Beyond the Liability of Newness: Nonprofit Organizations in an Emerging Policy Domain

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The number of new nonprofit organizations has grown considerably. New organizations influence public policy. The early years of a new organization are a time of “imprinting,” as well as vulnerability. The concept of the liability of newness has influenced organizational research, but its dimensions have not been explored fully. This article reviews past research and presents descriptive data on the experiences of newly founded HIV/AIDS organizations. The fate of new AIDS organizations was highly dependent on their acquisition of stable funding sources, particularly public funds. Internal organizational problems had a limited impact on the deaths of organizations, especially those with public funds. Although new organizations face hazards, there are also common dilemmas at other stages in the life cycle that can be traced to nonprofit organizations’ dependence on multiple funding sources.

The nonprofit sector responds to environmental changes in three ways: Existing organizations modify their missions and their structures (V. A. Alexander, 1998; Baum & Singh, 1996; Galaskiewicz & Bielefeld, 1998); new organizations are founded (Chambré, 1995); and existing organizations merge or die (Hager, 2001). The process of new births is particularly critical at the current time. The number of nonprofits in the United States has increased steadily since 1940 (Burke, 2001). Even though closures and mergers are common (Galaskiewicz & Bielefeld, 1998), the number of births far exceeds the number of deaths, creating a “demographic transition” in the nonprofit sector. The growth has been especially steep for human service organizations, an...
important consequence of privatization in the U.S. welfare state. Between 1992 and 1996, 26% of human service nonprofits closed, but there were three openings for every closing (Twombly, 2001).

Newly founded nonprofits play a central role in the development of new social policies. Existing organizations may have full agendas and are not able to respond to new issues when funding is not available (Perrow & Guillén, 1990). New groups are created by volunteers who are concerned about a public issue that falls outside of the mission of existing organizations (Chambré, 1995), often an unmet community need (Smith & Lipsky, 1993). They play a central role in framing a social issue and developing new service models. New advocacy groups serve as key players in making claims about an issue, recommending new policies, and identifying the gaps and limitations of existing programs and services (Reid, 1998).

The early years of a new organization are critical for yet another reason: as a time of “imprinting.” Policies and practices developed during an organization’s formative years have an enduring impact (Stinchcombe, 1965), particularly on its capacity to adapt to environmental changes, which, in turn, influence long-term survival (Tucker, Singh, & Meinhard, 1990). Despite their large number and central role in the implementation of new policies and the importance of imprinting, there has been little systematic exploration of the circumstances surrounding the birth and growing pains of nonprofit organizations.

Building on past research, this article describes some of the growing pains of nonprofit organizations that were established in the context of a new policy niche, the HIV/AIDS epidemic. It reviews what past researchers have identified as the dilemmas faced by new organizations. It then presents descriptive information about the histories of newly founded organizations in one policy domain—HIV/AIDS organizations in New York City—as a way of enlarging our understanding of the meaning of the liability of newness and the vulnerability that organizations experience at different stages of the life cycle. It describes how and why organizations were founded, challenges they faced in moving from a start-up phase to adolescence and to maturity, factors associated with mergers and deaths, the applicability of the concepts of the liabilities of newness and of adolescence, and whether the challenges of new organizations that Stinchcombe identified are reasons for the higher death rate of new organizations. To our knowledge, this is the first study specifically on the growing pains of new AIDS nonprofits. Previous studies and surveys have been cross-sectional and do not distinguish between AIDS organizations and agencies offering a more broad range of services, or between old and new organizations (Conservation Company, 2001).

WHAT DO WE KNOW ABOUT NEW NONPROFIT ORGANIZATIONS?

Stinchcombe’s (1965, p. 148) concept of the “liability of newness” has dominated research on the evolution of organizations. He observed that “as a
general rule, a higher proportion of new organizations fail than old” and identified four challenges of new organizations: developing new roles and socializing a new set of participants to play these roles, establishing structures to ensure proper performance including rewards and sanctions and management systems for financial accountability and control, developing trust among strangers, and cultivating and maintaining stable ties with customers. He does not specify, however, whether these are reasons for the liability of newness or simply sources of strain and conflict.

Numerous empirical studies and two theoretical perspectives, organizational ecology and new institutionalism, have been influenced by Stinchcombe’s article. Organizational ecologists have done the bulk of research on the liability of newness (Freeman, Carroll, & Hannan, 1983; Hannan & Freeman, 1989). They have studied the dynamics of organizational foundings, looking at the impact of size and density on births and deaths in organizational populations (Baum & Singh, 1994; Podolny, Stuart, & Hannan, 1996). Many more studies have looked at for-profit organizations like newspapers, wineries, hotels, Webzines, and sports leagues (Dobbs & Harrison, 1999; Eisner, Jett, & Korn, n.d.; Hannan & Freeman, 1989) than nonprofits like new social service agencies in Toronto, Canada (Tucker et al., 1990), a sample of nonprofits in Minneapolis, Minnesota (Galaskiewicz & Bielefeld, 1998), credit unions in New York City (Barron, West, & Hannan, 1994), labor unions (Hannan & Freeman, 1987) and new for-profit and nonprofit day care centers in Toronto (Baum & Oliver, 1996).

A large number of studies have documented “age dependence”: the fact that an organization’s age influences its fate (Baum, 1994, 1996; Hager & Galaskiewicz, 2000; Hager, Galaskiewicz, Bielefeld, & Pins, 1999; Hannan & Freeman, 1989; Tucker, Baum, & Singh, 1992). They point out that newness is conflated with smallness; new organizations fail because they are small and find it difficult to compete with older and larger organizations particularly in densely populated niches. Little systematic attention has been given to differences between the developmental patterns of for-profits and nonprofits; the one analysis that addressed this question observed that “nonprofit organizations escape severe selection pressures in their first several years of existence” (Carroll & Huo, 1988, p. 184).

New institutionalists stress the embeddedness of organizations in their economic and political environment and the importance of achieving legitimacy and developing viable forms and functions (J. W. Meyer & Rowan, 1977; Powell & DiMaggio, 1991). Some studies have combined or compared these two theoretical perspectives to explain organizational growth and decline (Hager & Galaskiewicz, 2000; Singh, Tucker, & House, 1986). Social histories of nonprofit organizations also provide important information on new organizations like community development organizations and organizations serving adults and children with disabilities (Katz, 1970; Stone, 1996; Wiewel & Hunter, 1985; Young, 1987).
A more nuanced view has begun to emerge in the literature over the past decade that has challenged the dominance of the liability of newness and led to studies that combine ecological, institutional, and historical variables. This rethinking began when a series of studies suggested that there was a complex relationship between age and organizational death rates. Freeman et al. (1983) found that different types of industries had different types of deaths, either dissolutions or mergers. It also is not so clear that small size itself is critical. A review of 18 studies found that only half of them concluded that organizations failed because of their small size (Hannan, 1998). Baum (1996, p. 79) observed that “after controlling for contemporaneous organizational size, failure rates do not decline with age,” and Barron et al. (1994, p. 414) concluded that the “evidence from this and other studies may now be strong enough for the liability of newness hypothesis to be finally laid to rest.”

To understand births and deaths, researchers have simultaneously considered historical, ecological, and institutional variables, such as the adaptive strategies organizations pursue in the kinds of new products and services they offer (Henderson, 1999), the uniqueness of an organization’s service in the face of competition by other organizations occupying the same or an adjacent niche (Baum & Oliver, 1996; Tucker et al., 1990), and the types of strategies used to obtain resources and ensure legitimacy. Within particular organizational niches, like social service agencies, new minicomputer firms and health maintenance organizations (HMOs), there are differences in the survival rates of specialist and generalist organizations and between different organizational forms (Romanelli, 1989; Tucker et al., 1990; Wholey, Christianson, & Sanchez, 1992).

There is growing interest in the idea that organizations are at risk of failure at two other points in their life cycles: during adolescence and old age (Brüderl & Schüssler, 1990; Hannan, 1998). The liability-of-adolescence argument posits that new organizations experience a honeymoon period. New organizations continue to exist because of an initial stock of resources (Fichman & Levinthal, 1991), including working capital, which takes time to be depleted, and the goodwill, trust and, initial commitment that led to the conscious decision to create an organization. After a honeymoon period, failure rates increase because the initial stock of resources is no longer sufficient. Organizations are also at risk of failure during old age because they do not adapt to environmental changes (the liability of senescence) or they continue to offer products or services with limited demand (the liability of obsolescence).

A series of studies, some of them unpublished, note that organizations’ strategies have different impacts at various stages in the life cycle. Thornhill and Amit (n.d.), for example, point out that young organizations fail because of poor management, whereas older organizations fail when they do not adapt to environmental changes. Henderson (1999) concluded that “multiple patterns of age dependence may simultaneously exist within a single population.” This observation also characterized changes in the population of sports
leagues, where there were high death rates among new organizations and old organizations (Dobbs & Harrison, 1999). These studies suggest a need for research on the nature of an organization’s vulnerability at different stages in the life cycle in order to understand the nature of the liabilities of newness, adolescence, and old age.

METHOD

This article synthesizes empirical research with practice-based knowledge. Since 1988, Susan M. Chambré has been studying the role of the nonprofit sector in responding to the HIV/AIDS epidemic. This work has involved several interrelated projects that examined the mobilization of volunteers in response to the AIDS epidemic, the evolution of the city’s AIDS community, and its role in influencing local and national policy. Both qualitative and quantitative data have been collected, including archival material, observation of conferences and presentations (a total of 198), formal and informal interviews with paid staff and volunteers (250 interviews), and the development of two databases: one listing all AIDS organizations and a second that includes foundation grants for AIDS-related activities in New York City between 1983 and 1998. The use of these diverse sources should reduce the probability of one common source of error in studies of organizational populations, “left censoring,” which is the omission of organizations that died before a study began (Baum, 1996).

All of the examples in the article are based on this research project. Given the age of the organizations, the article only considers new and adolescent organizations. The generalizations based on Chambré’s research were refined and confirmed by the coauthor, Naomi Fatt, who has spent more than three decades working in a broad range of local, national, and international nonprofit, union, and government organizations involved in community organizing, public education, service provision, technical assistance, and advocacy. She has led programs working to improve minority, women’s, children’s, youth, and occupational health, and to increase the availability of high-quality child and elder care. More recently, her experience includes 8 years of management and technical assistance work in the AIDS community in New York City, including 5 years as the executive director of an HIV/AIDS and substance use prevention organization serving active and recovering substance users in Latino and African American communities. She currently directs a technical assistance project serving nonprofit agencies in New York City. This project provides organization development management consulting services on program and infrastructure issues.
FINDINGS

THE GROWTH OF NEW YORK’S AIDS COMMUNITY

The HIV epidemic provides a context for examining an organizational population that evolved in response to a new policy domain. From the beginning, AIDS was a disease of the socially marginal—gays and racial and ethnic minorities, particularly those in the underclass. Although some individuals contracted the disease through blood transfusion, AIDS was primarily spread sexually or through unsanitary injection of illegal drugs. In addition to being a new area without a faithful constituency, established programs, and committed funders, it was a disease of society’s disowned and disenfranchised. New organizations were started in the early phases of the epidemic because older organizations were unwilling to respond (Perrow & Guillén, 1990). Many features of the epidemic made the process of forming new AIDS organizations distinctive (Community Resource Exchange, 1992). The organizations that grew up in response to the AIDS epidemic were not only building new agencies, they were responding to a new disease. Most of our observations about the dilemmas of forming new organizations are not unique to AIDS. Many social problem areas are viewed as crises or emergencies (Lipsky & Smith, 1989), a fact that greatly shapes the character of policy development. Indeed, American social policy is crisis oriented, and the reality or perception of a crisis is often needed to mobilize a response.

We have identified 172 organizations that were founded to “fight AIDS” (see Table 1). An entity was considered to be an organization if it had its own identity and stakeholders. Not all organizations were incorporated, and some continued to be part of larger organizations but were viewed as autonomous by their clients and supporters. The founding of organizations increased as the epidemic itself expanded. By the end of 1985, there were 18 new organizations. The largest number (66 or 38%) were founded between 1986 and 1990. The rate of founding of new AIDS organizations began to decrease in the 1990s: 48 organizations were established between 1991 and 1996, and 16 organizations were established after 1997. The total number of organizations involved in AIDS is far larger because generalist organizations developed AIDS programs. In 1995, 400 organizations provided AIDS services in New York City (Health Systems Agency, 1995). At the end of the 1990s, approximately 554 organizations were involved in AIDS research, health care, services, advocacy, education, information, fine arts, or performance activity (Chambré, 1999).

A large proportion of HIV/AIDS activities in the United States are located in New York City. A study of 501c3 organizations using the 1999 GuideStar/NCCA National Nonprofit Organization database identified 1,297 HIV/AIDS organizations in the United States, and 1,911 organizations with AIDS programs; 144 of them were in New York State (Lampkin & Romeo, 2001).
Table 1. Founding Dates of AIDS Organizations in New York City at Different Stages of the HIV/AIDS Epidemic

<table>
<thead>
<tr>
<th>Years</th>
<th>Nature of the Epidemic</th>
<th>Social Policy Stage</th>
<th>Number of Newly Founded Organizations</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-1985</td>
<td>Uncertainty about the nature of the disease, its transmission, and the scope of the epidemic</td>
<td>Reactive policies</td>
<td>18</td>
<td>10.4</td>
</tr>
<tr>
<td>1986-1990</td>
<td>Fear and alarm about the potential impact but greater awareness of the kinds of services and prevention efforts that needed to be undertaken</td>
<td>Emergence of policy strategies and funding streams</td>
<td>66</td>
<td>38.4</td>
</tr>
<tr>
<td>1991-1996</td>
<td>Recognition of the long-term nature of the epidemic and the need for extensive funding</td>
<td>Greater involvement of the federal government in shaping and funding AIDS services and prevention</td>
<td>48</td>
<td>27.9</td>
</tr>
<tr>
<td>1997-2002</td>
<td>AIDS becomes a long-term illness with the introduction of more effective medications</td>
<td>Institutionalization of AIDS policies and continued expansion of funding</td>
<td>16</td>
<td>9.3</td>
</tr>
<tr>
<td>Unknown</td>
<td></td>
<td></td>
<td>14</td>
<td>8.1</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>172</td>
<td>100</td>
</tr>
</tbody>
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STARTING NEW NONPROFITS

New nonprofits are created in response to government, market, or voluntary failure where the need for a particular organization or type of service becomes apparent (Chambré, 1995). The formation of a new nonprofit can be achieved with relative ease; it is facilitated by the existence of post office boxes, answering machines, and, more recently, electronic communication and the Internet. In some organizations, volunteers serve as the first staff members: They develop new service models and policy paradigms and adapt methods used by other organizations to raise money, provide services, engage in advocacy, and do routine office tasks. Many groups were not able to mobilize a cadre of volunteers to serve as staff, and founding members devoted their time to seeking public and foundation funding (Chambré, 1997). The very fact of being founded as an all-volunteer group means that the acquisition of social capital and the development of roles, myths, symbols, and ceremonies predate the legal founding of an organization.

People who begin a new nonprofit organization are brought together by a cause or concern; often their mission and goals are vague and unstated. Typically, they lack funds and a business plan. Early volunteers at the first AIDS organization in the city (and the world), the Gay Men’s Health Crisis (GMHC), recalled that they were “making it up as we went along,” an experience that is probably not unique to AIDS or to GMHC. As organizations grew, a series of tasks—hiring staff, developing a board, managing resources, and establishing relationships with potential donors and funders—created challenges that sometimes resulted in strain and organizational crises. The rapid spread of the epidemic left little time to build organizational infrastructure. Many of the early leaders of AIDS organizations were HIV positive, and some of them died while the organizations were just getting started. Some leaders saw their deaths as imminent and did not want to waste precious time on anything that slowed them down. The growth of an organization is highly contingent on environmental factors and the density of organizations in the same niche (Baum & Oliver, 1996; Tucker et al., 1990). Pioneer organizations, the first of their kind in an organizational niche, play an important role in establishing the legitimacy of that organizational form, because

just as it is hard for a new business to convince a bank that it will prove to be a good investment, new not-for-profit community organizations have a hard time convincing foundations, corporations, and city departments of their worthiness. The problem for a new organization is that it has nothing to offer but promises. (Wiewel & Hunter, 1985, p. 486)

Several months after the first AIDS cases were reported, a small group of gay men began to raise money to support scientific research for what was then called “gay cancer.” It took 6 months to form an organization and another year to begin to develop publications and provide services. GMHC developed a
service model that was adapted throughout the United States and abroad. At the same time, it needed to establish the legitimacy of the organizational niche it occupied. It is striking that one program officer, whose foundation was committed to the development of new community organizations, recalled his first reaction: “I don’t see that there needs to be a new organization that is exclusively gay men because it is a problem that gay men are having” (interview, January 3, 1995).

SELECTING AND REPLACING EXECUTIVE DIRECTORS

Starting any new venture requires strong leaders and a set of collaborators, both staff and volunteers, who develop effective working relationships. As a rule, founders of new organizations had a strong commitment based on common goals. Over time, however, this initial unity sometimes became attenuated because of interpersonal conflicts and differences of opinion about specific objectives (Rosenthal, 1996). Early volunteers began to experience burnout or fatigue, while others died, most often of AIDS. These events support the validity of the liability of adolescence because many organizations had a honeymoon period when unity about the cause overshadowed interpersonal tensions and sometimes idiosyncratic and unpredictable performance of organizational tasks. These tensions, often overlooked in discussions of new organizations, can be an important brake on growth and survival because unresolved tensions and conflicts may have long-term negative consequences. Conflicts often surfaced over the choice of an executive director (ED) and, in some cases, created turbulence and turnover in board membership.

For many groups, the first major decision was the choice of an ED. Little is known about how organizations choose their first ED and the longevity of early EDs. The choice was fairly logical if an organization was founded by one person; when an organization was established by a group, founders either selected an insider or an outsider for the job. The choice of an insider had mixed results if there were interpersonal conflicts and differences of opinion about the direction the group ought to take. In some cases, outsiders did not become fully integrated into the founding group. The first ED of the GMHC was a graduate student in social work who was willing to work without a salary because his job as ED was his field placement. He was not one of the founders, and once the job became a paid position, he was passed over in favor of someone with stronger ties to the founders.

A low salary combined with higher risk sometimes ruled out the natural leader becoming the first ED. Choosing the first ED often involved a compromise: The person willing to take the low salary was not necessarily qualified, which is the result of newness and smallness (Twombly & Gantz, 2001). At the Upper Room AIDS Ministry, the first ED worked extremely long hours at very low pay because of his commitment to the Catholic Worker movement, which emphasizes the importance of living simply. An early volunteer in the Association for Drug Abuse Prevention and Treatment (ADAPT) became the first ED
because she was willing to devote enormous blocks of time to the organization while holding a full-time job. Another volunteer reflected back on her leadership and recalled that “we were sitting comfortably in our positions, you know, thinking about families or colleges or whatever... She took the risk and basically started that little storefront on Bergen Street” (interview, May 21, 1997).

The first ED of another group was chosen while she was out of the room. Neither the founder nor the natural leader, she was articulate and committed but did not stay in the job for long. A decade later, she looked back and recalled that

for me, in the very beginning, I didn’t have any designs on becoming ED... It just seemed to me that somebody who had been an ED before should be the ED. But nobody wanted that salary, so they chose me. (interview, December 5, 1999)

The group’s next ED was the president of the board. She took the job because “we searched for many months for an ED and there were no takers. We were looking for a combination of skills and quality. The final candidates that we got, they all said no after they went through a process” (interview, June 2, 1993). Similarly, it took several years for an adolescent organization with serious fiscal problems to replace its founding leader: The board did not choose any of the staff members, a promising candidate turned down the job, and the agency was in such disarray that it was hard to find anyone to undertake the job at the salary that was being offered.

The selection of a charismatic first ED had a paradoxical impact. It reduced turnover, increased commitment, and gave the organization a clear vision of what it might become. At the same time, many charismatic founders lacked technical expertise and management skills. Some of them recognized their limitations, recruited capable staff and board members, and developed managerial skills. This was the case for God’s Love We Deliver’s founder who educated herself and also relied on the chairperson of the board. When the chair stepped down, the organization’s newsletter pointed out that

her knowledge and guidance have been priceless to us over the past 4 years. She has been available to answer questions and handle emergencies on week-ends, at night... [She] taught us what staff positions were needed, and then made sure that the right people were hired. It is to her that the lion’s share of the credit for the overall excellence and professionalism of this agency must go. (“Board of Directors,” 1992, p. 1)

Other charismatic but inexperienced leaders did not adopt this strategy and surrounded themselves with supporters. Staff, volunteers, or boards who challenged their methods were viewed as opponents, not helpful critics. Not infrequently, board members who challenged such leaders became inactive or
resigned. In one case, three board members resigned simultaneously. They felt that the ED was turning the organization into a “cult of personality” and were concerned that the lack of fiscal prudence and poor organizational practices—purchasing items that were not in the organization’s budget, salary checks that were bouncing, and hiring a relative—would not be corrected. Two other members had a different recollection: They thought that the three dissenters were interested in taking over the organization but realized later that there were serious management problems and they too left the board. By the time the ED left the organization, because of his death, the board had three members.

Turnover among early EDs tended to be higher for some groups than for others. In sample of 16 AIDS organizations in the city that were founded between 1981 and 1990, 11 had had 1 or 2 EDs by 1992. The 5 others had had a combined total of 21 (Chambré, 1997). Although a sign of instability, turnover of EDs increases the chances of survival because it allows an organization to adapt to change (Singh et al., 1986). The departures of some EDs allowed organizations to correct deficiencies. This supports the premise that the turnover of EDs has positive functions in new organizations. One ED took over an organization whose founding ED had died and where there were three successors in 3 years. The entire staff threatened to quit because the acting ED had not been hired for his job. All of them resigned within weeks of his arrival. He hired nine replacements within a few months and for the remainder of the year did

simple tiny things like timesheets. And a vacation schedule. And a handbook. By-laws. Standardizing the computers. People had different versions of the same software package. I mean, ostensibly, these things sound simple but they took unbelievable amounts of time. Changing the filing system . . . getting all the contracts bound and put in one place. Having a system to collect the statistics. Setting up space for hotline volunteers. Setting up forms to capture what a hotline call was. Setting up a mechanism for volunteers to report the demographics of the thing that they did. (interview, November 23, 1993)

BOARD DEVELOPMENT

As new nonprofit organizations move away from the start-up phase of being run by a founding group or charismatic leader to becoming more institutionalized, the development of a board becomes critical for obtaining resources, establishing legitimacy, increasing visibility, and mobilizing expertise (Abzug & Galaskiewicz, 2001; Harlan & Saidel, 1994; Middleton, 1987; Saidel & Harlan, 1998). Having a large board positively contributes to a nonprofit organization’s survival (Singh et al., 1986) because the membership can include donors, fund-raisers, and people with prestige who help the
organization to become more visible because their presence at fund-raising events makes the organization newsworthy.

Some AIDS organizations in New York, like the GMHC and God’s Love We Deliver, were able to develop boards composed of individuals who contributed to all of these functions. GMHC’s early founders included men with extensive business expertise who did fund-raising and marketing, and human service professionals who developed its service model and who recruited and trained volunteers. A year and a half after it was founded, GMHC took over Madison Square Garden for a Ringling Brothers circus fund-raiser, a remarkable accomplishment for a young organization. In the mid-1980s, GMHC expanded the range of people on its board to include members of the city’s business and philanthropic elite, who greatly increased the organization’s donor base. This led to a rapid expansion in revenue as well as greater visibility and legitimacy.

In contrast, most of the groups established in communities of color and outside of Manhattan had boards consisting of human services professionals, clergy, and clients, who neither raised nor donated very much money. These organizations raised modest sums from individual donors, and somewhat more, but relatively small, proportions of their income from foundations and corporations. The limited fund-raising role of most boards of AIDS organizations defies conventional wisdom but is consistent with most empirical studies (Middleton, 1987). A development director in a community-based organizations described the difficulties of educating a board about fund-raising, a task that she thought would take several years and required that she “refocus the thinking of a board where the state is paying the bills” (interview, June 8, 1993). The main function of many boards was to provide legitimacy with public funders because, by virtue of the members’ sexual orientation, race, ethnicity, gender, HIV status, and residence, they were thought to represent the community (Chambré, 1997).

New, small, and minority AIDS organizations also found it hard to recruit board members with the ability to oversee fiscal operations. Few board members had the expertise to understand complex financial requirements, much less provide appropriate fiscal support and oversight. Rather than being a source of assistance to staff, especially EDs, fiscally inexpert board members became another inefficient layer of financial oversight requiring staff time and energy.

ACQUIRING FINANCIAL RESOURCES

One limitation of past research on organizational ecology and organizational change is a lack of attention to the importance of financial resources. An organization’s survival is influenced significantly by its income and on its development of multiple sources of revenue (Froelich, 1999; Hager & Galaskiewicz, 2000). A major difference between many for-profit and not-for-profit organizations is that nonprofit organizations do not raise capital before
they start; they develop in response to new problems and new funding streams and begin their operations on a shoestring, sometimes with volunteers, under conditions of extreme uncertainty. The belief, shared by providers and funders alike, in the primacy of altruism and volunteerism in the nonprofit sector, no matter what the personal or organizational cost, leads to serious dilemmas in organizations of all ages, but especially in new organizations with limited cash reserves. Because the emphasis is on the mission and doing the work, new nonprofits are unlikely, and sometimes unable, to build the expertise and the infrastructure necessary to estimate the real costs of “doing business.”

Another related paradox in nonprofit management is that balancing conflicts between an organization’s mission to address an urgent need or problem and the necessity of operating in an efficient businesslike fashion poses challenges for transplanting business practices to nonprofits (J. A. Alexander & Winer, 1998). Raising funds and building infrastructure are very time-consuming, and their benefits may not be immediately apparent. For organizations founded to deal with a pressing issue—battered women, hunger, developmentally disabled people living in institutions, and victims of drunk driving—leaders faced a dilemma in dealing with the sense of urgency and, at the same time, developing an organization’s infrastructure.

This problem was distinctive for AIDS organizations but not altogether unique. Many nonprofit managers view revenue seeking and reporting as secondary and even distasteful. Inexperienced leaders confronting the urgency of responding to the HIV epidemic, especially EDs infected with HIV, were less likely to build a strong fund-raising and fiscal infrastructure in the early years of organizational development. Furthermore, most of the early EDs had no experience costing out services or developing budgets. Some of them underestimated the real costs of expanding their organizations, and their reach greatly exceeded their grasp.

For nonprofits, the nature of funding arrangements creates enormous constraints on their operation throughout the life cycle, but especially in the early years. Nonprofits have two types of customers: clients and funders. They need to maintain two distinct sales and marketing efforts: one to entice funders, the other to sell their product to potential clients. This requires creating and maintaining ties to two distinct social networks: clients and donors (Galaskiewicz, 1985). For a few organizations, donors also were clients, but most of the growth experienced by major AIDS organizations in the city depended on large donations from individuals, public agencies, and foundations, rather than from clients (Chambré, 1997).

For an individual organization, marketing to public, corporate, private foundation funders and to large and small contributors each require different strategies and a different set of proofs. Developing a smooth working relationship with the volunteer chair of a fund-raising dinner requires a different set of tactics than providing a 100-page response to a government request for proposals. There also are significant transaction costs involved in accounting for
funds received from different types of funders (Grønbjerg, 1993). Our research and work with nonprofits suggests that the cost is not just financial. The nature of the work that is involved in different types of resource development creates enormous demands, especially in new and small organizations. Organizations with small staffs (especially organizations where each staff person wears several hats) find it particularly difficult to seek and account for funds from different types of funders at one time.

Moving from a volunteer group with limited resources to a nonprofit organization with a budget requires a radical shift in organizational culture. Organizations need to develop an infrastructure to receive funds, spend them prudently, and account for their use (Smith & Lipsky, 1993). As AIDS funding expanded in the late 1980s, organizational growth was very rapid: ADAPT, for example, went from having an income of $21,110 in 1986 to $263,118 in 1987 to $877,128 in 1988. Momentum started out as a once-weekly dinner program that also offered stress reduction, food packages, and clothing to participants. In 1988, it received a $453,723 grant from Robert Wood Johnson and a contract from the city’s Human Resources Administration, resulting in rapid growth to eight dinners per week in eight separate locations throughout the city. The scope of services also expanded to include drug counseling, nutritional counseling, and nursing services at every program site.

The risks of rapid growth with underdeveloped fiscal systems provide support for the idea of a liability of adolescence. Funders gave new organizations some slack in developing an effective infrastructure because the epidemic was expanding, the work needed to be done, and there was not much competition among potential contractors. By the early 1990s, as more organizations began HIV/AIDS services and the deficiencies of some groups became apparent, some organizations lost funding. Public funders also began to develop in-house services or hired firms to provide technical assistance to struggling organizations.

ACCOUNTABILITY REQUIREMENTS AND FUNDING CONSTRAINTS

Because they obtain capital from public sources and foundations, nonprofit organizations are required to maintain complex and often burdensome financial systems. The most complex are the accountability requirements of government agencies that need to demonstrate that taxpayer funds are being spent prudently. An ever-growing bureaucracy of requirements exists to protect public money. This places organizations in a situation of needing to respond to procedures and deadlines that vary from one public agency to another and sometimes between departments in a single agency. Although there is no question that nonprofit organizations should be held accountable for the funds they receive, many procedures are overly cumbersome and some requirements are unnecessary, unduly restrictive, and, ironically, provide limited protection for the grantor. In addition, organizations that receive more than $300,000 from all federal sources are required to conduct an expensive
A-133 audit, which adds to transaction costs. These various requirements create challenges for organizations at various stages but especially for new and small organizations.

Although public grants tend to be more stable, larger, and of longer duration than corporate, private foundation, or individual donations, government payments are notoriously slow (Grossman, 1992), spending requirements are highly restricted by category, and budgetary changes are difficult and time-consuming. AIDS nonprofits in New York faced enormous uncertainties in obtaining public funding, including routine delays in the passage of the annual New York State budget as well as state and city delays in executing contracts. Public funders sometimes provide cash advances, but the amounts given can be relatively small and may be delayed so that they arrive long after the start date of a contract. This situation not only takes a toll on organizational leadership and staff morale, it makes an agency more liable to incur late payment costs.

For organizations almost totally dependent on public funds, the intricacies and delays inherent in the process of receiving funds on a reimbursement basis created organizational strains and crises. Many of the early AIDS organizations faced significant financial problems, and a large number experienced one or more periods of crisis. Much of this was compounded by the stresses of rapid growth, inexperienced leadership, and inadequate fiscal management systems.

I think the problem is that you throw pennies and then you expect an unrealistic product and that’s how you choke them. And that’s how they end up. . . . I know we do it here, when we write a proposal, we give away the store. . . . Because we’re competing for that contract and we pretty much do it, but it’s nuts. (interview, December 5, 1999)

Organizations delivering needed services often find it difficult to obtain public funds because their financial operations are deficient. If they do receive such funds and do not develop adequate fiscal systems, they continue to be at a disadvantage because their inefficiencies slow down reimbursement of expenditures, reduce their ability to spend the full amount of their grants, and result in unreimbursed expenditures that lack adequate documentation. These, in turn, affect organizational solvency.

Seldom are the costs (in staff, time, money, and systems) of capitalizing an organization underwritten by funders. Nonprofits are expected to keep the costs of fund-raising and public relations to a minimum. A number of organizations instruct donors not to contribute to agencies that spend more than 50% on costs not directly related to services (Prives, 2002). It is the rare organization that receives more than 10% for indirect expenses from corporate, private, or government funders.

Nonprofit organizations have limited access to unrestricted funding, especially for operating expenses. Public funders, foundations, and corporations
prefer to support direct services and programs, and organizations serving low-income populations have limited access to individual donors (Chambré, 1997). In the past 20 years, the proportion of foundation grants for operating support declined from 20% to 14% (Foundations Today Tutorial, n.d.). Most often, operating support comes from individual donors, a limited source of support for grassroots organizations serving inner-city groups (Chambré, 1997). Nonprofit organizations also find it difficult to obtain credit. Despite this, nearly 7 in 10 nonprofits had some debt, but this was somewhat (64%) lower among nonprofits with annual budgets of $500,000 or less and presumably even less common for new nonprofits without a track record (Tuckman & Chang, 1993).

Because funders often underpay the real costs of doing business, many organizations are in a continual position of deficit funding. Although some nonprofits do receive some funds that can be used as a cushion against a variety of contingencies, this is less likely for small organizations and certainly uncommon for new ones (Chang & Tuckman, 1990). Lack of liquidity results in many EDs having to struggle to meet every payroll. This may be one reason why a recent study of EDs shows EDs seeing themselves remaining in their jobs for a relatively short time, and half planning to find another type of job once they leave their organization (Peters & Wolfred, 2001).

Undercapitalization means that low salaries and making do with aging or unimproved sites, furnishings, and technology are accepted realities of nonprofit life. Low salaries make it harder to find and keep staff with administrative and fiscal skills. In the long run, undercapitalization and resulting low staff salaries are counterproductive. Undertrained staff working under difficult conditions with aging equipment and unnecessarily time-consuming systems compromise the efficiency and cost-effectiveness of nonprofit organizations. In reality, all of these elements converge to create enormous stresses on new and small nonprofits, particularly those lacking unrestricted funds. One ED summed up the interrelation between all of these factors, noting,

The reality is that most of our organizations live from hand to mouth. Most of our organizations depend on public dollars. And when you depend on public dollars, to a great extent you have to pretty much guide your programmatic initiatives by the funding that’s available and that you can get. We’re able to do it in a way that meets our mission because we won’t let go of our mission. But, it also means that the public funding generally does not support much administrative overhead, not much. Which means that the foundation and corporate fund-raising has to be targeted toward addressing gaps. And foundations and corporations don’t want to fund the infrastructure; they want to fund innovative programs. (interview, December 5, 1999)

The lack of serious consideration of the real financial needs of organizations result in nonprofit organizations that start without resources, operate without
a business plan, continue with too little funding, and, not surprisingly, provide services that reflect these deficits. The result is that many organizations do poorly because underfinancing leads to inefficient and inadequate administration and programs alike.

PERMANENTLY FAILING ORGANIZATIONS AND THE POLITICS OF FUNDING

In light of all of the challenges facing new organizations, generally and AIDS organizations in particular, it is instructive to examine the fate of AIDS organizations that were established in New York. Just more than one half of the 172 new organizations (54%) were operating in mid-2002. Mergers were relatively uncommon; only 13 organizations had merged. Often, mergers involved the death of one organization, which transferred its goodwill and perhaps one or two staff members to a stronger surviving organization. Two closures (the Persons With AIDS [PWA] Coalition and the Community Research Initiative) were essentially bankruptcies and reorganizations because the same organization was reestablished with an almost identical name, many of the same stakeholders, and the same funding.

A substantial number of organizations had survived one or more periods of organizational crisis. Many of them improved their operations, and some became permanently failing organizations whose performance, by any standard, fell short of the expectations of owners, members, and clients (M. Meyer & Zucker, 1989). Other groups were technically alive in the middle of 2002 but had greatly reduced revenues and might not survive much longer. In fact, two organizations were in the process of merging into more stable groups as this article was nearing completion.

It is beyond the scope of this article to analyze fully the factors that account for why some organizations survived and others did not. One finding merits discussion: the significantly higher survival rate by organizations that moved beyond the initial start-up phase and obtained public funds. The state played a limited role in the founding of most organizations because individuals or groups of citizens responded to the sense of urgency of the epidemic and, in a few instances, to the prospects of the availability of public funding for an issue that concerned them. In most cases, however, the initial survival of organizations was not ensured by public funds because it took several years for most groups to begin to receive government support. The mortality rate was very high for small and informal groups that depended on private funding. Only 39% of organizations that relied on private funding were in existence in July 2002, as compared with 82% of organizations that received public funds.

Why was the death rate so low for organizations that received foundation and government funds? HIV/AIDS organizations established in the late 1980s, particularly those founded between 1988 and 1992, were operating in an environment where funding was expanding rapidly. Staff in foundations, public charities, and government agencies needed to spend money
responsibly, which sometimes required that they reach out to potential recipients and provide them with technical assistance. Funders depended on new organizations so they could demonstrate their support for this urgent social problem, which, in this way, enhanced the survival and growth of some organizations early in their development.

In a contracting regime, public agencies depend on nonprofits and are sometimes unable to cut off funding even if an organization’s work is suboptimal. Seibel (1996) points out that resources continue to flow to organizations that may not be functioning effectively as a way to symbolically be involved in responding to a social problem. Poor performance is generally not a reason for the closure of such groups. This is a further illustration of Saidel’s (1991) observation that there is an interdependence between the state and nonprofit agencies. Continuation of funding was not only based on performance but also on political factors. One minority-controlled organization with enormous support from the city’s AIDS community was able to reverse the city’s decision to cancel its contract despite serious organizational and fiscal problems. The organization was doing work that was needed and important. It received a groundswell of support from other organizations that thought that the cancellation of the contract was due to the controversial nature of its work rather than its internal problems.

Malfeasance rather than poor performance tended to be the basis of closure for publicly funded organizations. Seven organizations that received public support did close. In three of these cases, the closure was due to financial mismanagement. Continued support for organizations that are inefficient, if not failing, is not only true for nonprofits (Saidel, 1991; Smith & Lipsky, 1993; Wolch, 1990) but for for-profit organizations in industries like savings and loans and the airline industry, where government subsidies and loans have ensured the survival of strategic organizations.

We find evidence of both the liability of newness and the liability of adolescence in the organizations we studied. Of the 59 closings or mergers, 34 were new organizations that were in their start-up phase just beginning to develop their services and programs, but 25 were organizations that had operated for several years with private funding. The accounts of their closure, usually from informants, were that the organization closed because of limited resources. In most cases, the group was unable to continue to raise funds because it had a narrow focus and limited constituency, and the founder or founding group lost momentum or became burned out. There was an especially high mortality among a number of advocacy groups related to promoting either acceptance or modification of HIV prevention practices for gay men. One closure was predetermined: the Citizen’s Commission on AIDS, a planning group that was intended to be temporary. Among the 13 mergers, most were adolescents (8) rather than new organizations (5).

Some groups closed because of ossification: Organizational practices prevent them from remaining competitive and adapting to changing circumstances, evidence of characteristics thought to be due to old age in much
younger organizations. The PWA Health Group was an innovative organization originally founded to help PWAs obtain underground medications. It viewed itself as more of a social movement organization rather than a business because obtaining underground medications was an act of resistance to the power structure that initially prevented PWAs from obtaining experimental drugs. Over time, its function changed as more and more people gained access to experimental drugs and the Health Group served a different and important function: It sold medications at a lower cost than pharmacies. When it merged with a similar organization, Direct Access Alternative Information Resources (DAAIR), in 2000, this was due to its controversial public positions and to DAAIR’s more extensive marketing effort, including use of the Internet.

CONCLUDING THOUGHTS

New nonprofit organizations are established to meet the challenges of changing historical conditions, particularly the development of new policy domains. AIDS provides a useful context for studying the emergence of new nonprofits in a new and changing policy area. In less than 20 years, an HIV diagnosis moved from being a death sentence to a chronic disease. Although it is beyond the scope of this article, previous work (Chambré, 1995) suggested that new organizations are formed because of a combination of voluntary, market, and government failure. Because AIDS was seen as a crisis, AIDS organizations received major infusions of government funds in the latter part of the 1980s. Rapid organizational growth fueled by funders who did not cover start-up or overhead costs but demanded complex fiscal systems and oversight was common. Increased funding within a relatively short time was both a benefit and a burden to new organizations because rapid growth frequently led to organizational crises, although rarely did this lead to closure. Stinchcombe (1965) implies that four features of new organizations might contribute to the early deaths of new organizations. Although they are clearly important sources of strain and conflict, our work does not support the idea that these four reasons account for the closure of new organizations. The need to institutionalize new roles and develop trust among strangers sometimes created strain, but the commitment of people drawn together by a common cause far outweighed the lack of familiarity among stakeholders. As organizations moved into adolescence, tensions and interpersonal conflicts became major obstacles to growth and optimal performance, but they were not reasons for closure. The major reason why new and adolescent groups closed was their inability to raise adequate resources. When groups survived into adolescence, both with and without government funding, deaths appeared to result from an overly narrow focus or being in an overpopulated niche.

It is not surprising that new nonprofit organizations are at risk. They often have untested, inexperienced leaders. They may lack skilled staff and volunteers; well-connected boards; and established traditions, contacts, and
systems. They sometimes confront new problems and experience rapid growth, limited funding, or both. It is no wonder that all of these conditions combined with undercapitalization would put new organizations at higher risk. But these are not always the reasons for closure. Ties to the state as a customer were critical. Organizations that depended on private sources of income failed at a much higher rate than those receiving public funding.

In our experience, the main source of stress tended to be fiscal: Organizations that were fiscally irresponsible were at risk of closure, but if they were needed, assistance was provided and staff changes took place. Sometimes organizations contracted in size and in other cases they merged, but the probability of closure was greatly increased when there was malfeasance. This is a hidden aspect of the nonprofit sector. Despite extensive coverage of nonprofit scandals in recent years, none of the closures of state-funded AIDS organizations were covered in the press.

Many of the examples provided in this article note the problems of newly starting nonprofits: limited funds, especially to hire an ED; lack of experience; and a need to determine the course of an organization’s future and clarify what are often inchoate goals developed in response to a problem area. Other examples, however, support the idea of the liability of adolescence. The emotional connection that motivated early members and supporters of organizations often became attenuated during adolescence, especially when there were interpersonal conflicts, an overly narrow mission, and a lack of funds. As leadership changed—sometimes because of illness and death—deficiencies became more glaring. This article supports the idea that a broad range of factors—historical, cultural, institutional, and ecological—need to be considered in understanding the births, mergers, and deaths of organizations and the fact that organizations are vulnerable for different reasons at various stages of their life cycles.

References


Nonprofit Organizations in Emerging Policy Domain


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