Which Light is Right? Healthy Coexistence or Too Many Nonprofits?

by Mark Light and Paul Light

Dear Paul,
If I've heard it once, I've heard it a million times: "There are too many nonprofits." You said it yourself, Paul, "It's the number one complaint I hear from donors, and there is general consensus within the industry that there *are* too many nonprofits."[1] What's wrong with this picture, Big Guy?

Dear Mark,
There's nothing wrong with the picture, if you take a good, hard look. As the Urban Institute now reports, the vast majority of nonprofits have budgets of less than $1 million.[2] Their lives are tough, the stresses on finding staff and board members are increasing as the baby boomers head off to retirement, and they have extraordinary problems "scaling" up to a reasonable size. Moreover, there seems to have been an explosion in the number of niche nonprofits. Passion is important to survival, but it's got to make sense for the sector as a whole, too.

Dear Paul,
I think the bottom line of your point is akin to what Trent Stamp from Charity Navigator says: "If there were fewer charities, we'd spend less as a nation on fundraising and administrative costs, and more on the programs and services the high-performing nonprofits seek to deliver."[3] Alright, I'll play along. Now, just how do we get on the diet? Simply close a bunch of nonprofits? Set up a commission for decommissioning selected nonprofits?

Here's what you advise: "What needs to happen is for nonprofits to start thinking about merging or consolidating their operations."[4] Not a bad idea, even if most mergers in the for-profit sector bomb.[5] Not so in nonprofits, where, although there are fewer mergers,[6] the success rate is pretty much the opposite. David La Piana says that about 70 percent succeed;[7] others have pegged it at between 86 and 100 percent.[8]

The million dollar question here is whether those mergers save the bucks. Granted, the literature on the topic is still pretty thin,[9] but it doesn't look promising. Linda Lampkin, former director of the National Center for Charitable Statistics, says that "bigger isn't always better or more efficient;"[10] Jan Masaoka, formerly of CompassPoint, concludes that "nonprofit mergers don't result in reducing administrative costs."[11] Robert Harrington, with La Piana Associates agrees, "Organizations probably should not enter into a merger with the primary goal of saving money."[12] The bottom line on mergers is that even though the drivers for merger are broad and varied—from outright survival to better services[13]—you need a better reason than saving a buck.

Dear Mark,
The problem isn't mergers, it's the lack of space for the onslaught of new organizations, and the sizable number of nonprofits that have either given up or just can't quite make it. I know that "economy of scale" is a pretty promise, but there are savings embedded in sharing back office operations and finding opportunities for working together. The devil is always in the details, of course. You ask what we do to get the hoped-for costs that might be in some net reduction of the sector, which is basically a question about which nonprofits should go. Should it be some of the big, old sluggish nonprofits that long ago forgot why they existed and continue to limp along as giant fundraising machines? Should it be some of the tiny young nonprofits that show such great promise for innovation, yet are often so narrowly focused that there's really no hope for growth or sustainability? Or how about those middle-aged nonprofits that are stuck between small and large—too small to get past the constant fear of folding, but too big to be fashionable any longer?

The market pummels small and large for-profit businesses if they don't succeed. Failure rates of new small businesses are stunningly high—you wouldn't start one if you knew what you were up against. The nonprofit sector has a much higher survival rate, in part because some nonprofits go dormant when they start struggling, in part because it only takes one angel or contract to keep the lights on. The market failures that create so many nonprofits also keep many nonprofits alive.

Don't get me wrong here, I happen to like small, new nonprofits, and have seen some of the most interesting, provocative ideas flow from the passion of a new organization. There is a big role for the small nonprofit in the sector. But there is also an acknowledged proliferation of nonprofits in niches that might be better served by larger organizations with greater administrative capacity. You don't want to get me started on the capacity building issue again, do you? Too many of the new nonprofits are just too weak to have much chance of moving from the organic stage of nonprofit life up the development curve to intentional action, let alone robustness. There's very little venture capital around for these young ones, and we ought to be very careful about where it gets invested.

I agree that some funders are promoting mergers to ease their decisions about grants. They want nonprofits to get into every social business possible—from thrift stores to coffee shops—to loosen dependencies. I've always believed that self-generated revenue is the very best kind of revenue to have—no strings, no paperwork, no nitpicking. But just how much social enterprise can the sector take? We've already got six coffee shops per block in NYC, half of them Starbucks.

Dear Paul,
Don't get me started with this stuff about wasteful duplication of services! Funders just adore waging war on duplicate services, which is often hyped as collaboration. It is a false hope, however—monopolies are inherently wasteful; competition is the life blood of innovation. In monopoly environments, things can go to hell in a handbasket because there's no incentive to make the improvements and innovations that come naturally with open systems where competition exists. Competition keeps everyone on their toes; it's "essential to the nonprofit sector."[14]

Dear Mark,
What is good about all this talk about too many nonprofits is that it is a way of getting into some critically important issues about the future of the sector—especially the growing inequality between the gigantic nonprofits that constitute less than a percent of the number of nonprofits but control more than a quarter of the sector's assets and resources. Ultimately, the inequalities grow with each new nonprofit as the little organizations struggle for survival against each other. The big, well-endowed nonprofits have nothing to worry about unless the little nonprofits figure out that there is little strength in numbers, but plenty of strength in size.

Nonprofits go out of business at a rate equivalent to small for-profits, about 7 percent per year, which is more than triple the 2.1 percent rate for large publicly traded firms.

Dear Paul,
Show you some competition? You want the grim reaper? Okay, here it is: Nonprofits go out of business at a rate equivalent to small for-profits, about 7 percent per year, which is more than triple the 2.1 percent rate for large publicly traded firms.[15] The good news is that even though a bunch of them get creamed, some take huge risks that the behemoths don't even dream of taking. And in taking these risks, those little nonprofits come up with innovative ideas that can change the world and often put the heat on or even unmake the large organizations.[16] I'd bet on the little nonprofit every time. And what's wrong with that? As Thom Jeavons, the new executive at ARNOVA, says, "Despite the potential redundancies and inefficiencies, the proliferation of nonprofits mostly represents a kind of cause-related, values-driven entrepreneurship. Most of these nonprofits are tiny and do not need much management or support. Those that grow larger will probably be able to find good people and resources."[17] Grow sector, grow, that's what I say!

Errata: In our recent article about the impending leadership crisis, Mark made the point that the sector had confronted and bested a similar situation during the 10-year period beginning in 1993. While his point stands, his facts were incorrect. Instead of 100,000 senior executives, he should have stated that the sector actually added about 300,000, which is about 10 percent below Tierney's conservative estimate for the 10-year period ending in 2016.

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Endnotes

1. (Hall, 2005, p. 13)
2. (Pollak & Blackwood, 2006)
3. (Stamp, 2004)
4. (Hall, 2005, p. 13)
5. (Kelly, Cook, & Spitzer, 1999)
6. (Bowen, 1994)
7. (La Piana, 2006)
8. (Lapham, 1997; Singer & Yankey, 1991)
9. (Kohm & La Piana, 2003; Toepler, Seitchek, & Cameron, 2004)
10. (MacDonald, 2006)
11. (Masaoka, 2004)
12. (Wallack, 2004)
13. (Singer & Yankey, 1991)
14. (La Piana & Hayes, 2005, p. xiv)
15. (Bates & Nucci, 1989; Keating, Fischer, Gordon, & Greenlee, 2005)
16. (Christensen & Overdorf, 2000)
17. (Jeavons, 2006)

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