public mission and a significant philanthropic dimension to merge. We begin with the development of a conceptual model that adapts the standard motivations for such a strategy in the business sector to the nonprofit context. We then examine three cases of recent mergers among community foundations, women's foundations, and public television stations, and analyze the lessons from these cases in understanding the application of business merger principles to nonprofit strategy and management.

The Decision to Merge

Considerable attention has been paid over the past two decades to the potential advantages of strategic partnerships among organizations. Business organizations were leaders in the formation of strategic alliances, and their phenomenal growth, despite high formation and maintenance costs, is a testament to their perceived value by these organizations. Recently we have seen an explosion of interest in formal alliances among nonprofit organizations (Golensky and DeRuiter, 1999; Kohm and La Piana, 2003; Pietroburgo and Wernet, 2004; Guo and Acar, 2005). These partnerships can take a variety of forms along a continuum, ranging from simple market-based contracts through equity and non-equity alliances to mergers (Graddy and Ferris, 2007). Movement along this continuum involves increasing integration of decision making and shared resources.

Some organizations carry the integration to its highest level and create a new merged organization from the component partners. Mergers are relatively common among business organizations. In that sector, they are primarily driven by efforts to either lower costs or expand market share. Enhancing the competitive position of the partner organizations is the primary motivation – and a powerful one. Vertical mergers offer cost savings by combining firms operating at different stages of the production process (e.g., an input provider and output distributor). Such mergers allow firms to take advantage of technological interdependencies at different stages of production and to reduce the costs and potential supply disruptions that are associated with using markets for backward or forward stages of the production processes. Horizontal mergers enhance market share by combining organizations that compete (i.e., offer the same product or service in the same market) with one another. The associated increase in market power from a horizontal merger can enable the new firm to charge higher prices, increase buyer power over suppliers, and deter entry or eliminate potential competitors. These mergers, however, also offer the promise of efficiency gains by realized economies of scale, access to patent rights or technical expertise that allow inefficient techniques to be abandoned, or access to better managers who may operate the new firm more efficiently.

Nonprofit organizations operate in a different environment, both in terms of their markets and their incentives for efficiency. For many nonprofits, mergers do not offer such obvious advantages. Those that do not face competition from for-profits may not have strong incentives to reduce costs. Some provide services that are not traded in the market, making it difficult to measure the efficiency of outputs. For many services, there may be few economies to be gained from a larger scale of production. Therefore, in the nonprofit sector, the rationale and consequences of mergers are likely to be different in important ways from that of for-profit organizations.

Here, we seek to understand why nonprofit organizations merge. What are the primary motivations for two autonomous organizations to take the risky step of combining into a single organization – integrating their leadership, boards, and staff and pooling their resources and operations? More precisely, we seek to understand the perceived benefits associated with nonprofit mergers over and above those that could be achieved from less-integrative partnerships.

Partnerships and alliances, short of mergers, can generate considerable benefits for the participating organizations. They can share resources, including staff expertise and competencies, which would allow organizations access to expertise they do not possess, but that would enhance their ability to achieve their mission and serve their clients. They can gain associational advantages; the legitimacy of an organization can be enhanced by an alliance with a well-respected, well-connected partner. This enhanced legitimacy can increase the organization's success in gaining future funding (Graddy and Chen, 2006). Therefore, the decision to merge must involve benefits that go beyond these.

The combining of two production processes and two managerial structures offers the opportunity to increase efficiency, to increase effectiveness, and to reduce uncertainty. Some of the advantages are simply the result of increased size. Organizations with greater resources are better able to absorb environmental shocks, exercise control over prices, and produce a wider range of services. Other advantages result from the specific benefits associated with the merging organization – reputation and expertise advantages that improve the effectiveness of the new merged organization.[2]

The most often cited advantage of nonprofit mergers is the potential for increased efficiency (Kohm and La Piana, 2003). There are three primary sources of potential cost savings – economies of scale and/or scope, decreased administrative costs, and increased buying power. Combining operations allows the new organization to spread the fixed costs of production over a larger number of services, thus reducing the unit costs of production (economies of scale). Similarly, combining the oversight and delivery of complementary programs may allow some costs to be spread over multiple programs (economies of scope). In both cases, duplicated staff functions and associated costs are eliminated. Administrative costs are also important candidates for scale reductions. Duplicated grant writing or grantmaking costs, for example, can be eliminated with the merger. Administrative costs associated with advocacy functions can also be reduced as resources are combined– especially if the former organizations were small. For community foundations, donor-advised funds in particular have high administrative costs. Spreading these costs over more funds would allow these foundations to be more competitive in a market that includes large for-profit competitors. Finally, increased size may also yield increased control over the pricing of inputs. This increased buying power has been a primary motivation for vertical mergers in the healthcare industry (Judge and Ryman, 2001).

A second potential benefit of nonprofit mergers is increased effectiveness. The primary avenue for such gains is the expertise gained from the merger. Mergers could bring staff expertise that allows the offering of a broader range of services, new and innovative approaches to functions, and the opportunity for increased integration of service delivery, all of which may improve the quality of outputs produced. Mergers also provide access to unique managerial effectiveness. Superior managerial skills are particularly attractive

[2] These benefits can also accrue to mergers between nonprofit and for-profit organizations, though in such instances, there may be additional benefits from the change in organization form. For example, a change from nonprofit to for-profit legal status can provide access to capital.

in the nonprofit sector, where there is a perception that skilled, experienced nonprofit executives are in short supply (Kohm and La Piana, 2003). Mergers thus provide a means for an under-performing organization to gain access to a specific visionary and effective leader.

Finally, mergers can offer increased stability in an uncertain environment. Nonprofits often face considerable uncertainty about their funding streams. Mergers can provide stability by expanding the donor base and by decreasing competition for limited resources. Organizations can also improve their relative position by merging with a more-respected partner – enhancing the likelihood of support with funders and donors. Together, these changes may yield a more predictable funding stream.

There are, however, considerable costs associated with mergers. Many are unsuccessful. The most important concerns include loss of autonomy or identity, the substantial transition costs associated with merging, and the serious difficulties associated with trying to integrate different organizational cultures – employees, managers, and boards. The ability to manage culture and mission conflicts, in particular, may be decisive in determining whether a merger is successful (Haider, 2004) or unsuccessful (Bubis and Windmueller, 2005). Given the nature of these costs, there is a tendency to underestimate the costs of merging, while perhaps overstating the gains to merging. There is, thus, a substantial risk that the new organization will fail to realize the expected benefits.

Faced with this risk, what motivates nonprofit to merge? In the business sector, competition and the profit motive are powerful incentives for mergers that are expected to enhance one's competitive position. But, nonprofit organizations face less competition than their for-profit counterparts, at least traditionally, and less managerial pressures to achieve efficiencies. In the absence of strong internal motivations for managerial efficiency, what would motivate a nonprofit to voluntarily give up its autonomy? An environmental shock – especially one that can threaten the very survival of nonprofit organizations – is the most likely candidate. The often small scale of nonprofit organizations and their limited funding sources make these organizations particularly vulnerable to uncertainty in their environment.

Environmental uncertainty can be generated in a variety of ways, but there are three major triggers that are relevant to nonprofit mergers – changes in funder behavior, increased market competition, and broader changes in the external environment. A great challenge for many nonprofits is their dependency on a small number of funders. This resource dependency makes an organization particularly susceptible to changes in the behavior of a funder, or efforts by a funder to change the organization's structure. A major funder may lose interest in a particular issue. For example, changes in strategic direction or the adoption of new initiatives by foundations can pose a serious threat to nonprofits that are heavily dependent on a handful of foundations for funding. Similarly, a change in public funding from supply side subsidies to demand side subsidies is a major shock to nonprofits dependent on public funding (Gronbjerg and Salamon, 2002). Such changes in funder behavior increase the competition for the remaining funding sources and the need for strategic mergers. Donors and funders may also become concerned about inefficiencies associated with small scale organizations, and encourage mergers to achieve the efficiency advantages noted above, either through grants for the transition or providing technical assistance. It would be difficult for an organization dependent on such funders to resist these efforts – regardless of the perceived disadvantages of merging.

Second, nonprofits in many service contexts have seen a growth in competition – particularly from for-profit firms. For-profit competition has long been important in the healthcare market where nonprofit and for-profit organizations have competed for decades, but many more nonprofits are now facing direct competition from businesses. The Welfare Act of 1996 encouraged the expansion of the for-profit sector into several social service industries that they had not previously entered, radically changing these markets for nonprofit organizations (Gronbjerg and Salamon, 2002). Finally, community foundations have also faced increasing competition with for-profit organizations for the provision of donor services (Graddy and Morgan, 2006). This trend of increasing direct competition between nonprofit and for-profit organizations more closely aligns the incentives of managers in both sectors, and makes it more likely that leaders of nonprofit organizations will consider mergers that are believed to improve their competitive position. For example, Golensky and DeRuiter (1999) found that competition from a managed healthcare system prompted five small social service agencies in Michigan to merge.

Finally, mergers may be prompted by broader changes in society. For example, economic business cycles that reduce donor assets often threaten the viability of small nonprofits if foundation grantmaking budgets fall. Technological changes in an industry may affect the cost structure of a service and necessitate larger scale production or the need to access to capital. Finally, industry changes may be prompted or facilitated by changes in the legislative or regulatory environment. For example, the previously cited welfare reform legislation allowed local governments to choose for-profit providers of social services, dramatically changing the supply market for job training and other welfare services and ultimately the competition between nonprofits and for-profits.

In response to any of these triggers, financially vulnerable organizations are more likely to respond by exploring the radical restructuring possibilities associated with merging because their survival depends on strategic action. Some organizations, however, will be in a better position than others to seriously consider mergers. Those that have successful existing relationships with other organizations have partners with whom they have developed trust and effective working relationships. Such partners are good candidates for further integration. In addition, boards with more linkages with other nonprofits enhance the likelihood of collaboration (Guo and Acar 2005), and thus these boards may be more willing to consider mergers.

This discussion suggests that nonprofit mergers are likely to be influenced by a complex set of organizational, market, and societal factors. We summarize our major hypotheses here:

- Organizations that are in a vulnerable strategic position, with respect to solvency, liquidity, or relative performance, are more likely to consider a merger.
- Larger organizations have the capacity to absorb the substantial transitional costs associated with restructuring, but smaller organizations may have a greater need for the expected benefits. Small organizations, however, have greater vulnerability around loss of identity. Therefore, although organizational size is expected to be important, its effects are difficult to predict.
- Organizations that have strong networks and those with experience with less integrative partnerships, have more knowledge about potential merger partners and thus are more likely to merge.
- Increases in for-profit competition are expected to increase the likelihood that nonprofit managers will consider mergers.
- Decreases in funding streams increase the likelihood that nonprofits will try to improve their relative position in accessing available funds. For example, advocacy organizations for which there are only a few viable funding sources or strong competition for the same donors in a community are more likely to consider mergers.

In the next section, we explore these hypotheses through the analysis of three recent cases of nonprofit mergers in California. Since the organizations chose to merge in all three cases, we expect to see evidence of a response to some environmental uncertainty as a primary motivation for the mergers. We seek to explore how the motivations for the mergers varied and how they interacted with each unique organizational, market, and societal context. The richness of the case details should provide considerable insight into our understanding of the complexity of the merger decision for nonprofit organizations.

Three Case Studies

We have chosen three cases with which to explore the decision to merge in the nonprofit sector: a new community foundation – the Silicon Valley Community Foundation; a new women's foundation – The Women's Foundation of California; and a new public television corporation – Northern California Public Television.

These three mergers occurred over the past four years. Their recent vintage facilitates our examination of the environmental forces at work that encourage mergers, as well as the rationales and motivations of the antecedent organizations, which is our primary purpose here. Our ability to capture evidence of the motivations for mergers as they unfold is critical since it is difficult to fully appreciate these influences after considerable time has elapsed from the original decision. Consequently, we will not be able to evaluate whether the mergers actually accomplished their intended objectives since assessing the success of such organizational changes requires a longer time frame and would in any case merit an analysis of its own.

These three cases are of particular interest to our inquiry because the philanthropic dimension of each organization and their respective "industry" is significant within the nonprofit sector. The first two cases involve public grantmaking charities – nonprofits which are focused on both raising philanthropic dollars and making grants to benefit the community. The third is focused to a significant degree on philanthropic fundraising to deliver a public good – non-commercial radio and television programming. Recall that we focus on these types of nonprofit organizations because nonprofits that have become heavily dependent on public funding or commercial activities are presumably more likely to closely mirror their counterparts from government or business, and the application of strategic principles from public or business management should be fairly straightforward. Our focus on nonprofits with missions of broad public purpose and substantial philanthropic support should enable us to isolate distinctive nonprofit approaches to the strategic decision to merge.

The case studies were developed based on interviews with key informants both within the organizations and in the broader industries, and an extensive review of publicly-available documents and sources. We now consider each case in turn.

Silicon Valley Community Foundation

The Silicon Valley Community Foundation (SVCF) was recently created from the merger of two pre-existing community foundations of considerable scale, and increasingly overlapping service areas and philanthropic markets – the Community Foundation Silicon Valley (CFSV) and the Peninsula Community Foundation (PCF). The merger, outlined in a Memorandum of Understanding signed by the CEO's of the merging organizations in 2006, was approved by state and federal agencies and went into effect January 1, 2007.

Community foundations are increasingly important in the philanthropic landscape. An innovation in philanthropy in the early part of this century, community foundations serve as vehicles for generating philanthropic contributions from the community to be directed to the community's most pressing needs. In recent years, community foundations have seen significant growth as a result of the increasing popularity of donor advised funds, which enable individuals to direct their giving and time the associated tax benefits.

The two merging community foundations are among the most dynamic community foundations in the United States. Each experienced robust growth as wealth was created by the high tech and venture capital industries located in their "backyard" -- the Bay area-Silicon Valley corridor. With effective leadership, each foundation was able to capture the imagination of local wealth holders, while simultaneously responding to the pressing needs of their communities.

Founded in 1954 and headquartered in San Jose, California, the CFSV traditionally focused on issues relevant to greater Santa Clara County and, specifically, on urban issues relevant to the greater San Jose metropolitan area. Located in the heart of the Silicon Valley, the foundation's innovative culture was a product of the inventive, high-tech community it served. It was a leader in providing mechanisms to facilitate the creation of funds for high tech entrepreneurs and corporations. As a result, the majority of CFSV's assets are held in donor-advised funds and supporting foundations. In 2006, the CFSV had assets of $919 million, $19 million of which were unrestricted; it made grants of $101 million.

The Peninsula Community Foundation (PCF) founded in 1964 and headquartered just 30 miles north of CFSV, traditionally focused on issues of concern to greater San Mateo County. While the high tech industry extends into San Mateo, the PCF had a more diverse funding base, including a relatively large unrestricted endowment, which enabled it to be more traditional in its fundraising and grantmaking approaches. PCF had assets of $630 million, $125 of which was unrestricted, in 2006; it made grants of $92 million.

The challenges faced by the two community foundations included a changing industry environment, with the growth of alternative vehicles for donor advised funds, the increasingly blurred boundaries between their two, once distinct, communities, and the consequences of the slowing economy that followed the high-tech bust of 2001.

Community foundations do not have a monopoly on donor advised funds.[3] Large national financial institutions, beginning with Fidelity in 1991, created their own philanthropic funds to make donor advised funds available to their clients. Yet, the economic boom of the 1990s provided ample opportunities for both these national funds and local community foundations to grow in size by attracting donations through donor advised funds. Recent studies, however, show that these funds can be costly and cumbersome for community foundations to administer. With the slowdown in giving in the early 2000s,[4] some of these operational problems have become evident. Many community foundations were ill-prepared for the sudden change in economic conditions after the economic boom ended, forcing them to reassess organizational strategies (Bernholz, Fulton, and Kasper, 2005).

In addition, the communities that these two foundations serve have become blurred as they grow towards each other in an increasingly urbanized region. The map below demonstrates the distinction between San Mateo and Santa Clara counties, the two primary geographic regions served by PCF and CFSV, respectively. While Santa Clara is larger geographically and dominated by urban areas surrounding San Jose in its northwest corner, San Mateo County is smaller in size with smaller cities lining its northeast bay front region. Over time with growing urbanization in the region, the communities have become less distinct, and the areas served by PCF and CFSV increasingly overlapped.

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[3] Donor advised funds are among the fastest growing segments of philanthropy, with a 25 percent growth between 2005 and 2006 in contributions to these funds in community foundations, financial institutions, and nonprofits (Barton and Panepento, 2007).

[4] In 2001, charitable giving declined nationally for the first time since 1994, falling from $243 billion in 2000 to $238 billion in 2001. In the years since, charitable giving has grown, but has yet to match the double-digit growth rate experienced during the technology boom of the 1990's (Ferris, Graddy, and Ferree, 2006).

Thus, there was duplication of effort in grantmaking, as well as increased competition for philanthropic funds.

Community foundation mergers are rare. It is much more common to see a long established community foundation spin off community funds for emerging areas as they grow in capacity, rather than to see two well-established and successful foundations merge. So what were the motivations for this merger? Based on interviews with key informants as well as documentary sources, including press releases and media coverage, the apparent motivation for the merger was strategic positioning in an increasing competitive industry and a growing region.

Both organizations saw the merger as an opportunity to create a stronger foundation to serve San Mateo and Santa Clara counties. With the establishment of the Silicon Valley Community Foundation, there will be an opportunity to reduce unnecessary competition for donations in an increasingly competitive philanthropic market, accentuated by the uncertainty of proposed changes in federal incentives for giving.[5] This is especially important to the extent that donors in the community see the commercial funds, with their lower costs, as an attractive alternative for their philanthropic pursuits, presumably because they do not value the community-specific resources that community foundations provide.

[5] Recently proposed legislation to regulate donor-advised funds would negatively impact the ability of community foundations to compete for philanthropic dollars by subjecting them to the same regulations as private foundations. Moreover, ongoing discussions about the permanent repeal of the estate tax continue to generate uncertainty in the fundraising community, in particular around planned giving which has traditionally been the source of endowments for community foundations.

Another critical motivation for the merger was the expanded capacity for regional leadership. Sustained growth has unified the region in important ways and many issues are no longer easily contained within traditional county borders. And, while it is true that the distinctions between Santa Clara and San Mateo Counties are decreasing in importance, some differences between the communities remain, and the existing community foundations were not well positioned to deal with issues beyond their borders. The SVCF with a unified voice will have the ability to quickly take leadership roles in advancing important regional policy issues. In addition, the larger community foundation should be able to better serve both donors and nonprofits, thus increasing its positive impact on the community.

In addition to strategic positioning, there is the potential benefit of scale economies in the operations of the new foundation. Specifically, the merging of these two organizations is expected to reduce duplicate expenditures, such as redundant staff, and allow for capital improvements, such as the purchase of costly information technology and investment management capital upgrades.

Of course, the merger is not without risks. Conversations with community foundation leaders and stakeholders suggest both short-term and long-term risks. In the near future, there is concern over the successful integration of the two organizations' very different cultures, especially given the rate at which the merger occurred, and the ability to assure stakeholders throughout the new service areas that there will be continued high level donor services and responsive grantmaking. Over the long haul, the ultimate success of the merger will need to be judged by its ability to compete for philanthropic dollars, serve the needs of the communities that comprise the foundation's service area, and provide leadership in addressing the region's critical issues.

The Women's Foundation of California

The Women's Foundation of San Francisco (TWF) and the Los Angeles Women's Foundation (LAWF) joined together to form The Women's Foundation of California (TWFC) in 2003. The original foundations were created in 1981 and 1985, respectively, at a time when identity-based funds were emerging in communities to focus on particular segments of the population. These funds are public grantmaking charities; they raise funds in order to make grants targeted to their chosen population subgroup. In this case, the mission was to address issues of critical importance to women.

The emergence of women's foundations was a legacy of the feminist movement, and the perception that institutional philanthropy did not adequately address issues affecting women and girls. The founding of the Ms. Foundation in 1972 provided a model for the development of women's foundations. By 1985 there were 35 in communities throughout the United States and over 90 by the end of the decade. As women have become successful in their own professional and social life, they have been able to direct significant philanthropic dollars to women foundations and women's causes. Yet toward the end of the 1990s, some of the women's foundations were no longer thriving.

Changing views of women as donors, expanded roles for women in more traditional philanthropy, as well as increases in the net worth of women, have increased the competition for women's philanthropic resources. In addition, private foundation support for such funds waned as they moved on to seed other institutions and programs.

While the two California women's foundations were both focused on women's issues, they had quite different strategies, tactics, and funding streams – and their fates were different. The San Francisco foundation adopted a policy advocacy focus that promoted social justice. It emerged as a highly visible organization with significant funding from women in the San Francisco community. In contrast, the Los Angeles foundation pursued a strategy of funding direct services. It depended heavily on foundation funding, and did not develop a loyal individual donor base. TWF thrived, while LAWF struggled in the period leading up to the 2003 merger.

As the two organizations contemplated a merger, each party had different motivations reflecting their relative positions. LAWF had decided that it could not survive as an independent organization. It considered becoming a fund in the California Community Foundation, or merging with another public grantmaking charity – either the Liberty Hill Foundation, a Los Angeles-based social justice foundation, or TWF. The first option was the least attractive; it would be a mechanism to shut down the organization gracefully, preserving the endowment and protecting the interest of donors. The other two options offered the potential to continue the work of LAWF in Los Angeles through another organization that shared its values, if not its specific focus or mission.[6] Ultimately, LAWF chose to merge with their counterpart in San Francisco, with whom they shared a long history as members of the Women's Funding Network.[7]

TWF and LAWF had collaborated in the past when there were issues of mutual interest, such as a state-wide women's health initiative. TWF had even made overtures earlier about a stronger statewide alliance or merger. Given TWF's advocacy focus, a broader geographic base would enhance its capacity to address women's issues at the state level. LAWF demurred, wanting to maintain its regional, service delivery focus. Thus, TWF was favorably predisposed to consider a merger with LAWF once the Los Angeles foundation decided to pursue merger partners.

The goals and objectives of the two organizations were divergent in some aspects and congruent in others. Most importantly, the LAWF was hoping to simply survive. The merger brought hopes for increased efficiency, increased funding, and increased grantmaking. TWF was not in financial trouble; the merger was an opportunity to realize its objective of an expanded scope of activities and a statewide platform. It allowed them

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[6] The Liberty Hill Foundation was an attractive partner because it had a similar culture, but the foundation is not focused on women. Liberty Hill declined, citing that they, too, were downsizing. It was the CEO of Liberty Hill who suggested TWF to the LAWF.

[7] TWF also served as LAWF's fiscal sponsor at its inception. Before LAWF was incorporated, the ARCO foundation gave it a large matching grant, which TWF agreed to sponsor without any fees. This early money and support helped the LAWF get started.

to cover the entire state without creating conflict with their southern California counterpart.[8] Finally, the merger also offered possible scale economies.

This merger, however, was fraught with risks – cultural, ideological, and financial. There were stark contrasts between the two regional foundations. Although they were of relatively similar vintage, their evolution and their strategic choices resulted in two different types of women's foundations with considerable variation in organizational capacity, strength, and success. Moreover, the geographic distance (400 miles) and the differences in the philanthropic communities of the greater San Francisco Bay Area and Los Angeles only complicated the acceptance of a single statewide women's foundation. Stakeholders in southern California, in particular, had reason to worry about the dominance of the stronger pre-existing organization, though the dissolution of the two existing boards and the creation of a new board with new recruits helped to mitigate this concern. In addition, there were financial risks to the new organization given the fiscal position of the Los Angeles foundation and the new merger-associated costs of travel and technology necessary to overcome the distance between the two offices.[9]

Northern California Public Broadcasting

On May 2, 2006, KQED, Inc. of San Francisco and the KTEH Foundation of San Jose announced their intent to merge and create Northern California Public Broadcasting (NCPB). The merging organizations continue to operate under their own identities and provide their local communities with regularly scheduled television and radio programming and services. With the merger, which was approved by the Federal Communications Commission in October 2006, NCPB became the most watched public television broadcaster and the second-most listened-to public radio broadcaster in the United States.

The public broadcasting industry began early in the 1900s when several universities began operating radio stations that focused on educational programs. The industry, as we know it today, can be traced to the creation by federal legislation in 1967 of the Corporation for Public Broadcasting (CPB). This private, nonprofit corporation promotes public telecommunications services, including television, radio, and, more recently, online programming, and is funded through annual appropriations. CPB is the largest single source of funding for public television and radio programming in the United States, investing in more than 1,000 local radio and television stations, as well as in the development of diverse and innovative education and cultural programming. In 1969, the Public Broadcasting Service (PBS) was founded as a nonprofit organization. It is a membership organization that oversees program acquisition and provides program

[8] Years before, an agreement between the two organizations defined TWF's reach as the 52 counties of Northern California, while leaving the six counties of Southern California to the LAWF. LAWF did little work outside of Los Angeles, and TWF was eager to increase their coverage in the state.

[9] The merger agreement stipulated that a physical presence must be maintained in Los Angeles, but the TWFC had to work to ensure that those in the Los Angeles office felt included and the office was not overshadowed by the much larger San Francisco office.

distribution and promotion; education services; new media ventures; fundraising support; engineering and technology development; and video marketing programming and related services to 168 noncommercial licensees that operate 354 member televisions stations serving the United States and its territories.

CPB awards grants to both PBS to create programs and to local public broadcasting television stations for the creation of local programming and the purchase of content from PBS. The local grants are based on a complicated formula, including factors such as the station's market size (audience), the amount of nonfederal financial support – philanthropic donors, member contributions, corporate sponsors, and other underwriters – and differentiation of program services from stations that serve the same market.

The two merging PBS stations are located in the San Francisco Bay Area. KQED Public Broadcasting, a nonprofit corporation, was founded in 1954 and is one of the nation's flagship public broadcasting stations. It is a multi-media organization, with a mission to "provide the people of Northern California with consistently high-quality, noncommercial media that inform, educate and entertain." KQED is consistently one of the most watched public television stations in the United States, reaching 48 million viewers each month, as well as one of the most listened-to public radio stations in the country, reaching almost 800 thousand listeners each week. It has an annual budget of $47 million, approximately 190,000 members, and a staff of almost 250.

The KTEH Foundation, a nonprofit corporation, was founded in 1964 to provide on-air television programming and outreach services to 14 Northern California counties. It currently has an estimated audience of 1.8 million weekly viewers, offering programs to the San Jose-San Francisco-Oakland viewing area on KTEH and Santa Cruz, Monterey, and Salinas Counties on KCAH. Its mission is quite similar to KQED's – to provide "high-quality on-air programming and support services in the community which educate, inform, entertain, and culturally enrich its multicultural pre-school through adult audiences, assisting them in making decisions on issues which affect their lives." KTEH has an annual budget of $8 million, 39,000 members, and a staff of almost 40.

While the two stations had previously collaborated in sharing programming content, (e.g., KQED shared the rights of PBS news programming with KTEH, while KTEH shared the rights of BBC programming with KQED), the organizations competed in the same market for viewers and members, and to some extent, for donors and underwriters. KQED was the main carrier of PBS content and captured 80 percent of the public television audience, while KTEH, due to its much smaller size, carried just 40 percent of PBS content and shared the remaining 20 percent of the market with two other stations, including KCAH, which is operated by KTEH, and a small community college station. There was a significant overlap of signals, and through cable television, many viewers in Northern California have access to both KQED and KTEH.

The challenges facing these two public television stations result from a number of important changes in the industry over the past two decades, including rapidly changing technology and the federal mandate to convert the nation's television system from analog to digital transmission,[10] increasing competition from commercial television with the advent of cable television and various channels offering similar educational, scientific and cultural programming, and efficiency-oriented incentives from the CPB to increase collaboration and consolidation within markets.[11] The cumulative impact of these forces has been to fundamentally alter the economics of public television stations. At the same time, membership decline, limited growth in fundraising productivity, and an increasingly competitive market for philanthropic dollars suggested little likelihood that philanthropic contributions could accommodate this changing financial landscape. Evidence that the conditions for industry restructuring had been created is the merger of two New York City public television stations in 2002.

The main goal of the partner organizations in the creation of Northern California Public Broadcasting was to strengthen the long-term fiscal health of both stations and to better serve the public through expanded programming and services. The merger was expected to save approximately $1 million a year in operating costs by allowing the new organization to buy more PBS content for less, as a result of increased negotiating power (greater market coverage), and of shared "back office" resources. For example while NCPB will maintain the capacity of the three separate station offices in San Francisco (KQED), San Jose (KTEH), and Monterey (KCAH), the new organization will be able to consolidate much of the administrative, and some of the fundraising, functions of the three offices.

In addition, the NCPB will be able to offer more services to the communities it serves. Prior to the merger, KTEH did not have the budget to purchase all of the available content from PBS; therefore, KTEH and KCAH only had access to about 40 percent of PBS content. As a result of the merger, all three stations will have the benefit of the entire PBS content portfolio. There will still be some overlap in content between KQED's and KTEH's programming, but KTEH will now have access to increased funding to produce more local content. In addition, KCAH, which had previously carried KTEH's programming, will now have its own program delivery to serve the special needs of the Monterey community.

Because KQED and KTEH air in many of the same communities (as illustrated in the coverage map below), the organizations did compete for some donors and members. In

[10] The Telecommunications Act of 1996, the first major overhaul of telecommunications law in almost 60 years, required the conversion of the nation's television system from analog to digital transmission. This imposed significant costs on the entire broadcast industry, as stations had to acquire new equipment, build new towers, and change their programming to fit the new digital spectrum under an aggressive implementation schedule set up by Congress – the conversion deadline for commercial broadcasters was set for May 2002, while public broadcasters had until May 2003. The estimated cost of this mandate ranges from $2 million for a station that could merely transmit national programs to $6 million for a facility that could produce its own programs. Many stations sought financial aid from both the federal government, through CPB, and state governments.

[11] Prodded by criticisms from congressional leaders for being inefficient and duplicative in markets with more than one station (signal) in the mid 1990s, CPB adopted a one-base-grant-per-market approach to funding public television stations.

the face of decreasing membership and funding sources, both KQED and KTEH will benefit from sharing a donor pool. In the past, KQED had not solicited major gifts or corporate sponsorships from the Silicon Valley because it did not want to tread on KTEH's funding base. However, given its size and budget, KTEH had not been able to fully tap into the wealth of Silicon Valley with its fundraising efforts. Therefore, as NCPB, KQED and KTEH will be able to combine forces and take advantage of a bigger donor base.

NCPB Coverage Map

Of course, there are risks associated with merging two organizations of considerably different scale, context, and culture. There is a concern that KTEH and KCAH will be overshadowed by the larger KQED and the smaller stations would lose their identity, as well as their ability to be responsive, to the community. These concerns may be exacerbated by the fact that the new CEO of NCPB, Jeff Clarke, was the previous head of KQED.[12] To address these concerns, the new organization is working to create a new culture while maintaining each station's identity through differentiated programming and allowing member contributions to reflect the station to which the donor has pledged. Because there is some overlap in membership between KQED and KTEH, NCPB is developing a strategy to retain member support for both stations.

[12] KQED acquired KTEH through an asset purchase agreement through which KQED purchased KTEH's assets and assumed its liabilities.

Analysis and Implications

There are several common themes that emerge across these cases. First, as we expected, each merger was motivated as a strategic response to a significant environmental shock. For the community foundations, the critical change was increased competition from national providers of donor services. For one of the women's foundations, it was reduced donor interest in its mission. For public television, it was changing technology and policy mandates by a public funder. All three cases thus reveal the acute vulnerability of nonprofits to the changing commitments to their mission by third-party donors.

Second, in all three mergers, partner organizations sought specific resources that were necessary to continue their organizational mission -- buying power and managerial expertise in the case of public television, financial resources in the case of one of the women's foundations and geographic market coverage in the other, and reduced costs in all three cases. Some existing organizational resources, however, was a necessary condition for each merger. All involved at least one large, fiscally healthy organization. Merging two organizations into one is a costly process. And, with lack of access to capital markets, it is difficult for financially strapped nonprofit organizations or those of modest size and capacity to absorb the costs. Of course, third party sources could underwrite the costs of nonprofit mergers through grants and technical assistance, and we observed this in one of these cases.

Finally, with all three mergers, the partner organizations acknowledged the significant risks involved with combining different organizational cultures and meeting unique donor and community needs, and took steps to mitigate them. A particular concern in these cases was the loss of identity that comes from merging organizations and the risk of alienating donors loyal to the antecedent organizations. This challenge is accentuated in the nonprofit sector, in general, and in the cases we have chosen, in particular. These are organizations that because of their function as community assets – public grantmaking charities and providers of a community level public good – encounter considerable risks to their community ties if the merger is not carefully executed. Although different tactics were adopted to structure the merged organization in each case, e.g., whether to close the pre-existing organizations and create a new one with a new CEO and a new board, or whether to blend one of the existing organizations into the larger of the two (an acquisition in business terms), all identified ways to ensure that the communities linked to the pre-existing organizations would be served after the merger.

These cases thus reveal the nonprofit merger decision to be motivated by an interplay of organizational, industry, and market forces that determine when a merger is the strategic response that will allow the new organization to more effectively adapt and respond to a changing environment. In terms of organizational characteristics, we find evidence of a role for financial vulnerability, size, and prior relationships. Only one merger was driven primarily by an immediate threat to solvency –the Women's Foundation of California was born out of the survival instincts of the Los Angeles Women's Foundation, coupled with the willingness of its San Francisco counterpart to seize the opportunity to advance its longstanding interest in a statewide platform for policy advocacy. The previous working experiences of these two organizations appeared to be a necessary precondition to the decision to merge. Previous ties between the antecedent organizations also facilitated the public television merger. Finally, as noted earlier, all mergers involved at least one large organization with the requisite resources necessary to absorb the transitional costs associated with restructuring.

This analysis however underscores that some nonprofits are driven to consider mergers as a strategic response to their organizations' inability to attract sufficient funding – in these instances philanthropic dollars – as well as to realize cost efficiencies that improve their relative viability and competitiveness in response to changing market or industry conditions. In this response, they mirror the behavior of their for-profit counterparts. Mergers thus fulfill similar strategic goals in both nonprofit and business organizations. They provide a means to strengthen the organization's strategic position in response to market or industry changes. For nonprofits, it is changes in donor preferences; for business, changes in customer preferences. For both, changes in competitive industry conditions are also drivers. This commonality in strategic rationale is particularly interesting since we focus here on nonprofits that are the most dissimilar to business. Thus, our analysis underscores that nonprofits – even those with a significant philanthropic dimension, must respond to their markets – whether philanthropic, political, or commercial. Nonprofits do not stand in isolation from changes in their environments, whether these changes are triggered by changing cost structures, economic cycles, or public policy.

It is important, however, to remember that mergers remain a relatively rare strategic choice for nonprofit organizations. In these three instances the forces driving the change were sufficiently strong to overcome the costs, risks and challenges of organizational restructuring. In the majority of cases, other strategies– including but not limited to less integrative partnerships are pursued. However, with the increasingly uncertain resource environment of nonprofits, we may find that nonprofits mergers become more frequent. Recent trends in the market and industry environment of nonprofits, particularly for service delivery nonprofits, have tended to minimize the competitive advantage of the nonprofit form. While the tax advantages of the legal form (in particular for public charity 501c(3) nonprofits) still remain, the importance of philanthropy and community ties has been diminished as the public sector has worked through nonprofits increasing the relative importance of public funding. Even more important is the increasing commercialization of nonprofits and the change in public subsidies from supply side to demand side instruments that reinforce the marketization of the sector (Young and Salamon, 2002). To the extent these trends continue, the threshold for nonprofit mergers is likely to be reduced and their incidence increased. Though, the absence of the profit-motive and the weaker efficiency incentives of nonprofit organizations should always keep the proportion of mergers much lower among nonprofit organizations than among for-profit organizations.

Finally, given the common strategic purpose of mergers across the sectors, nonprofit organizations should look to the experiences of their business counterparts as they consider the benefits and costs of this strategic option. Unfortunately, the wisdom of this strategy remains largely unknown for both sectors. Nonprofit mergers may not generate the expected benefits, just as business mergers often do not create the expected value for stakeholders. An evaluation of whether or not the *ex ante* assessment of the net benefits of these particular nonprofit mergers will occur *ex post* is an important question that will require more time and a different analysis.

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