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Management Company Model

It's a nonprofit merger by another name

There is still an almost visceral negative reaction in this sector toward the word "merger." Many people associate the concept of a merger with lost identity, lost autonomy, and lost opportunity. To some, the whole process seems certain to destroy many of the things that the participants have spent so many years building.

The current tough times are forcing more nonprofits to consider some form of collaboration. The answer to this dilemma is to be more creative about structuring the ultimate collaboration. One of the best ways to do that is to employ a management company model.

In a management company model, one or more nonprofits' corporate structures remain intact but become subsidiaries under the governance of a "parent" organization. Which entity becomes the "parent" and which become "subsidiaries" depends entirely on the situation's facts and circumstances. The attractive element of this option is that it makes it easer – in fact, desirable – for the existing brands to remain intact, and even for the boards to remain in place. The key is that the parent corporation is usually linked to the subsidiaries by means of the board of directors. Typically, the parent corporation board becomes the "sole corporate member" of each subsidiary board. This means that the parent board can decide who will be on each subsidiary's board.

Such a provision gives the merging entities' parent board of directors considerable flexibility. It can create an exact replica of itself in each subsidiary, or it can allow a subsidiary whatever degree of freedom it wishes. It can do this because the parent board always has the authority to elect – and remove – each subsidiary's board.

The management company model also allows for considerable flexibility in structuring the subsidiaries. Often it is desirable to segment various activities using subsidiaries for liability reasons, political considerations, or just to have clear management accountability for different brands under the same roof.

FOR EXAMPLE

Let's take a mythical example of a theater company that merges with a children's theater group and a dance company. A management company structure might look like the accompanying illustration. Here, the two theater companies and the dance company have created a parent corporation, moving all of the management staff, equipment and systems into the parent and creating an entity that provides management services to the two theater companies and the dance company.

One key to this structure is that money actually passes from one entity to another in return for services, although these transactions are cancelled out in the end of the year audit, which typically communicates the overall health of the four organizations -- called a "consolidated" audit.

The most significant thing about this chart is the public perception: The public doesn't care. The brands of the theater companies and the dance group stay intact. The restructuring of the parent company board of directors is a non-event for the public, because no one goes to a theater performance and contemplates the nature of the board of directors that governs the organization. And the actors and dancers themselves are more interested in their craft than in the niceties of how human resource practices are carried out. Subscription ticketholders might be dimly aware that the organization putting on the adult productions is somehow connected to the children's group, but it has no effect on whether and how they purchase their subscription.

As an organizational model, the management company model is more robust than a simple merger. Among its greatest advantages is its flexibility. It offers single source management to entities that could use it but that for a variety of reasons it might not be practical to meld into a single legal entity. Within the system one can even use a variety of control mechanisms: single corporate membership for three subs, turnkey management contracts for two others, an individualized menu of administrative services with two others, a single paid executive for another, an agreement just to manage the administrative affairs of, say, a step dancing troop.

The management company model can also be expanded almost indefinitely. It will take some time to set up the management capacities needed to run a truly integrated management company/subsidiary relationship, probably longer than it would take to do an ordinary merger. But once the setup phase is completed, bringing in a new subsidiary should take less time than a merger. The hardest part in that case is likely to be how -- or whether -- to incorporate the new entity's board of directors into the management company's governance.

DISADVANTAGES OF A MANAGEMENT COMPANY

There are also potentially significant disadvantages in using a management company, starting with the model's complexity. There really has to be enough at stake to justify the high-level restructuring that must be done, with all its accompanying costs and time demands. Most of the time it doesn't make sense to create a management company-subsidiary relationship for two or three small nonprofits. The legal and accounting set-up and management costs alone may make it too costly.

The flexibility can also be elusive. Capital might not flow easily from the parent to subsidiaries, as planners might have hoped (lenders don't always agree that it should). Even though it might appear to be a good idea to put all these programs together in this way doesn't mean that the integration of these formerly independent entities will actually happen. Without good information technology to support the whole system, it will be hard to realize any gains and good information technology is hard enough to put in place for a single entity, let alone an entire system.

Other, less concrete factors can influence the success of a management company model. Most notably, it might not help integrate programs and services. This is largely a failure of front-line managers to grasp the benefits of moving out of their silos, but it could also come from top executives' singular focus on structure (form) rather than programs (function). And it could actually be an easy way to avoid the hard work of a merger of corporations.

Of all the forms of collaboration, the management company structure is the easiest to create by top-down planning: record a few board votes, design a governance structure, and file the necessary forms. This tempting prospect can be a short-term victory at the expense of true long-term collaboration because it violates the principle that nonprofit mergers are planned top-down but implemented bottom-up.

There is a simple yet powerful guideline to use when thinking about a management company model: form should follow function. Think first about the function -- the desired outcomes of the collaboration. Be very clear about this desired end result. Only after you have clarity about the endpoint (the function) should you consider matters of structure (the form). A management company model is no more a one-size-fits-all solution than is a merger. *NPT*

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How to Recognize a Parent/Subsidiary Corporation Relationship

For those of interested in this sort of thing, the Internal Revenue Service (IRS) provides a handy way of learning whether a nonprofit is related to any other entity, tax exempt or not. On the old federal Form 990 (which was replaced by a new version in calendar year 2009), the key question can be found on line 80a.

On the new form, essentially, the same question is on line 34, with additional disclosures required if there is a related party relationship. This is where most parent/subsidiary relationships will be disclosed by all of the related entities that file the federal Form 990, which is the nonprofit world's equivalent to the corporate tax return.

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