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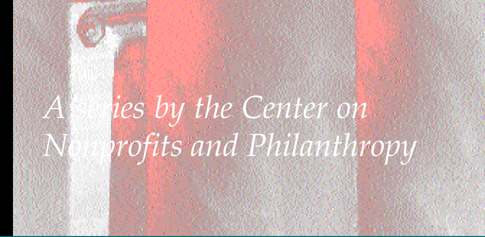

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Welfare Reform's Impact on the Failure Rate of Nonprofit Human Service Providers

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The introduction of waivers in metropolitan areas has generally had little impact on the deaths of human service providers.

The 1996 federal welfare reform legislation marked the continuation of the devolutionary trends that began earlier in the decade under the Aid to Families with Dependent Children (AFDC) waiver program, which allowed states to obtain exemptions from the federal AFDC guidelines.[1] Accompanying the AFDC waiver program—and the devolution of welfare policies more generally—was the assumption that nonprofit human service organizations are important mechanisms for providing the necessary services to move welfare recipients into the labor market.

But policy initiatives that increasingly shift the responsibility for providing public services to the private sector implicitly rely on the effective adaptation of nonprofits to new environmental conditions.[2] Nonprofit human service organizations must adjust to new contracting systems and efforts toward public accountability, while meeting the changing needs of clients. They must raise sufficient resources to continue operations, while addressing the desires of charitable donors and other funders. Not all nonprofits can adjust successfully. While many organizations prosper, other nonprofits, including some with strong historical ties to their communities, go out of business.

This brief presents a series of findings regarding the impact of AFDC waivers and other factors on the demise of nonprofit human service providers. The research uses data on nonprofit organizations from the National Center for Charitable Statistics,[3] as well as socioeconomic data and information on AFDC waiver programs from various government agencies and other sources, to assess the variables that relate to the closings of human service nonprofits in large, intrastate metropolitan areas between 1992 and 1996. This time frame marked the widespread implementation of welfare reforms under the federal AFDC waiver program. The study uses a logistical regression model that incorporates several economic, organizational, and policy indicators—including a fourfold categorization of AFDC waiver experimentation[4]—and yields several important findings.

Four Major Findings

Welfare reform initiatives had a limited impact on the deaths of nonprofit providers. Experimentation by states and metropolitan regions with AFDC waivers substantially changed the environment in which human service nonprofits operated. Experimentation with waivers signaled the reorientation of public welfare goals—from income support to promotion of economic self-sufficiency and personal responsibility—and modified what was expected of social service systems. In this changing context, one might expect more radical experimentation efforts under waiver plans to cause greater rates of exit, because, as some have argued, nonprofit organizations rarely undergo major transformations (Grønbjerg 1993). Instead, nonprofit providers often establish and maintain persistent, basic modes of operation (Benjamin 1994).

The analysis, however, suggests that the experimentation with AFDC waivers caused only limited numbers of nonprofit human service providers to go out of business in urban areas between 1992 and 1996. Although there was a positive relationship between the level of experimentation with AFDC waivers and the deaths of human service nonprofits during this period, the findings do not meet standard tests of statistical significance. That is, while the exit of nonprofit human service providers was more likely to occur in metropolitan regions that pursued welfare reform than in non-reform areas, the difference in non-profit human service failure rates was not pronounced. Moreover, human service nonprofits were not likely to fail at higher rates in metropolitan areas that operated under extensive waiver programs than in urban systems that instituted moderate or minimal reform efforts.

Larger human service nonprofits were well positioned to adapt to social service changes. The availability of slack resources, more advanced administrative structures, and potentially greater legitimacy provide bigger human service nonprofits some cushion from system change. Not surprisingly, then, smaller nonprofit human service providers, which have less capital and more limited resources, were more likely to fail than other groups. Indeed, small nonprofit providers, or those with annual assets of less than $35,000, were roughly 20 times more likely to die than human service nonprofits with assets in excess of $750,000. More generally, the larger the nonprofit human service provider, the less likely the organization was to exit urban social service systems between 1992 and 1996.

Very young nonprofits are the least likely among human service providers to go out of business. The newest nonprofit human service providers—those in operation for five years or less—were less likely to exit the social service field than human service nonprofits that had existed for 20 years or more, when other factors are held constant. Indeed, the youngest nonprofit providers were 72 percent less likely to fail than the oldest—and most institutionalized—human service agencies. The resiliency of very young nonprofits may reflect their greater use of volunteer labor and lack of physical assets compared with older providers, features that could help them quickly generate cash in times of fiscal emergencies.

In contrast, nonprofit providers that were between 5 and 9 years of age were significantly more likely to fail than nonprofits that had operated for more than 20 years. Indeed, organizations in the moderately aged category were the most likely to die. These failures may reflect the increasing complexity of operating an expanding business, the effects of sunken costs, and issues of timing, predictability, and continuity of funding (Grønbjerg 1993).

Nonprofit human service providers that were at least 10 years of age but less than 20 years fared somewhat better than the 5- to 9-year-old human service organizations, but they were still significantly more likely to die than the oldest human service nonprofits. This finding suggests that the longstanding relationships of older nonprofits with funders and other groups in social services may have helped buffer their operations from environmental change.

Job training and other core service nonprofits were more likely to fail than groups that supply emergency services. The analysis found that emergency providers were roughly 27 percent more likely to survive than core providers, when other factors are held statistically constant. Emergency service nonprofits include homeless shelters, food pantries, and other organizations that might be needed if a welfare recipient were dropped from the welfare rolls or an emergency arose. Core services include job training, child care, and other items that relate directly to preparing welfare recipients for work or supporting them in their transition to work.

The higher likelihood of survival by emergency services over core providers is somewhat surprising. The shift in policy goals from income support to labor-market entry increased the need for local service systems to concentrate on job skills, child care, and transportation. Thus, to the extent that social service systems reoriented goals away from long-term support, nonprofits focusing on emergency services might have been expected to exit the market. But the data reveal precisely the opposite phenomenon: These service providers held their own in the context of changing urban social service systems.

Several possible explanations for this finding include the robust network of emergency services in urban areas, as well as the relative youth of many nonprofit emergency providers. Emergency service nonprofits tend to be less than five years of age, a group that fails at a lower rate than moderately aged human service organizations. Moreover, core providers may face a different set of competitive pressures, as they battle for government dollars through the contractual process, which increasingly includes large, for-profit firms. Highly competitive contracting systems can cause more core groups to fail, despite the apparent congruence between their organizational mission and the shift in policy goals.

Assessing the Impact

The findings presented in this brief reveal several key factors that contribute to the organizational dynamism in urban nonprofit human service sectors. For example, the size, age, and organizational focus were key determinants in the failure of nonprofit providers. Smaller groups were more likely to die than larger ones. Except for the very youngest nonprofit human service providers, younger groups were more likely to fail than older ones. Surprisingly, emergency service providers were significantly less likely to die than core nonprofits such as job training and child care organizations, despite the congruence of the core group's mission orientation and shifting policy goals.

Overall, however, the study does not support concerns about the relationship between welfare reform efforts and the deaths of nonprofit human service organizations. In the broadest sense, the introduction of waivers in metropolitan areas had little impact on the deaths of human service nonprofits, although the probability of failure was higher in areas that experimented with some measure of reform.

The limited impact of AFDC programs on the deaths of nonprofit human service providers suggests that many of these groups maintained an adequate level of capacity to meet organizational commitments and client needs. Moreover, many human service nonprofits successfully navigated changing contracting systems during this period. De Vita and Twombly (1997), in a study of the finances of a panel of human service nonprofits in 13 states, determined that the majority of groups had revenues that exceeded expenditures from 1992 to 1996. And while some nonprofits failed during this period, their deaths appear more closely related to organizational factors than to socioeconomic conditions or policy changes. For example, spending by local governments on social welfare, the size and organizational density of local social service systems, and the population of the metropolitan region were not significantly related to the closures of nonprofit providers in urban areas.

Whether nonprofit providers either changed their operational strategies during this period to become more like for-profit organizations or diversified the quality and quantity of the services are additional questions to be explored. Also worth considering is the role of nonprofit human service organizations' ability to market their services to those in need. While many welfare recipients receive assistance from nonprofits, the evidence suggests that low-income families turn to other sources for support. Loprest (1999) found that between 1995 and 1997, 72 percent of welfare leavers had not sought help from nongovernmental sources. Of those seeking help, about one-third used a faith-based provider, while only one-tenth sought assistance from secular nongovernmental organizations. The remainder of welfare leavers relied on their families and friends for help. Yet, in the context of welfare reform, the rate of nonprofit human service failures remained low, and the finances of existing providers stayed relatively strong. Given this stability, the surprisingly low reliance of welfare leavers may reveal a mismatch between their needs and the accessibility and affordability of nonprofit human services organizations.

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Endnotes

1. Before the passage of the 1996 federal welfare reform legislation, states had gained wide latitude to redesign public assistance systems under Section 1115 of the Social Security Act (SSA). This provision provided the Secretary of Health and Human Services with broad discretion to waive provisions of Section 402 of the SSA for state demonstration projects. The waiver authority was intended to free states from many of the provisions of the AFDC program and to give states the flexibility to demonstrate alternatives that better match their residents' needs.

2. An important distinction exists between the financing and provision of public goods and services under privatization and devolution. Although policy initiatives like welfare reform do not necessarily reduce the government's role in financing public goods, they have a considerable impact on the manner in which goods and services are supplied to consumers.

3. The National Center for Charitable Statistics is the national repository of data on nonprofit organizations. Originally formed at the Independent Sector, it relocated in 1996 to the Urban Institute's Center on Nonprofits and Philanthropy.

4. The measure of AFDC waiver experimentation stems from a policy typology developed by Twombly (2000), who identified 10 key elements of AFDC waivers plans, including changes to JOBS program exemptions, modifications to JOBS sanctions, time limits, family cap provisions, earned income and asset disregards, resource or asset restrictions, transitional childcare or Medicaid, rules on two-parent AFDC eligibility, child support enforcement, and the expansion of JOBS eligibility to noncustodial parents. Metropolitan areas that used waivers with at least 90 percent of the elements are considered "extensive" experimenters. Those that operated under waivers, which contained 60 to 80 percent of the 10 elements, are classified as moderate experimenters. Minimal experimenters are metropolitan regions that used between one and five elements in their waiver plans. Metropolitan areas that did not operate under a statewide waiver between 1992 and 1996 are classified as nonexperimenters and serve as the reference group in in the regression models.

About the Author

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