Diversity in Nonprofit Entrepreneurship

Factors that influence the creation, growth, and survival of new nonprofit organizations are key to understanding the vitality, diversity, and representation of the nonprofit sector

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Executive Summary

What prompts the birth of a nonprofit? Nonprofits are often created to meet a variety of challenges arising in diverse contexts, including responses to current events such as natural disasters, reactions to crisis and suffering, realizations of visions for a better world, or manifestations of personal beliefs and desires to live out values. The creation of a new nonprofit is rarely the end goal for a social entrepreneur; rather, it is a necessary step in formalizing and resourcing an emergent mission, need, movement, or vision. Knowledge about variation in the nonprofit start-up process is important for charting a roadmap for research and generating the types of knowledge that can support social entrepreneurs and civil society champions.

The concept of nonprofit formation is nuanced. Many nonprofits are born through a "slow hunch" process (Johnson, 2011) where activities emerge as organic solutions to problems in communities or entrepreneurial activities responding to challenges within organizations. Founders may have no initial intent of creating a nonprofit until they find themselves at a juncture where they need to formalize pilot programs or organizations to move an idea forward. The average nonprofit founder operates informally for about 6.5 years before formalizing and incorporating (Lecy et al., 2016). Many nonprofits undergo dramatic reorganizations and personnel shifts between conceptualization, informal start-up, and formal incorporation (Andersson, 2019). It is also possible that new, nonprofit-like programs may exist for many years through innovative structures, such as fiscal sponsorship, for existing entities to nurture new programs. Thus, we may not necessarily see a formal nonprofit incorporation (Andersson & Neely, 2017).

Creating a sustainable organization is no small feat. Highly competitive start-up environments favor experience, and existing networks of power and finance do not allow equal opportunities for all. Nonprofit entrepreneurs must recruit board members, raise start-up capital, build community partnerships, and garner program resources, volunteers, and staff. Success in the start-up process often depends heavily on whether founders have had prior start-up experience, access to sufficient financial support, managerial expertise, and the intellectual and social capital of dense social and professional networks (Andersson, 2019). Not all founders have the same access to such resources and support, however.

Since many nonprofits are formed around distressed communities, marginalized peoples, and economically disenfranchised populations, it is important to understand the intersection of the start-up process and entrepreneurial dynamics surrounding those communities. We currently lack an understanding of disparities in emerging organizations' access to resources and social support needed to build managerial competency, including disparities based on the racial and socio-demographic composition of a nonprofit's leadership team, the people they serve, or the communities where they are located.

For nonprofit entrepreneurs from underrepresented racial-ethnic backgrounds, how does access to financial resources translate into creating or scaling social innovation that could address the unmet needs of their communities, or that could fulfill their dreams of having autonomy with the work they value and believe in? Individuals with lived experience in marginalized communities understand the needs of their communities best, but structural inequalities may leave them with the least access to the resources required to meet those needs.

Because the start-up environment does not offer everyone equal support for innovation and community solutions, do we have a system that perpetuates and duplicates systemic failures to address the needs of marginalized populations? Are we creating a space where even nonprofit entrepreneurship perpetuates racial discrimination due to a lack of understanding of what allows a new nonprofit to succeed? What is the risk that marginalized people—including people of color—are subject to a start-up system that are not best equipped to formulate solutions because they are often fueled by donors and outside actors who may have genuine interest but have limited understanding of the issues that marginalized people face? To what extent is that risk handicapping the planning and implementation of socially innovative ideas from nonprofits focused on minority and marginalized groups?

How can we encourage the growth of more experimental tools and strategies to meet the needs of marginalized populations, especially from the people who best understand the problems they face? For instance, Black and Brown women are overrepresented in caregiver roles, especially in healthcare and childcare, but they are severely undervalued and underpaid for this work (Gould, Banerjee, and Sawo, 2021). Do these women have time to raise awareness of their issues, discuss them in public spaces, and advocate for themselves? Kim's (2015) study provides some support for these questions as her study has shown that communities with a high level of income inequality tend to have more nonprofits per capita, probably owing to differences in need and interest between the wealthy and the marginalized. But her findings are only suggestive and more data is needed to understand this crucial issue.

This white paper reviews relevant academic literature on nonprofit creation, growth, and survival in order to better understand what is known using current research on nonprofit entrepreneurship and issues of equity and representation in the sector. We specifically focus on understanding the current environment for nonprofit founders, and whether there is an uneven, unequal playing field for nonprofit entrepreneurship in the sector. To that end, we discuss a series of research questions that must be answered to address the disparities that exist in the start-up environment. We also discuss how such systematic disparities continue to create greater racial minority representation in the nonprofit sector.

Introduction

Nonprofits play many important roles in building vibrant communities. They serve as voices for the voiceless, provide critical social services, and contribute to economic stability. They help to keep the government and the for-profit sector accountable and responsive to the needs of citizens (Salamon, 2012). Greater presence of nonprofits in similar market spaces has been shown to encourage less rent-seeking behavior for their for-profit counterparts (Costa and Harrison, 2019). In other words, having more nonprofits in a community tends to deter for-profit counterparts from taking economic advantage and increasing profits through manipulating means. In addition, many nonprofits focus on advocating for marginalized communities, elevating their voices and needs such that they become public policy priorities.

The size of a nonprofit sector in a community influences the vitality of the community's arts and culture programs, access to human services, the supply of affordable housing, the efficacy of public health, protection of civil rights, the quality of parks, access to recreational activities, and much more. Thus, the growth and sustainability of the nonprofit sector are topics that should concern communities and policymakers. Each year, many new nonprofits are created, but many of the existing nonprofits also stop operating. Harrison and Laincz (2008) establish that, for incorporated nonprofits that file tax returns, the rate of entry is about twice that of the rate of exit, but we know little about the similar turnover of nonprofit start-ups. Andersson (2020) and Searing (2020) have found that rates of nonprofit creation and shutdown vary widely across geographies and datasets.

While a growing number of empirical studies (e.g., Kim, 2015, Lecy & Van Slyke, 2013; Harrison & Thornton, 2014) have explored the factors associated with nonprofit density—the measure of which local communities have more nonprofits per capita relative to comparable peers—we still have relatively limited knowledge about the factors contributing to the establishment and growth of nascent nonprofit organizations, as well as their stagnation or demise. These cycles clearly determine nonprofit densities, but an understanding of the inflows and outflows is crucial and has very different policy implications. For example, a community may have higher nonprofit density due to higher entry, or due to lower exit rates, or perhaps both. Moreover, there is strong evidence in for-profit entrepreneurship that a robust cycle of formation and exit is critical to innovation, growth, and productivity (Foster, Haltiwanger, & Syverson, 2008). Does this finding hold in nonprofit settings? We know very little about whether or how such mechanisms translate into goods and services specifically targeting the social safety net, as opposed to goods and services tailored to private sector interests.

Nonprofits serve important roles in distressed communities and provide many activities that support vulnerable populations. However, some studies have highlighted a possible misalignment between nonprofit activities and disadvantaged communities. For example, only 27% of social service nonprofits primarily serve vulnerable communities, while most nonprofits are beholden to narrowly focused interest groups (Ben-Ner 2021). Minority neighborhoods have access to only half the nonprofit social services provided in predominately white neighborhoods (Allard, 2009). Ben-Ner and Van Hoomissen (1992) find that racial diversity is positively related to the number of educational nonprofits, but negatively related to the number of social service nonprofits. Corbin (1999) similarly finds no relationship between the density of social service nonprofits and racial diversity. Across Dallas County census block groups, nonprofits were more likely to locate in neighborhoods characterized by more racial diversity and larger proportions of aging citizens but were less likely to locate in communities that are economically diverse (Bielefeld, Murdoch, and Waddell, 1997). Yet, a recent Urban Institute report, based on a representative sample of US nonprofits, found that nearly half of nonprofits (45%) have programs that focus on those below the poverty level, and many organizations provide programs that focus on historically marginalized groups (Faulk et al., 2021). This report also found that at least one-fifth of nonprofit executives and board chairs are people of color, and most nonprofit boards have people of color. In other words, there is still much remaining to explore regarding the demographics nonprofits serve and how the demographics of nonprofit service recipients match with those who run nonprofits. Most importantly, to what degree these findings are the result of a lack of minority entrepreneurs is an open question.

Having a better understanding of the factors that promote a strong nonprofit entrepreneurial process can allow funders and policymakers to support smaller and newer nonprofits to increase successful outcomes. Nurturing new nonprofits will promote innovative nonprofit programs that benefit their communities. Similarly, understanding such factors can help funders and policymakers to help unsuccessful or less impactful programs exit the market more quickly. We must note here that the sector should normalize the idea that some programs will fail, and failing a nonprofit program does not necessarily imply that the entrepreneur themselves is a failure. We should also normalize the idea that such failure during the entrepreneurial process is a healthy part of innovation. A strong entrepreneurial process will support successful ideas and resilient nonprofits. Equally important is the need to build capacity for entrepreneurial training and development.

Knowledge of these success factors is limited, partly due to challenges in identifying young nonprofit organizations—including nonprofits that have not yet incorporated or registered with the IRS. Current studies of U.S. nonprofits tend to rely on government administrative data (e.g., lists of incorporated nonprofits in each state or IRS-registered nonprofits), but that approach leaves out many nonprofit entities that are not captured in administrative files. Nonprofit organizations include all entities that (1) form voluntarily, (2) operate without distributing profits to stakeholders, and (3) exist without clear lines of ownership or accountability (Frumkin, 2005). Based on this conceptual definition of nonprofits, many nonprofits exist well before they file a Form 1023 with the IRS, if they file one at all. It must be noted that much nonprofit activity can and often does take place before formal steps, such as incorporation and/or IRS registration (Levine Daniel & Andersson, 2021), making it even more difficult for current research methods and existing data to capture the behavior of nonprofits early in the cycle. Indeed, Lecy et al. (2016) found that registered nonprofits take 6.5 years on average (with a median of three years) before deciding to register with the IRS, but again, this is the case known among those organizations that eventually registered their nonprofits.

To address this knowledge barrier, in this white paper, we provide a conceptual model of nonprofit industrial economics. Then, we define new nonprofits and outline why it matters that we understand them. We also discuss the entrepreneurs who create nonprofits and transition them from concept to start-up, as well as the factors that enable new nonprofits to sustain themselves and grow, or to languish and collapse. To that end, we identify underlying issues of equity surrounding the birth and growth of nonprofits, along with implications for policymakers. We also identify the data that the sector needs to collect in order to better understand and support the growth of nonprofits.

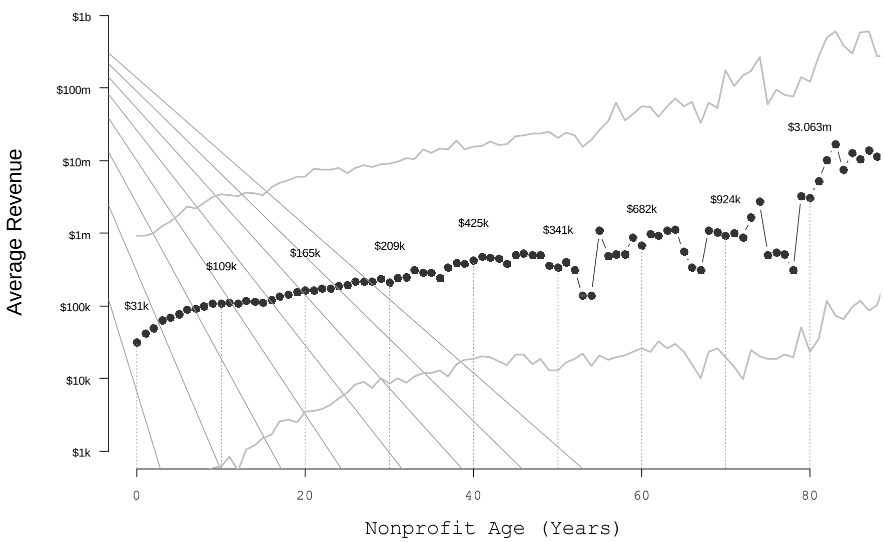
A conceptual model of nonprofit industrial economies

Before we begin the discussion of new nonprofits, we must recognize two broad stages in the nonprofit lifecycle based on organizational ecology theory (Carroll & Khessina, 2005): (1) the attempt to start a new nonprofit, and (2) the operations of a nonprofit once it exists. In the first stage, success depends on whether the entrepreneurship ideas materialize into an actual nonprofit institution (i.e., founded, incorporated, and/or registered with the IRS). In the second stage, success is evaluated based on whether the organization continues to operate and survive as a start-up institution (Edenfield & Andersson, 2017). The key is to understand that the birth of a nonprofit is not a single, distinct event that takes place all at once, but is instead a process that takes place over a long period of time (Edenfield & Andersson, 2018). Further, even if it is an operational start-up nonprofit organization, it could still fall under the administrative radar by choosing not to incorporate at the state level or not to register with the IRS. Some may operate under the umbrella of a fiscal sponsor (Andersson & Neely, 2017).

Stevens (2008) argues that different stages are likely to be different in terms of needs, capacities, and processes. That is, the formal start-up stage of nonprofits would look quite different from the pre-organizational nascent stage as they would have at least one distinct operating program, well-defined work roles and paid staff, basic administrative and financial systems, and a board of directors—and all of these structures would create different requirements. In order to understand how entrepreneurial support might impact the nonprofit economy, it is important to start with this basic model of the organizational dynamics that drive innovation and growth within economies. In this simplified form, we can think of the entrepreneurial process as a series of state changes among different phases within the nonprofit lifecycle.

In the first state—the nascent or pre-formal stage—an entrepreneurial individual encounters an unaddressed problem or need in their community or interest area in such a way that it inspires them to become engaged in a sustained manner. That problem or need could be dramatic, such as survivors of a school shooting recognizing legislative inaction in response to gun violence in public spaces, or it could be something mundane yet still important, such as a curious individual becoming interested in the history of a town's buildings. Often it is as simple as an individual recognizing there is an important need in a community that they perceive is not being met, and then begin a process of investigating how the need might be addressed. This phase is defined by ideation, invention, piloting, and experimentation with new activities, programs, or business models in a period before the nonprofit is formally incorporated.

Figure 1. Average nonprofit revenue by years of operation (median, 5th, and 95th percentiles)



Note: Authors' calculations using the 2022 NCCS Business Master File

The second state describes a newly incorporated nonprofit, or an organization that has recently received formal tax-exempt status from the IRS. This phase begins when founders are confident enough in their idea or their team to undertake the somewhat onerous process of seeking formal corporate status and navigating the additional process of applying for tax-exempt status. Based on a small sample of about 100 nascent nonprofit entrepreneurs, Andersson (2018a) finds that start-up costs would be somewhere between $5,000 and $20,000, and these entrepreneurs tend to focus mostly on philanthropic grants and individual donations. Most nonprofits fall much closer to the $5,000 end of that range, which is generally sufficient to cover not just physical costs, such as office supplies, but also fees for setup, incorporation, and IRS registration; meanwhile, about one quarter reported start-up costs close to or in excess of the $20,000 end of the range (Lecy et al., 2016).

Still, even with relatively low start-up costs, the reality is that many nonprofit founders have to draw from personal contributions—including their own and those of board members—even though only a few intend to finance their nonprofit ventures from personal funds for more than a year. Taken all together, we must note that these estimations still need further research and start-up costs tend to vary drastically. Moreover, this leaves the question of how society can increase the chances of initiating new nonprofits that can address unmet social needs or try innovative approaches. It must be noted that not all nonprofit entrepreneurs have the vision to address the unmet needs of their communities, much less evaluate market needs, because their motivations are often personal (Carman & Nesbit, 2012). Still, it raises the additional question of who creates nonprofits. Unfortunately, current research does not offer much of an answer, an inequity we discuss in the next section.

While it may not seem to be a huge cost to initiate a new nonprofit, it can still be a barrier, especially when combined with the need for managerial competency and the capacity to solicit funds for sustainable program offerings. Given that creating structures and formalizing the institution are likely to help nascent nonprofits become more successful (Andersson, 2019), it is reasonable to expect that those who want to be successful and sustainable would need to invest in those start-up costs. Although in terms of activities, a newly incorporated nonprofit may look a lot like its nascent or pre-formal version, the new phase represents a level of commitment beyond recreational or symbolic engagement with a mission because the founding team and board begin to focus on building sustainable programs that require more substantial commitment to the organization. For instance, a nonprofit may not have had a formal board or by-laws until filing either or both the 1023 and incorporation forms at the state level, but such institutional structures must be established to have those filings complete and as part of the process of formalization. Despite the costs of time and resources that the filings require, there are clear benefits to being incorporated at the state level and registered with the IRS, including tax-deductible donations and recognition as a legitimate legal entity.

These two phases are still challenging, however, thanks to either or both the “liability of newness” and the “liability of smallness,” problems that trouble organizations early in their development. At this stage in a nonprofit’s existence, the organization has yet to establish significant social capital with its stakeholders or their communities; the founding team is most likely working together for the first time; the executive team may be inexperienced in leadership roles; programs are still under development; and business models are rarely stable. As a result, organizations are especially fluid and vulnerable early on.

These liabilities have been well-documented among for-profit start-ups, but we know much less about how they manifest in nonprofit settings. In a comprehensive study of nonprofits filing tax returns, Harrison and Laincz (2008) show that the exit rate for new for-profit firms is roughly twice that of all nonprofits. In addition, new and surviving nonprofit organizations are larger than all entrants combined and, equally important, grow at a relatively fast rate. Based on the analysis of nonprofits filing with the IRS, we find that over the course of a decade, a new nonprofit is almost twice as likely to cease operations as it is to grow beyond a small, grassroots state (See table 1 below). The small organizations (less than $100k in 2010) are three times more likely to die than to grow to the next revenue size category ($100k to $1m) over the decade. It is interesting to see the failure rates increase over that second decade.

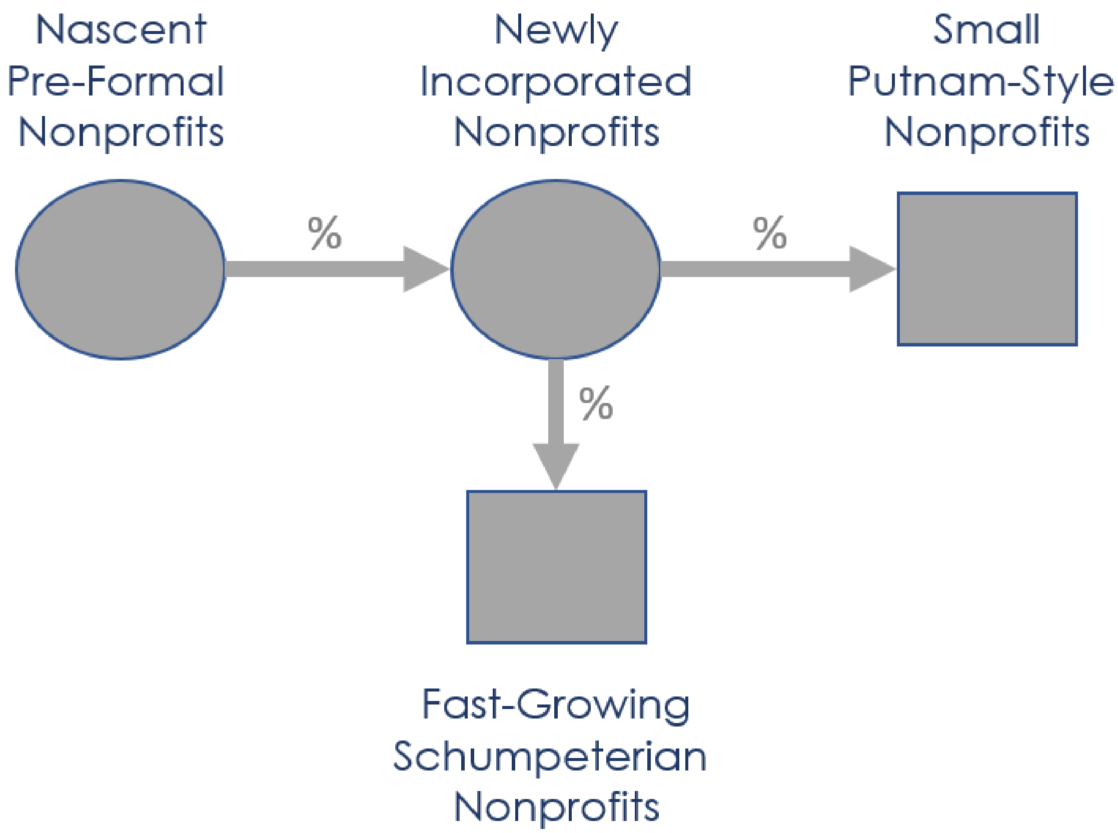
Table 1. Nonprofit Size Growth Over the Years

SIZE IN 2000	$0 to $100k	$100k to $1m	SIZE IN 2010 $1m to $10m	$10m +	Dead
Born After 2000	0.585	0.338	0.065	0.011	0.000
$0 to $100k	**0.443**	0.189	0.008	0.001	0.360
$100k to $1m	0.099	**0.556**	0.127	0.002	0.216
$1m to $10m	0.014	0.094	**0.637**	0.119	0.135
$10m +	0.004	0.013	0.067	**0.812**	0.103

SIZE IN 2010	$0 to $100k	$100k to $1m	SIZE IN 2019 $1m to $10m	$10m +	Dead
Born After 2010	0.537	0.352	0.087	0.024	0.000
$0 to $100k	**0.386**	0.154	0.006	0.000	0.454
$100k to $1m	0.100	**0.545**	0.108	0.002	0.245
$1m to $10m	0.014	0.079	**0.636**	0.093	0.177
$10m +	0.007	0.009	0.059	**0.760**	0.165

Note: Authors’ calculations using the NCCS Core files (2000,2010, and 2019).

Figure 1. Three types of new nonprofits



Of course, the goal for new nonprofits is typically to reach a level of stability and formalization that will ensure sustained engagement with the mission, something that does not necessarily imply continuous growth. This can mean different things for different types of organizations. For some organizations, this might mean growing to a size where operations can be codified and a professional team developed to institutionalize the management of programs, resources, and human capital. It is rare, however, to reach a size that allows for these types of economies of scale early in an organization's existence. Rapid growth may not be an option or even the desired outcome for all nonprofits. Consider, for example, that the average nonprofit is 40 years of age when it reaches about $425,000 in annual revenue and the revenue size may even fluctuate a lot before it stabilizes with a scale (see Figure 1). For most nonprofits, sustainability comes by establishing a specific niche in the nonprofit ecosystem where some stable set of clients, financial donors, or philanthropic relationships are established and enough institutional memory, culture, and operational protocols are established to create continuity through time and leadership transition.

To leave the nascent phase, nonprofits must transition into one of the two other states (See figure 1). Schumpeterian nonprofits are those that have an explicit mission of being disruptive or changing industry in some meaningful way (Young & Lecy, 2014). The Susan G. Komen Foundation has mobilized hundreds of millions of dollars for breast cancer research, treatment, and education[1] . The Federalist

[1] See https://www.komen.org/about-komen/

Society set out to reshape the American court system[2]. ProPublica has ambitions of changing the landscape of investigative journalism[3]. These are the equivalent of venture capital-backed start-ups that require significant growth and reach to be successful. They tend to have a national or international scope of operations. They also are often backed by wealthy philanthropists from the start and built for scale, making them outliers in the sector.

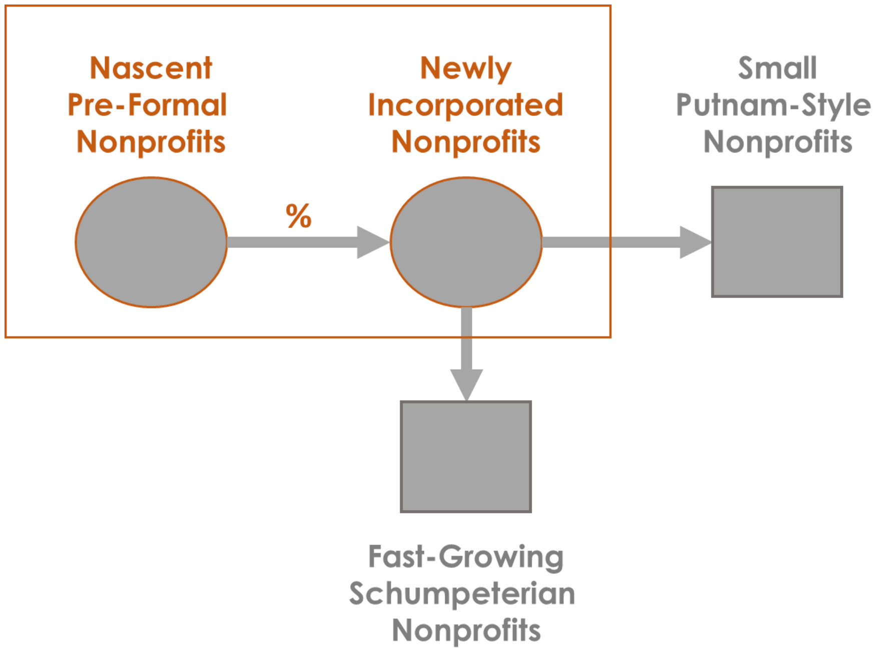
Conversely, the vast majority of nonprofits are small, community-based organizations. Over 50% of nonprofits have revenues of less than $200,000 per year, according to the authors' calculation using the 990 tax return database. Furthermore, trends in the U.S. nonprofit sector most strongly parallel small businesses: they make up the vast majority of organizations by count, provide a large share of employment, but comprise a modest proportion of the total economy since large corporations still generate the most GDP (US Small Business Bureau, 2020). We refer to these as Putnam-style nonprofits because they tend to promote the types of social capital that glues communities together—festivals, neighborhood associations, parent-teacher associations, little leagues, animal shelters, and food banks, among others. Identity, reputation, and community capital are extremely important for nonprofits of this type. They tend to rely more heavily on volunteers and often have deep ties within communities. As a result, smaller nonprofits follow different models of sustainability. A parent-teacher association or children's sport league may evolve over time, but these entities do not require sustained, continued growth for impact. They typically operate with a couple of paid positions and a largely volunteer management team. Their impact comes from sustained engagement with their communities and emergent local networks that create venues for community self-reflection and actualization, as well as by enabling collaborative problem solving, collective action, and information exchange. Considering that many fall under the category of Putnam-style nonprofits, we must be clear that the liability of newness and liability of smallness should not confound them with failure to scale since their intentions and purposes do not include growing large. At the same time, Figure 3 suggests how rare and difficult it is for nonprofit start-ups to scale, as it shows how small the typical nonprofits are and how slow growth can be for most nonprofits.

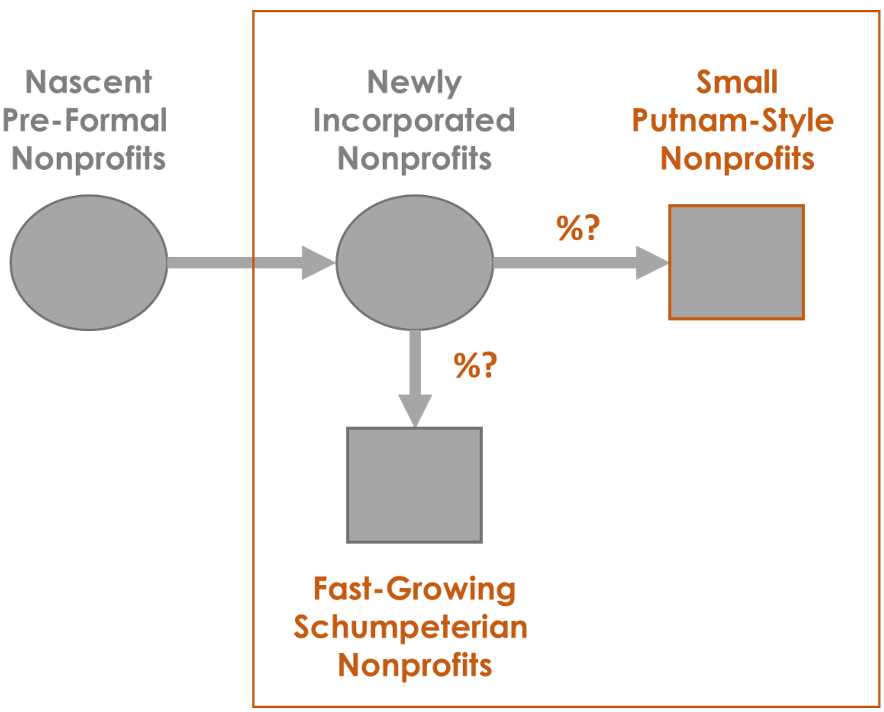
What do we know about the determinants and successes of nonprofits in these stages of transition? The short answer is very little. We lack similar statistics for rates of survival and exit as nonprofits transition from the nascent to the incorporated stage. This transition period is crucial, but not well documented. And new innovations in partnering, such as fiscal sponsorships, leave open a real possibility that many nascent organizations may not "transition out" as much as "transition in" to an existing nonprofit, effectively becoming a subsidiary to an older, more established organization. Similarly, what are the transitions and what determines whether a nonprofit will leave the new, incorporated phase as a small, Putnam-style organization or a fast-growing Schumpeterian? Reiterating the diagram from before, we now highlight how little we know about the transitional phases of the nonprofit lifecycle (see figure 3), nor do we know the percentage of nonprofits that move from one phase to another—not just nascent to newly incorporated, but also how many newly incorporated become Putnam or Schumpeterian nonprofits.

Figure 2. Transitional phases of the nonprofit lifecycle

[2] See https://fedsoc.org/about-us

[3] See https://www.propublica.org/about

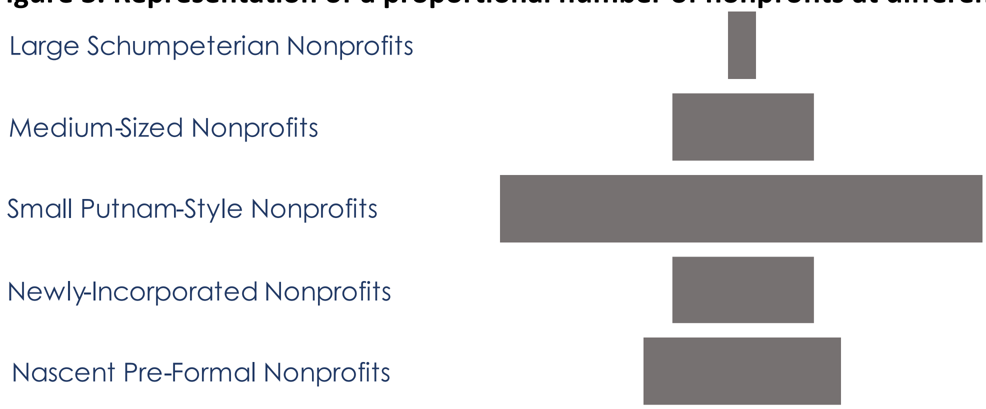




We know that intent varies widely among nonprofit founders, board members, and management: Only 10% of new nonprofits have ambitions of rapid growth, while the other 90% have ambitions of slow and steady growth or no growth at all (Lecy et al., 2016).

From a practical perspective, the needs of entrepreneurs and start-up organizations seeking sustainability as a modest Putnam-style nonprofit are likely very different from the needs of entrepreneurs and organizations that are attempting to scale as Schumpeterian nonprofits. The literature needs to be conscious of the distinction between these entrepreneurial endeavors and begin to clarify which definition of entrepreneurship and, correspondingly, which managerial recommendations are appropriate for each type. More importantly, which category of entrepreneurs best describes racially and economically diverse groups of founders that lead start-up processes in distressed communities? Are they more likely to be Schumpeterian or Putnam-style leaders? If we want to tailor start-up support to increase diversity in the sector where would it go? The distribution in Figure 4 and Table 1 below shows how heavily skewed the sector is toward the small, grassroots, Putnam-style organization (approximately 75% of the sample). At the same time, they account for less than 1% of revenue. Conversely, large organizations comprise about 2% of the sample but account for almost 90% of revenues.

Figure 3. Representation of a proportional number of nonprofits at different phases



(Based on numbers below, large is 2%, medium is 23%, small is 75% of total)

Note: Based on authors' calculation by combining the IRS BMF with 990-N post-card filers (https://www.irs.gov/charities-non-profits/annual-electronic-filing-requirement-for-small-exempt-organizations-form-990-n-e-postcard).

Approximately one-third of small nonprofits are "newly incorporated," a figure that shifts to one-quarter of all nonprofits. Smith (1997) estimates that about 90% of nonprofits are not adequately captured in statistical maps of the nonprofit sector because they are informal groups. Even though nonprofit scholars have advanced the methodological approaches to estimate not only registered or incorporated nonprofits, but also informal or pre-formal groups since Smith's attempt with 1990s data, we still lack a clear idea of how large the pre-formal group might be.

These statistics help demonstrate why theory should be tailored. There are a very small number of Schumpeterian-style nonprofits in the start-up phase at any given moment, but they can have a disproportionate impact on society (the Federalist Society being a timely example). For example, Foster and Fine (2007) show that of the 200,000 nonprofits created approximately between 1970 and 2005, only 144 reached a size of at least $50 million in annual revenue. Over the same period, 46,136 new for-profits grew to exceed $50 million in annual revenue (Pallotta, 2013).

But this group of large nonprofits generates the majority of nonprofit revenue. If a better start-up theory can double that rate of scaling, it could achieve a sizable impact. Nonprofit start-ups might be most starved for capital since equity options are limited. Former President Obama's initiative on social impact targeted some of these challenges. Conversely, both entrepreneurship and social entrepreneurship studies on scaling start-ups offer very little for Putnam-style nonprofits. What would meaningful start-up research look like for this group?

New nonprofits: What are they? Why do they matter?

While most would agree on the values and benefits that nonprofits bring to their communities in general, emerging and new nonprofits add particular benefits, such as creating new employment opportunities (Hopp, 2012) and driving social innovation (Bornstein, 2007). Further, the classic nonprofit theory states that nonprofits are created to address unmet social needs and diverse preferences (Weisbrod, 1977). Even so, some say that the nonprofit sector does not need to add new organizations to be vibrant; it just needs existing nonprofits to be bolstered in some way. Some call for more mergers and collaboration amidst crowded market conditions and constrained resources (McLaughlin, 2010). However, evidence supporting these calls is muddled by the fact that very few nonprofits actively close their doors and declare their exits, which skews net entry rates in a higher direction than those in the for-profit sector (Harrison & Laincz, 2008). While it is partially true that the sector has redundancies and inefficiencies, it is also true the sector can stay vibrant only if it continues to allow new entrepreneurs who inject innovations into existing systems, testing and then re-testing those innovations in a process similar to the classical understanding of natural selection.

While the increase of new nonprofits itself should not be considered a problem, there should be discussions about who has the access necessary to create new nonprofits that address unmet needs and social innovation. Understanding who creates nonprofits and which newly established nonprofits survive or fail can have implications for how public funds are utilized, especially in terms of equity. Furthermore, equal access and opportunity to initiate new nonprofits also provide avenues for entrepreneurial activity to respond to different needs, as suggested by government failure theory (Weisbrod, 1988). More nonprofits also can lead to more competition, which can lead to higher quality service and greater social impact. Additionally, new nonprofits can be products of necessity-based entrepreneurship, meaning that those needing to create employment opportunities for themselves may initiate new institutions that fulfill their visions (Andersson, 2018). Overall, a vibrant nonprofit sector builds social capital that then nurtures economic growth, community cohesiveness, and quality of political institutions (Putnam, 1995). Unfortunately, existing literature suggests that many nascent nonprofit entrepreneurs fade away before reaching the start-up phase (Andersson, 2019), which is one reason it is so important to understand the factors that help nonprofit entrepreneurial ideas become nonprofit start-ups.

What factors encourage or prevent the formalization of nascent nonprofits?

To understand the factors that help nascent nonprofit ideas enter the market, we need to first understand who creates them and why, as well as factors that influence their development process, regardless of whether they register with the IRS or incorporate at the state level. As discussed previously, Lecy et al. (2016) found that half of the nonprofits registered with the IRS between 2008 and 2011 operated informally for an average of 6.5 years before being incorporated. That means they were in at least an experimental stage of development while voluntarily offering services, suggesting that it is fairly common to run pilot programs before being able to operate official programs. This, in turn, raises the question of whether all nonprofit entrepreneurs with socially innovative ideas have the capacity to endure iterative experimentation before incorporating.

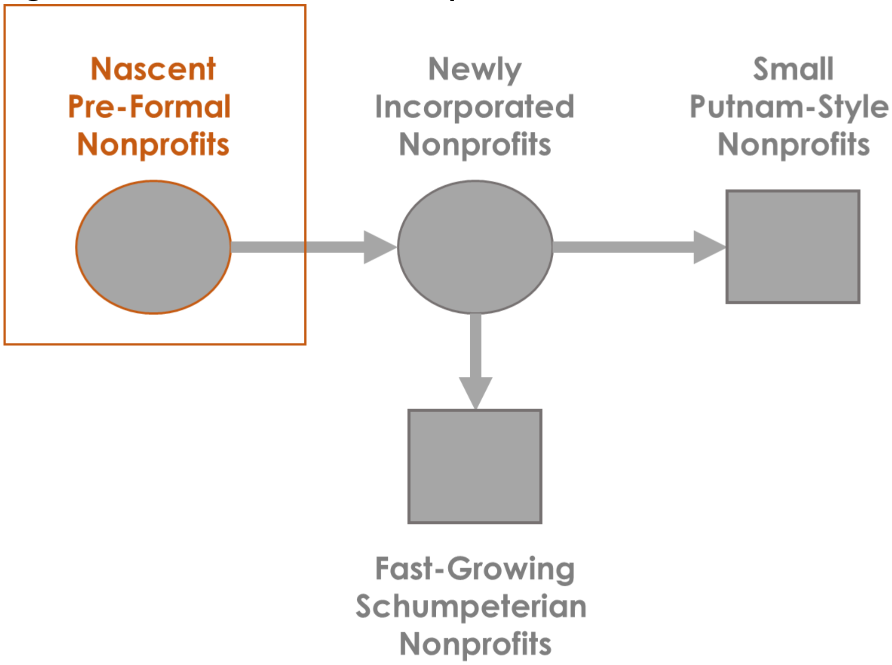
Research suggests that new ventures with highly formalized and administrative procedures tend to perform better because those structures help them gain legitimacy of operations (Sine, Mitsuhashi, & Kirsch, 2006). Andersson (2019) similarly finds that nonprofit entrepreneurs who had to deal with more regulatory issues were more likely to have moved a nonprofit organization to the start-up phase because they had to formalize processes in order to survive the regulatory environment. Further, those regulatory concerns drove nonprofit entrepreneurs to create structures and routines that make start-ups more stable and successful, such as board governance and by-laws (Andersson, 2019). In short, new nonprofit ventures must develop organizational strategies, procedures, managerial controls, and financial expertise (Chambré & Fatt, 2002; Frank, 2002; Nitterhouse, 1997; Strichman, Bickel, & Marshood, 2008). Returning briefly to Andersson (2016), both a strong impetus and commitment are required on the part of nonprofit entrepreneurs and establishing relations with multiple stakeholders that include funders, customers, and beneficiaries is crucial for sustainability. Doing so can help cultivate a strong base of support (Chambré, 1997; Jawahar & McLaughlin, 2001; Nitterhouse, 1997). Finally, nonprofits seeking to grow should develop a board of directors and governance capacity that can help build strong relationships with stakeholders in the operating environment.

Andersson (2019) advises that nonprofit entrepreneurs must learn more about start-up problems and how to handle them, rather than simply making multiple attempts that would only continue to fail. All nonprofit entrepreneurs experience challenges, but only those who learned from start-up problems and figured out how to handle them go on to create start-up nonprofits. Andersson (2019) also found that it is not how many problems nonprofit entrepreneurs face at any given time, but rather, the type of problems that poses the greatest risk. In general, financial and informational problems had negative effects on the transition from entrepreneurial idea to nonprofit start-up, while regulatory problems had positive effects. Andersson's (2019) study found that securing financial and informational resources plays a critical role in enabling start-up success. because not all start-ups will be successful, this indicates that not all individuals with entrepreneurial ideas have equal access to those resources. The data in his study suggests that unsuccessful nascent nonprofit entrepreneurs have encountered more financial problems, indicating that those with limited financial capacity and flexibility are much more likely to fail. Further, the abundant availability of information online and elsewhere about how to start a nonprofit does not appear to be helpful; if anything, nonprofit entrepreneurs need that information to be streamlined in order to use it effectively. This suggests a need for more customized support and additional training for nonprofit entrepreneurs to push their ideas to the start-up phase.

What else does it take for a nonprofit to move from the start-up phase to becoming an up-and-running institution? Searing and Lecy (2021) find that start-up nonprofits must be able to invest in professional fundraising and building access to government funds in order to formalize their institutions and grow. Further, growing from a small start-up to an established institution must come with formalizing managerial structures and organizational processes, as well as stabilizing the way programs are financed. It is worth noting that not all nascent nonprofits desire to grow bigger, as some might prefer staying small in size (Andersson, 2020). It is also important to consider how such infrastructure is incorporated, ideally with the goal of encouraging more minority entrepreneurs whose work is vital, but whose presence is largely absent or silent in the literature.

Who are nonprofit entrepreneurs/founders?

Figure 4. Nascent Pre-format Nonprofits



Who creates nonprofits and why? First and foremost, we must acknowledge that little is known about the lives and characteristics of nonprofit entrepreneurs, especially regarding their demographic backgrounds. Although some studies examined established IRS-registered nonprofits to understand who creates nonprofits, we know very little about the founders of small grassroots nonprofits, and even less about those who elect to remain unregistered. Again, we must emphasize that registered nonprofits comprise only a small fraction of the nonprofit world, especially for those at their nascent stage. Below, despite the limitations, we summarize a handful of studies that tried to understand the characteristics of nonprofit entrepreneurs, founders, and the potential reasons why they create nonprofits.

Nonprofit founders are often ideologically motivated and have a passion related to the mission of the organization they seek to create (Frank, 2002; James, 2003; Rose-Ackerman, 1996; Young, 1986). The combination of government failure, market failure, and contract failure theories explains that nonprofits are created to address needs that are either underserved or unaddressed by the government or market (Hansmann, 1987; Young, 1998). Contract failure theory further explains that nonprofit organizations are created in the areas where beneficiaries would either be put in a vulnerable position when determining the quality of programs, or would be wary of profit-driven service providers for healthcare, nursing, senior care, or education (James, 1987). Another theoretical perspective on creating nonprofit organizations is that they serve expressive purposes—that is, the desire to materialize one's values (Knutsen and Brower, 2010; Mason, 1996; Moulton and Eckerd, 2011). According to Handy, Mook, and Quarter (2007), "Expressive nonprofits serve to actualize values or preferences and include culture, sports, recreation, environmental protection, political expression, advocacy, labor unions, and professional and business associations" (pp. 80-81).

Using a survey of nonprofits created between January 2007 and March 2008 in Charlotte, North Carolina and its surrounding counties, Carman and Nesbit (2012) showed empirical evidence for all four theoretical perspectives discussed above. Many nonprofit founders start their organizations because of unmet needs in their communities, often for specific vulnerable populations—such as children with disabilities—providing support for the theoretical perspectives of government, market, and contract failure. Carman and Nesbit's (2012) study, however, also found that few nonprofit founders formally assessed community needs before creating a new organization. The lack of need assessments clearly coincides with increased perceptions of a crowded nonprofit sector teeming with redundancies and inefficiencies. Many argue that while the nonprofit sector should be a place to encourage new ideas and innovation, and thus promote anyone wanting to create a new venture, there also should be a support to assess community needs before duplicating efforts and constraining resources. However, it's also worth noting that Carman and Nesbit (2012) found community needs are not the only reason why nonprofits are created. That is, nonprofit creators are sometimes motivated by personal callings and lived experiences according to Carman and Nesbit (2012), and "make a living doing what I love" is also one of the main reasons why nonprofit entrepreneurs created new nonprofit organizations.

The current literature on "nonprofit entrepreneurs/founders" emphasizes that many come with passion, the desire for self-employment, and the ability to make a living doing what they love. While society must continue to encourage new ventures and entrepreneurship, nonprofit entrepreneurs themselves should also be encouraged to collaborate (Yankey and Willen, 2010). Many nonprofits, especially new ones, tend to work in isolation, losing opportunities to collaborate with one another. Thus, they lose the opportunity to engage in boundary-spanning activities, resulting in little interest in finding out how their work fits within the larger nonprofit sector (Carman and Nesbit, 2012) and potentially losing opportunities to be successful at turning their passion into tangible outcomes.

What do we know about their demographics? Not much empirical work exists for those who create nonprofits. Van Ryzin, Grossman, DiPadova-Stocks, and Bergrud (2009) found that social entrepreneurs are likely to be female, non-white, younger, and college-educated individuals with some business experience, are more likely to live in big cities, have more social capital as measured by their activity in clubs and organizations other than work, and more likely to be happy, interested in politics, extroverted, charitable, and ideologically liberal. They used the internet access panels of individual participants and identified social entrepreneurs to be those who answered that they had tried to start or manage "any kind of social, voluntary or community service, activity or initiative" (page 133). As such, it is worth noting that this group includes far more than just nonprofit entrepreneurs.

Lecy et al. (2016) examined the demographics of nonprofit founders whose work led to their organizations receiving tax-exempt status between 2008 and 2011. They found most nonprofit founders to be white, middle class, and well-educated. Nearly nine out of ten nonprofit founders are white and the average reported income level prior to founding a nonprofit was close to twice the national average. It should be noted that both Carman and Nesbit (2012) and Lecy et al. (2016) relied on the collection of formal nonprofits registered with the IRS, and therefore neither study covers those founders who fall below the radar.

Andersson (2019) similarly found that most of his 77 respondents had a college degree, but his survey of nascent nonprofit entrepreneurs included both those who successfully launched their nonprofits and those who have not yet done so. His finding is not surprising, given that college degrees are still suggestive of access to some form of wealth, and having sufficient start-up funding is an important element to operate nascent nonprofits (Andersson, 2018). Nonetheless, the finding clearly suggests an unequal opportunity for nonprofit entrepreneurship, and being able to start a nonprofit is not something that everyone can afford. Interestingly, his study also found slightly more female entrepreneurs than male entrepreneurs in the nonprofit sector (55% versus 45%), which is opposite to the trends in for-profit entrepreneurship (Wilson et al., 2007).

What else should we know to support the growth of new nonprofits?

Existing studies tend to capture the founding of a new nonprofit using its IRS registration date. Cordes et al. (2004) use the IRS ruling date to argue that organizations are likely to register shortly after their initial, informal stage because IRS recognition provides tax exemption and several other legal benefits. Another measure often used in the literature is the date of incorporation at the state level. Grønbjerg and Clerkin (2005) argue that state corporate registries can more accurately capture newly created nonprofits. They also find that many nonprofits are incorporated at the state level, but do not register with the IRS and vice versa, thereby creating a discrepancy between IRS and state records (Grønbjerg & Clerkin, 2005; Grønbjerg et al., 2010).

While there is room to debate whether researchers should choose to focus on registration with the IRS or incorporation within a state, studies looking at the early stages of nonprofits indicate that there are many nonprofits worth examination and consideration, even if they are neither incorporated nor registered (Levine Daniel & Andersson, 2021). Studies have consistently found that many nonprofits operate without administrative recognition, either because they choose not to pursue it or because they simply have not committed the time or resources to obtain it (Lecy & Van Slyke, 2016; Grønbjerg et al., 2010; Twombly, 2003). In other words, many nonprofit entities come to exist well before they file IRS Form 1023, the form required to obtain 501(c)(3) tax-exempt status, or are officially incorporated at the state level (Andersson, 2021).

Even with those discrepancies, the most common method found in existing studies is to identify nonprofits by looking at IRS-registered 501(c)(3) public charities (e.g., Kim, 2015, Lecy & Van Slyke, 2013; Harrison & Thornton, 2014; Van Puyvelde & Brown, 2016), then trace their establishment to the date of their IRS tax-exempt status. This tendency to conflate determinations by the IRS with the actual founding of nonprofits creates significant shortcomings because there are several stages where nascent organizations have not yet filed IRS Form 1023, and therefore are not fully captured in the most commonly utilized datasets. As such, simply relying on either the IRS forms or the incorporation date limits our capacity to understand the beginning of the lifecycle of nonprofit organizations.

With the disparities between registration and incorporation and the gulf between abstaining from recognition and being unable to achieve it, there exist severe inconsistencies in how researchers define new nonprofit organizations. These methodological inconsistencies, in turn, have made the nonprofit lifecycle more difficult to study and understand.

Another important and related question is what it takes for a pre-venture nonprofit to become a start-up nonprofit organization. Most studies focusing on the early stage of the nonprofit lifecycle tend to focus only on internal factors, especially entrepreneurs who bring new ideas to start nonprofit organizations (e.g., Edenfield & Andersson, 2018). Even when studies do mention external factors, they do so through an internal lens, treating them only as motivations for an organization's founders and did not focus on obstacles.

Knowledge of the beginning of the nonprofit lifecycle is fairly limited, and we have a disconnected understanding of the factors that contribute to a vibrant nonprofit community, especially regarding what it takes for nonprofit organizations to scale their programs and how various funding streams either stimulate or stymie nonprofit growth. Where do new nonprofits get funding? How, when, and why do they prioritize between developing programs, current programs, and general operations? When do they scrap programs and when do they scale them up or down? What actually happens when they try to scale programs? What factors would explain survival rates over three to five years? Answering these questions requires a longitudinal panel survey to follow a set of nonprofits over their lifecycle. Currently, all existing studies that attempted to answer these questions rely on surveys that used relatively small samples (i.e., small sample surveys) or case studies, which limits the capacity to generalize findings.

What data do we need?

The most common method for identifying nonprofits—looking at the IRS 501(c)(3) registry and then tracing it to the date of tax exemption—overlooks the reality that nonprofit creation is a process rather than a single distinct event (Edenfield & Andersson, 2018). This tendency to conflate IRS determinations with nonprofit creation results in significant shortcomings because there are several stages of organizational development before filing IRS Form 1023; these stages are not fully captured in the most commonly utilized datasets. As such, simply relying on IRS forms limits our capacity to understand the beginning lifecycle of nonprofit organizations. Further, there are variations in the way the death or exit of a nonprofit can be measured, when it can be measured at all (Cordery et al., 2013; Hager et al., 1996; Searing, 2018; 2020).

Nonprofit scholars must develop coherent methodologies to measure the entry and exit of nonprofits, drawing jointly on theories from the scholarly literature of entrepreneurship, organizational ecology, and industrial organization. Further, there should be an investment in creating a panel of newly formed nonprofits to capture the broader dynamics of the nonprofit sector and highlight the effect these dynamics have on the sector's vitality. Such panel data can help modify existing theories of organizational development that, until now, have largely been transplanted into the nonprofit arena with little attention to the structures and behaviors that are specific to the nonprofit form. The studies cited here are mostly based on regional and small sample surveys that are highly specific in both time and place, and which therefore offer limited utility when attempting to generalize and refine knowledge across a sector that spans every country on Earth. The sector needs to conduct a new large-scale survey of nascent nonprofit firms. Using the panel data developed in such a survey would create a tremendous contribution to the way we understand the sector's behavior.

Conclusion

There is much to be discussed about unequal opportunities in creating nonprofits. This white paper focused on describing the current start-up environment that does not address underlying systemic disparities for nonprofit entrepreneurs. Why does unequal opportunity to create nonprofits matter? The classic nonprofit theory expects that nonprofits are created to address unmet social needs (Weisbrod, 1987), and those unmet social needs can be best articulated by those who know the issue.

Unfortunately, the current nonprofit landscape allows only those with some form of affluence—whether social, professional, or financial—the ability to successfully transition their nonprofit ideas into nonprofit institutions. If so, it is questionable whether people of color, who are generally underpaid but overrepresented in fields like healthcare, have sufficient time and funds to create nonprofits that address the issues that resonate most with them. While we must recognize this issue, it cannot be meaningfully discussed or addressed without systematic data collection on nonprofit entrepreneurs, including who they are, how they start, who succeeds, who fails, and why. Such new data collection can be the first of many steps that must be taken to address the fundamental issue of inequity embedded in the nonprofit sector.

With the collection of new data on nascent nonprofits, we urge the sector to address the following questions: What disparities exist in the start-up environment? What community-level support exists for nonprofit start-ups? What differences exist between the demographics of nonprofit leadership among new nonprofits versus established nonprofits? Do systemic disparities lead to greater racial minority representation among nonprofit start-ups? How does this compare to more established nonprofits? How do nonprofits manage resource disparities? What role do disparities and experience play in failure rates for people of color-led organizations? Answering these questions can be the first step to addressing the underlying issues that create unequal opportunities for nonprofit creation.

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