NONPROFIT ORGANIZATIONS AND THE THEORY OF PERMANENT FAILURE

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ABSTRACT

Is longevity an appropriate goal of nonprofit human services organizations? If so, is superior performance the essential ingredient in achieving that end? Mainstream economic theory presumes high performing organizations survive while poor performing ones fail. Yet this thinking does not accurately describe what is observed in the nonprofit human services marketplace, where long-lived nonprofits frequently persist despite failing to meet even minimum performance expectations over extended periods.

An alternative theory grounded in sociology argues that, under certain circumstances, sustainability is achieved despite low performance. This outcome occurs when key stakeholders more concerned with organizational maintenance than organizational performance seize effective control from those vested with legal control. Typically, this circumstance arises after poor organizational performance causes stakeholder interests to diverge and renders traditional incentives ineffective in restraining the pursuit of self-interest. The consequence of the resulting contest for corporate control is that poor performing organizations do not choose simply between success and failure, but instead must decide whether to pursue success at the risk of failure. Permanently failing organizations ultimately value organizational maintenance above all else.

The application of Meyer and Zucker's theory of permanent failure to nonprofits is timely because it offers valuable insights into the evolution of nonprofit organizations, especially long-lived nonprofit human services organizations, that have been obscured by efficiency theories. Their theory is important because multiple factors make nonprofits especially prone to permanent failure, notably including the absence of an ownership interest, and hence call into question the validity of longevity as an appropriate nonprofit goal.

This paper explores the theory of permanent failure, its implications for long-lived nonprofit human services organizations, and the challenges and strategies available to those seeking to escape its grasp.

INTRODUCING THE THEORY OF PERMANENT FAILURE

Efficiency models of organization championed by conventional economic thinking assert that organizational performance is the foundation of firm sustainability. Organizations strive for superior performance measured by objective criteria like efficiency or profitability, and those that outperform survive, whereas others do not. Organizations succumb over time due to exogenous forces including competition, economic downturns, technological changes, or because of internal factors such as

ineffective governance or management. Permanent failure is impossible given the premises of the efficiency models except in isolated instances[1].

More than thirty years ago, Professors Meyer and Zucker disputed the central premise of the efficiency model, arguing that chronically poor performing organizations can persist indefinitely (Meyer M.W., 1989). Meyer and Zucker's theory of permanent failure proceeds from two observations, supported by extensive research: that organizational mortality declines with age, but organizational performance does not improve with age. The authors infer that performance, defined as the extent to which the official goals of an organization are achieved, is therefore just one factor, and not necessarily the most important one, that determines organizational survival. Proceeding from an ecological perspective on organizational change, the theory of permanent failure offers a rationale for these observations that upends two fundamental assertions about how markets and firms actually behave. The first of these is that firms which are efficient and effective displace inefficient and ineffective ones; and the second, that firms act like utility maximizing actors, rather than function as arenas in which stakeholders with divergent interests compete for influence (Meyer M. W., 1978).

Under conditions of satisfactory or better performance, the interests of stakeholders valuing organizational *performance* and those more concerned with organizational *maintenance* are readily aligned. This alignment is challenged when performance deteriorates, and principals seek to restore performance by altering organizational strategies and structures[2]. These changes frequently include reallocations of resources to higher performing units from units whose performance is substandard. For principals, these changes offer the promise of improved performance and higher returns on invested capital. For dependent stakeholders, the benefits of the performance improvements may be minimal while the risks associated with their implementation may be considerable. While all stakeholders typically agree that decline is undesirable, fundamental disagreements can arise as to the appropriate policies to reverse it. Under circumstances in which these dependent stakeholders succeed in securing sufficient power to thwart the change initiatives of principals, the result is organizational inertia or the adoption of consensus-driven, low-risk policies, rather than the utility maximizing, decisive action urgently needed. Restoring performance thereafter is onerous or impossible but exit may be precluded for a variety of reasons.

As Meyer and Zucker note, *permanently failing organizations do not choose between success and failure, but rather whether to pursue success at the risk of failure* (Meyer M.W., 1989, p. 96). Their theory anticipates why organizational change occurs slowly and with difficulty under these circumstances and explains why leadership is so frustrating in these settings. Given the number and diversity of interests whose purpose is organizational maintenance rather than performance, all interests are usually served to some degree, but no single interest is served well. Ironically, permanent failure is not the result of deliberate, intentional, coordinated actions by stakeholders, but instead the product of unintended consequences of myriad actions by various stakeholders inside and outside the organization that sustain decline (Rouleau, 2008, p. 10). Ultimately, the normal and natural state of organizations may be low performance rather than high performance, especially as organizations grow in size and complexity.

[1] Notably, family-owned firms are sometimes distinguished by their focus on non-financial performance factors such as providing employment for family members.

[2] Principals as used in this paper refers to those individuals vested with legal control of the organization, typically owners of commercial enterprises or directors and officers of nonprofit corporations.

The possibility that stakeholders without legal control can sometimes exert effective control highlights the need for a broader conception of who benefits from maintaining organizations, and the ways these beneficiaries influence corporate policy. Clearly, beneficiaries of corporate activities are not limited to principals, but encompass others including customers, employees, suppliers, and the community, each of whom may be dependent on the organization. While the social processes through which power accrues to non-owners are both subtle and uncoordinated, they have the effect of eroding the prerogatives of principals, constraining economic forces that would sustain high performing organizations and eliminate low performing competitors, and thereby contributing to permanent failure.

Instances of permanent failure are on display in governmental agencies, commercial enterprises both public and private, family-owned businesses, and nonprofit organizations. Nonprofits can be expected to exhibit the strongest tendency to permanent failure due to the absence of an ownership interest, which impacts governance, capital structure, and end game strategies, and because nonprofits pursue multiple, hard-to-measure (and often contradictory) goals, unlike commercial firms that have historically focused on maximizing shareholder value.

This paper applies the theory of permanent failure to long-lived nonprofit human services organizations, highlighting why such organizations are especially prone to persistent failure, how it is manifested, its impact on the industry and stakeholders, and how directors and officers can respond to its advance.

NONPROFIT ORGANIZATIONS AND PERMANENT FAILURE

Nonprofit organizations are especially prone to permanent failure for reasons stemming from their origins, structure, and ethos.

Nonprofit Origins Demand-side explanations of the origins of nonprofits focus on the failure of markets to provide needed goods and services. Supply-side explanations propose that nonprofits emerged as a product of culture, norms, values, and history – none of which are related to market forces of demand or profit (Word, 2006, p. 38). Both theories agree that Western democracies have defined a wide array of purposes as charitable, all focused on addressing especially challenging and complex problems (Seibel, 1996). In response, nonprofits have adopted an array of approaches to meet these challenges, giving rise to a typology segmenting nonprofit organizations based upon the source of their income and the manner by which corporate control is exercised (Hansmann, 1980). *Donative nonprofits* receive a substantial portion of their income from contributions while *commercial nonprofits* earn the bulk of their revenues from fees generated from the sale of goods or services. Nonprofits controlled by patrons who are elected to the board of directors are deemed *mutual nonprofits* while self-perpetuating boards are characterized as *entrepreneurial nonprofits*. Control is central to this typology because control of assets and operations is the most valuable right that exists in nonprofit organizations because they have no owners (Fee, 2021).

Given their diverse missions and complex goals, there is no standard social performance assessment metric akin to return on invested capital for defining the effectiveness of nonprofits, and so no means of comparing performance relative to peers. The absence of clearly defined and generally accepted performance metrics and widely available comparative performance data enables dependent stakeholders to contest the strategies of principals in ways unavailable to dependent stakeholders of commercial organizations, whose exclusive focus is on generating economic returns. This vulnerability can be especially problematic for self-perpetuating boards of commercial entrepreneurial nonprofits, which tend to have greater scale, scope, and complexity than donative mutual nonprofits.

Nonprofit Structure Nonprofit organizations are a creation of state corporation law, whereas tax exemption is primarily a function of federal tax law. To obtain nonprofit and tax-exempt status, nonprofit organizations agree to serve one or more specified public purposes, and accept a prohibition on the distribution of profits which must instead be reinvested to further the organization's charitable purpose. Tax exempt status confers two potentially significant benefits on nonprofit organizations: they pay no taxes with respect to net income on charitable activities and donors may deduct contributions to most tax-exempt entities.

The absence of an ownership interest has at least three significant effects on the operation of nonprofit organizations: (1) it limits access to capital since there are no equity investors, (2) it sharply reduces pressure on management to preserve the net assets that are accumulated over time, and (3) it dilutes governance by impairing ownership's traditional role as a constraint on management's pursuit of its private interests. The latter occurs because directors frequently lack sufficient industry expertise and adequate information to monitor management performance, and because they have no economic interest in the performance of the organization. The absence of comparative performance data and pressure from owners to preserve equity effectively eliminates the drivers that would be expected to fuel exit by persistently low-performing entrepreneurial nonprofits.

Nonprofit Ethos While nonprofits have dual (social and financial) performance objectives, they exist primarily to create value for society (Weerawardena, 2009), and consequently are reluctant to abandon the programs for which they were created, and the values those programs embody. This ethos naturally results in differing standards of success for commercial and nonprofit organizations. While commercial organizations target competitive returns on invested capital over time, nonprofits are accountable for multiple outcomes to an array of stakeholders. The primacy of mission constitutes a formidable exit barrier and may lead nonprofits to define solvency as a satisfactory financial outcome. This conceptualization is incompatible with assumptions that organizations behave like utility maximizing actors, making ineffective the market forces intended to sustain high-performing organizations and banish low-performing ones.

Collectively, nonprofit's origins, structure, and ethos give rise to governance, managerial, and policy legacies that create both structural and cognitive constraints on an organization's ability to adapt to changing environments[3]. Path dependence – the tendency of an organization's business model, organizational form, and strategies to persist despite changes in the environment – constrain efforts to emulate successful peers by rendering some strategic alternatives difficult or impractical (such as divestiture or diversification), and others unimaginable (such as exit, liquidation or merger). This circumstance is not without irony, since the environment over time selects organizations with the high reliability and accountability that results from standardized practices and routines – yet in many instances, these very practices and routines contain the seeds of ultimate organizational failure.

NONPROFIT HUMAN SERVICES INDUSTRY AND PERMANENT FAILURE

Nonprofits human services organizations engage in the delivery of indispensable assistance to people in need. This indispensable assistance takes the form of programs such as behavioral health, child welfare, supports for people with intellectual or developmental disabilities, and similar endeavors focused on meeting basic and essential requirements of modern society. These programs are heavily regulated and

[3] Max Weber referred to these constraints as an "iron cage".

funded primarily by fees paid by public agencies such as state Medicaid programs. The human services industry is highly fragmented with low barriers to entry and high barriers to exit. Services are mostly undifferentiated, and competitive rivalry is limited, in part because appearing to pursue profit maximization strategies jeopardizes legitimacy. Providers of nonprofit human services are especially susceptible to permanent failure due to distinctive elements of their origins, structure, and ethos.

Nonprofit Human Services Origins Faith-based organizations have long sought to alleviate poverty, but efforts to augment (or in some instances supplant) public programs supporting individuals with intractable hardships such as serious and persistent mental illness or profound intellectual disabilities began in the mid-19th century. The entrepreneurial founders of these new nonprofit ventures faced two notable challenges: the beneficiaries of the services being offered engendered less sympathy, and so less revenue from donors, than alternatives such as children's charities or aid for the blind, while the capital requirements associated with lifetime residential care were imposing. The solution to these challenges in multiple instances entailed the construction of services around the needs of affluent individuals seeking alternatives to state institutions for members of their own families. Given the inability of disabled consumers to assess the performance of the services received, obtaining and maintaining legitimacy was fundamental to attracting these affluent family sponsors. One common means for securing legitimacy was to situate family sponsors on the governing board of the nonprofit, effectively installing parents or siblings in the dual roles of director and dependent stakeholder. Following the passage of the federal and state legislation in the 1960s that effectively created the modern human services industry, these donative mutual nonprofit organizational forms adopted more commercial entrepreneurial formats. Still, the dual role of family members as board members and dependent stakeholders remains a common feature of human services nonprofits, embedding a key factor enabling permanent failure when performance deteriorates.

Nonprofit Human Services Structure The capital access constraints stemming from the nonprofit corporate form, combined with the significant capital investments for facilities or technology implicit in the delivery of human services, have prevented nonprofit providers from achieving national scale. Consequently, the industry structure is characterized by a plethora of small providers, dominated by powerful payors, and subject to heavy regulation in the absence of uniform performance metrics. The predictable consequence of these factors is coercive isomorphism that compels adherence to established institutional standards and dampens the creativity and innovation that emanate from the adoption of different approaches to satisfying diverse consumer interests. Publicly traded companies and private equity firms have noted the size, growth rate, and fragmentation of the human services market - and the dearth of innovation - and in response are constructing service platforms that are altering the industry's weak competitive dynamics.

The participation of both nonprofit and for-profit firms in human services introduces significant market distortions because, like other nonprofits, human services providers disavow a profit motive, which depresses the pricing power of for-profit competitors. More significantly, the decision of nonprofits to exit markets is not necessarily dictated by the need to earn risk-adjusted returns on invested capital, and therefore, demand-supply imbalances are not restored to equilibrium via the exit of low-performing competitors as in other industries. The growing market share of for-profit competitors and the high exit barriers faced by nonprofit providers portend an interval of increased price competition and compressed margins. These circumstances will confront nonprofits with the prospect of making capital reallocation

decisions to redress performance shortfalls, and risk setting in motion conflicts between nonprofit principals and its dependents that can presage persistent failure.

Nonprofit Human Services Ethos The growing marketization of the modern human services industry presents a unique challenge to nonprofit governance, which must prioritize sometimes conflicting demands (social versus financial) and divergent stakeholder interests (Ebrahim, 2014). These dual performance objectives invite mission drift because the temptation is to assess performance by the generally accepted benchmarks related to finance rather than the ambiguities of social outcomes.

To deter this inclination, boards of human services organizations adopt strategies that incorporate controls and incentives intended to prioritize value for consumers (who typically are not the payor) over value for customers (such as Medicaid, local governments, or insurers). These controls and incentives are supported and fortified by service professionals (and their fields) engaged in service delivery, and enforced by multiple stakeholders, often achieving the intended effect of prioritizing organizational maintenance over financial performance. As a result, nonprofit human services organizations often operate well beyond the time that purely economic considerations would dictate abandonment of operations.

Taken together, the origins structure, and ethos specific to nonprofit human service providers create an environmental mix from which persistent low performance can emerge, especially in long-lived enterprises.

LONG-LIVED NONPROFIT HUMAN SERVICES FIRMS AND PERMANENT FAILURE

Most firms are unable to sustain a competitive advantage for extended periods, and even if advantage is sustained the resulting atypical returns may be appropriated by internal stakeholders (Betton, 1985). Mortality is an inevitable element of economic systems, engendered by the fit (and ultimately, misfit) between firm behaviors and the shifting levels of dynamism, complexity, and munificence of their industry's environment (Lawrence, 1967). While "long-lived" is the heuristic for organizations assumed to be at the decline or exit stage of the corporate lifecycle, firm age is not necessarily an indication of a firm's stage of development. Rather, the critical factor distinguishing long-lived organizations is the exhaustion of the long-term survival benefits conferred by organizational capital, referring to an organization's unique combination of financial resources, organizational routines, and external ties (Bercovitz, 2007). Not infrequently, these legacy assets and mindsets prevent managements from escaping from a successful past and accepting the financial and human costs essential to an effective adaptation to environmental change (Davis, 2014).

Firms engaged in industries in which consumer trust is critical are naturally inclined to longer life cycles. Some long-lived nonprofits are sustained well beyond the time that their ineffectiveness and lack of economic logic would suggest. This occurs for myriad reasons that may be ideological, political, or sentimental. Meyer and Zucker attribute this outcome to the preference of empowered dependent actors for organizational maintenance over performance; others theorize that those exercising control determine that even persistent failure is preferable to closure and choose hope against reason that organizational change will eventually lead to performance improvement (Rouleau, 2008). Meyer and Zucker contend that in any event the normal and natural state of organizations may be low performance rather than high performance, and all the more so as organizations grow in size and complexity. Indeed,

inertia is largely a phenomenon associated with the complex departmental structures of large organizations (Betton, 1985).

Long-lived human services organizations are uniquely prone to permanent failure as a result of the combination of *enablers and drivers* not found elsewhere. Permanent failure in long-lived human services nonprofits is *enabled* by their relative financial strength, the organizational routines that confer legitimacy, and the external ties constructed and maintained over time. Permanent failure in long-lived human services nonprofits is *driven* by specific internal and external practices that result in persistent underperformance that can *only* be redressed through transformation of the organization's ethos.

Relative Financial Strength as an Enabler of Permanent Failure The modern human services system is organized by state, managed by large bureaucracies, and governed by the political system, but it was not always so. Prior to the adoption of Medicare and Medicaid, nonprofits entered into agreements directly with affluent families seeking alternatives to state-administered institutional care for developmentally disabled or seriously and persistently mentally ill people. The service required or desired by these families was residential, and so capital intensive, and in the case of children with developmental disabilities, typically pursued with the expectation that the care would be life-long. Given nonprofits' structural limitations constraining capital access, early nonprofit providers such as Elwyn (1853), Sheppard Pratt (1853), Bancroft (1883), and Devereux Foundation (1912) were sustained by private fees paid by families of their clients, and by recurring gifts from those same families, their friends, and other benefactors. Typically located on large, serene campuses not too remote from major cities, and enjoying the legitimacy (and donations) accruing to any nonprofit purveyor of services to the affluent, these early nonprofits accumulated significant net assets and thereby constructed a meaningful comparative financial advantage by the time the modern human service system emerged.

Accumulated net assets are critically important because they constitute "slack" that enables nonprofits to pursue generalist (rather than specialist) strategies that facilitate longevity[4]. Generalist strategies facilitate longevity because they are optimally adapted to the set of possible environments, though not optimally adapted to any single operating environment. As a result, generalist strategies may underperform in stable environments because they maintain excess capacity, but they exhibit superior resilience (Meyer M. W., 1978).

Internal equity (or net assets in nonprofit parlance) is a major source of finance for small and medium businesses generally (Hughes, 2013), and particularly so for nonprofits, which cannot sell stock. The significance of net assets increases over time because firms typically pursue different capital structures over their lifecycles. This requires nonprofits to access debt as they grow larger, which can be a formidable task given that their services typically deliver modest margins and de minimis returns. In the absence of strong current performance, long-lived nonprofits can call upon their stock of accumulated net assets to finance growth through expanded scale or scope, and to buffer against failure when facing financial distress (Levinthal, 1991), regardless of the organization's inherent fit with the environment (Levinthal, 1991).

[4] This illustrates one of many inherent differences between nonprofits and their for-profit counterparts that preclude the direct application of theories from the business sector (Weerawardena, 2009, p. 347), as slack resources of commercial enterprises would have been returned to owners or diverted by managers as predicted by agency theory.

Organizational routines as an Enabler of Permanent Failure Single service nonprofits following a specialist strategy generate a relatively specialized set of operating routines, while larger, long-lived multi-service nonprofits must establish multiple sets of operating routines as well as coordinating routines to manage these activities. The repeated use of these operational and coordinating routines lead to refinements and efficiencies, providing survival advantages for long-lived nonprofits by supporting broader search and increasing routine recombination opportunities.

Empirical research shows that larger businesses survive longer than smaller ones (Bercovitz, 2007). Expanded scale and scope offer two important benefits that contribute to nonprofit longevity: risk reduction that dampens financial fluctuations, and capital allocation efficiencies stemming from the ability to reallocate capital across product lines (Bercovitz, 2007). The low-competition environment of human services benefits incumbents by prolonging the duration of these advantages, sustaining long-lived organizations that have accumulated specialized assets and the market power derived from scale and scope (Brito, 2014).

Bureaucratic coordination and control mechanisms that emerged with the modern human services industry have focused on nonprofit structure, organization, and service *outputs*, but not on routines, processes, nor difficult-to-measure *outcomes*. The latter, which ultimately constitute the true indicators of progress towards social mission, have been left uncontrolled and uninspected. Consequently, human services bureaucracies function largely as credentialing agencies, not unlike their role in the education industry (Meyer J. R., 1978). While state bureaucracies *tightly regulate* provider licensure and program features such as individual service plans, staff training, client records, and incident management systems, the ways in which care is delivered are *loosely managed* because the alternative would reveal significant variations in the content, cost, and effectiveness of provider practices that bureaucracies prefer to keep invisible[5]. Outcomes are assumed to be correlated with outputs, rather than inspected, and for this reason, providers focus on creating and maintaining systems to monitor outputs for which they ***are*** held accountable, and not the outcomes they were created to optimize for which they are ***not*** held accountable. Legitimacy, and access to the resources tied to it, are the reward for compliance with bureaucratic norms that establish procedural (rather than substantive) accountability, and long-lived organizations leverage their comparative financial advantage, organizational routines, and external ties to establish themselves as legitimate industry leaders in the static market for human services.

External ties as Enablers of Permanent Failure Strong external ties to affluent families of clients and to donors sustained many long-lived nonprofits in their early years; thereafter, the legitimacy conferred upon them as a result of these relationships enabled these nonprofits to accumulate superior information upon which they could rely to reduce risk and exploit new opportunities. Growth resulting from expanded scale and scope commenced a virtuous cycle of increasingly heterogenous connections central to organizational adaptability and longevity.

While external ties facilitate longevity, they can also advance permanent failure because organizations confront constraints generated by their own histories. Once the allocation of authority within an organization becomes normative, the costs of change greatly increase impeding adaptation. To cite one common illustration within the human services space, family members may prove exceedingly reluctant

[5] The interdependencies between providers, consumers, payors, and regulators may enable regulated firms to "capture" their oversight agencies, which bolsters industry stability to the benefit of long-lived organizations (Haverman, 2001).

to consider the relative benefits of community-based care for individuals long-served in congregate care settings.

Drivers of permanent failure Building upon the theory of permanent failure, other academics have offered a practice perspective on how the process unfolds (Rouleau, 2008). A repertoire of seven practices, four related to internal stakeholders and three to external stakeholders, have been offered as combining to create the framework within which the gradual process of decline, inertia, and permanent failure occur.

The four practices of the internal stakeholders (including principals, managers, and employees) leading to permanent failure include persistent reversion to established mental frames, recurring contradictions between discourse and action, systematic withholding of information, and ongoing disagreements over management priorities. These practices may be manifested by repeated reversions to past strategies to overcome new and different challenges, shelving aspects of the organization's approved strategic plan, seeking to protect "turfs", and ongoing disagreements over management priorities. The detrimental impact of each of these practices is exacerbated by the proclivity of persistently failing organizations for privileging values over performance (Rouleau, 2008).

These internal stakeholder practices are countenanced and intensified by three practices of external stakeholders (including consumers, payors, regulators, and donors): continuing endorsement of organizational mission, ongoing provision of financial support, and ongoing support of management. To illustrate, legitimacy is conferred upon organizations whose licenses are routinely reissued, with whom the payors repeatedly contract, and to whom donors offer annual support, as such actions constitute an endorsement to both consumers and the general public that the organization and its activities are reputable and valuable. These signals, if delivered over extended periods despite persistent underperformance, can trigger or nurture permanent failure. Similarly, actions by boards of directors communicating unwavering support of chief executives, especially long-tenured ones in the face of persistent underperformance, suppress consideration of the possibility that inertia is a source of the performance shortfalls.

Major changes in an industry's technological, economic, or political environment may render firms' existing assets and capabilities obsolete, creating strategic challenges that require the development of new capabilities and entry into new markets. These intervals of disruption demand that officers and directors alter the ways resources are deployed. Path dependence impedes timely resource redeployments resulting in organizational inertia that impairs firm performance. Accordingly, performance declines are initially met with efforts to exploit current competencies, and only after repeated failures do directors and officers shift strategies and explore new domains in an effort to restore performance. Uncertainty surrounding the ultimate success of newly adopted strategies places considerable pressure on nonprofit leaders who may be seen as the cause of today's crisis (Haverman, 2001). In the absence of a board chair or other officer able to initiate change in a top-down manner, the self-evaluation and reconfiguration of governance can be thwarted by directors' and officers' self-interest (Hoppmann, 2019). It is under these circumstances that the absence of owners and the structural limitations of nonprofit governance have the most profound adverse impact.

While the seven-factor framework drives persistent underperformance, it is the context in which the drivers coalesce that constitutes the essential element of permanent failure. Specifically, it is when the resolution of persistent underperformance demands the transformation of the very ethos of the

organization that permanent failure takes root. Under such circumstances, deeply ingrained institutional logics and organizational routines drive the actions of stakeholders, and adaptation to environmental change becomes impossible. Thereafter stakeholders remain steadfast in the hope that performance will eventually improve, ignoring all evidence to the contrary.

The theory of permanent failure anticipates that as power accrues to dependent actors in an organization, politics will degrade performance but enhance persistence. In the nonprofit human services sector, one effect of deteriorating performance has been to attract competition from private equity platforms to a market that nonprofits had long dominated. This increased competition empowers dependent stakeholders, but in different ways.

When consumers of human services are faced with few or only one service provider options, they will be interested primarily in provider maintenance, though they may wish to reform the provider if they deem its performance unsatisfactory. When multiple service options are available, consumers choose service providers without reference to price, because human services consumers are typically dependent actors who rarely pay more than a de minimis amount, if anything, for the services they receive. As the quality and effectiveness of clinical services is difficult to assess, consumers' choice of service provider rests on the provider's reputations, facilities, or other considerations.

Payors for services rendered by nonprofit human services organizations are primarily public agencies, including most prominently Medicaid. Like consumers, payors are primarily concerned with provider maintenance in markets with limited competition, but payor and consumer interests diverge in competitive markets because payors do not share consumer's disinterest in price and efficiency. Indeed, there is a growing focus on value-based payment arrangements intended to contain price inflation in human services.

Licensing and regulatory agencies in principle prefer to maximize consumer choice, but this preference confronts evidence that the larger the pool of providers, the greater the cost of care. Of course, public licensing and regulatory agencies (and the elected officials that control them) are ultimately accountable to the voters (Toepler, 2004), with the practical effect of imbedding a preference for organizational maintenance over organizational performance.

EMPIRICAL EVIDENCE OF PERMANENT FAILURE IN LONG-LIVED HUMAN SERVICES NONPROFITS

Empirical evidence supports the contention that long-lived human services nonprofits are especially prone to permanent failure. The authors have compiled the consolidated audited financial statements of 322 nonprofit human services organizations from thirty-six states for the five-year reporting periods ending in 2020[6]. The compound annual growth rates ("CAGR") of revenues and net assets for the five years were then calculated for each nonprofit because profit and growth are key metrics for assessing financial performance (Brito, 2014). The CAGR of net assets for the five-year period for the 322 nonprofits was 5.4%; the CAGR of revenues for the five-year period for the 322 nonprofits was *5.7%.*

Negative CAGRs of net assets for the five-year period were calculated for 69 (21.4%) nonprofits in the sample, and *negative* CAGRs of revenues were calculated for 52 (16.1%) nonprofits in the sample; 26 (8.1%) of the nonprofits reported negative CAGRs of *both* net assets and revenues. (Were these

[6] While business cycles vary between industries a five-year planning cycle is not uncommon for human services organization and longer planning cycles are believed to be rare.

commercial enterprises rather than nonprofits, most or all would have exited the industry in response to demands from owners wanting to reallocate their capital to investments promising superior returns). Of these 26 nonprofits, all but one was founded before 2000, and 13 of these were founded prior to 1960 with 9 in business for more than a century. The 13 organizations formed prior to 1960 reported average net assets in 2015 almost four times the level of the 13 organizations formed thereafter and experienced average declines in net assets in percentage terms nearly twice as large.

It is important to note that persistent underperformance by some well-healed, long-lived nonprofits during the five-year reporting period ending in 2020 may have been disguised because declines in net assets were avoided or minimized as a result of substantial nonoperating income from contributions or investment income.

MANAGEMENT RESPONSES TO PERMANENT FAILURE

In their seminal work Professors Meyer and Zucker highlight that their theory of permanent failure requires reconsideration of bedrock elements of traditional economic theory, most notably the conception of organizations as efficient rather than inefficient, as performing rather than non-performing. Traditional economic theory attributes low performance to exogenous forces rather than management, and asserts it cannot be sustained, while the theory of permanent failure argues low performance is the natural and normal outcome of social processes operating as much within the organization as without.

Meyer and Zucker's skepticism regarding the assumptions of traditional economic theory prompts them to contend that the role of management, especially in established organizations, is best understood within the framework of permanent failure. Over time, as the forces driving organizations to permanent failure accumulate, managerial leadership supplants entrepreneurial leadership.

Under circumstances in which goals are relatively unambiguous, management's principal task is to reclaim control of the organization so that alternatives to permanent failure are rendered viable. Management efforts to reverse persistent underperformance must focus on adopting strategies intended to reduce the power of dependent actors. These strategies typically include growth, corporate restructuring, or outsourcing. Growth is a highly attractive managerial response because actions related to new resources created by growth are far less constrained and contentious than actions seeking to reallocate existing resources. Additionally, stakeholders newly engaged as a result of growth shift the demography of the organization, introducing the prospect that the power of dependent actors can be eroded. Growth is not without risk, unfortunately, as greater scale, scope, and complexity can introduce multiple divergent interests that further complicate management efforts to improve performance.

Corporate restructuring seeks to isolate dependent actors from sources of power by separating strategic decisions from operational ones, most often through adoption of conglomerate-type organizational structures. To the extent that dependent actors and their interests tend to cluster around specific programs or services and not the corporate office, their ability to effectively mobilize may be diminished. Outsourcing can also be effective as contract workers have little or no ability to resist organizational changes intended to improve performance. Management's power to implement these strategies is greatest as organizations trend towards outright failure; management's power is weakest when outright failure cannot occur, as is often the case with essential public services such as those that human services organizations provide. (Meyer M.W., 1989).

Under circumstances of low performance in which objectives are ambiguous, the task of reclaiming control is complicated because as organizations grow and diverse interests increase, the task of negotiating between them multiplies geometrically. Research indicates that, as a result, control of organizations by managers rather than owners ultimately tends to promote low performance in older firms. Effectively, when performance is low and objectives ambiguous, the motivations of management to improve performance at the risk of failure decreases, and managers align with other dependent actors to maintain the organization regardless of performance (Meyer M.W.& Zucker, 1989). In this situation, reestablishing performance as primary may require a change of control transaction given the improbability of altering the strategic logics and decisionmaking process of the dominant governance coalition (Bruneel, 2020).

PERMANENT FAILURE OF A LONG-LIVED NONPROFIT ILLUSTRATED

Over the course of my fifty years working in the human services industry I have observed a number of long-lived nonprofit organizations that illustrate the Meyer-Zucker theory of permanent failure. Devereux Foundation, whose persistent failures are summarized below, is but one prominent example.

J. Kevin Fee

DEVEREUX FOUNDATION

In the late 1990s Devereux Foundation's promotional brochures proudly proclaimed: "We are now America's largest not-for-profit provider of mental health and developmental disability programs", adding that the nonprofit's lofty goals included: "The programs will be of such excellence that they may become models for this and other nations." Concurrently, an expansive strategic plan, DEVEREUX 2000, was adopted with the objective of creating "… a shared strategic vision [of Devereux as] the country's premier, non-profit network of broad-based, cost-effective, high-quality treatment services for children, adolescents and adults."

DEVEREUX 2000 contemplated "…organizational change likely to mean individual change for virtually all stakeholders of Devereux…" that would necessitate "…obtaining new skills, discovering new resources, working more in teams with internal and external partners, getting into some new businesses and getting out of others…" At the heart of DEVEREUX 2000 was a plan to reallocate resources from campus-based and community-based residential care to more managed-care friendly alternatives including wellness and prevention, outpatient, day, and home services and acute partial-day programs.

Twenty years later it is possible to summarize the outcome of Devereux's ambitious plans as follows:

- Dozens of lawsuits against Devereux have been filed in both state and federal courts nationwide alleging Devereux was negligent and failed to protect residents from being physically and sexually abused by staffers at its facilities in multiple locations across the U.S. According to an expose in the Philadelphia Inquirer in August 2020, the incidents of abuse dated back 25 years. In one case, a Georgia jury awarded a victim of sexual abuse $60 million, including $50 million in punitive damages.
- While Devereux ended Fiscal 2022 with $220 million in investments and $200 million in net assets (at book value), revenues from services increased at the compound annual rate of just 2.6% during the twenty-year interval between 2002 and 2022, despite a massive increase in public funding for services, and a national waiting list of approximately 200,000 people with intellectual and developmental disabilities. The apparent absence of any inclination to address the needs of

families awaiting service might be thought especially surprising given that family members of current clients are prominently represented on the Devereux board. Yet director-family members are understandable conflicted about allocating resources to meet the needs of individuals not currently served, as those same resources might alternately be used to secure the long-term future care of existing clients, including their own family member.

- In the fiscal year ending June 30, 2002, acute and residential services accounted for 77% of Devereux service revenues; In the fiscal year ending June 30, 2022 (i.e., 20 years later) acute and residential services accounted for 79% of service revenues. The shift to non-residential services contemplated by DEVEREUX 2000 was likely thwarted by the preference of existing client family members for congregate care settings (rather than community-based services), and by the substantial sunk costs that would be recognized in shuttering the specialized campus facilities.

Devereux offers an illustration of the theory of permanent failure because it persists despite failing to achieve the official goals of the organization for an extended period by virtually any standard of performance.

Founded in 1912, Devereux's lapse into permanent failure was *enabled* by its relative financial strength[7], unquestioned acceptance of its legitimacy by regulators, payors, accreditation organizations, and the general public, and extensive ties to prestigious donors and individuals of influence over an extended period of time. Permanent failure has been *driven* by recurring contradictions between discourse and action (evidenced by the deviation between the goals of the DEVEREUX 2000 strategic plan and subsequent performance), the willingness of licensing organizations to endorse, and payors to contract with Devereux (despite persistent poor performance), and by directors and officers persistent reversion to established mental frames (evidenced by the failure to replace directors and officers following lackluster growth and extensive and scandalous programmatic failures).

The organizational change leading to individual change for stakeholders promised by DEVEREUX 2000 never materialized. In the absence of a strategy targeting accelerated growth, corporate restructuring, or (better yet) a change of control, there is little basis for hope that Devereux's record of persistent failure will be reversed. `

NONPROFIT LONGEVITY AS A GOAL

Organizational theory concerns itself with how organizations evolve. Ultimately, all organizations fail, with only the timing of their failure uncertain. As society is exposed to a portfolio of firms rather than a single firm, the fate of any one firm is insignificant, and societal interest in the long-term lies in fostering an environment that promotes innovation while seeking to minimize negative externalities (Josefy, 2017).

Two leading theories of how organizations sustain (or not), adaptation theory and selection theory, are diametrically opposed with the former arguing that organizations adapt to environmental shifts, while the latter predicts that organizations are sustained as a result of the selection and replacement of inert organizations by the environment. Much research on organizational change from an adaptation perspective assumes that business environments are stable or change slowly giving managers the opportunity to experiment with adaptive responses. Research proceeding from a selection perspective tends to frame environmental change as ` and characterized by periods of stability punctuated by

[7] Devereux has consistently maintained an investment grade bond rating.

exogenous shocks related to technological innovations, social turmoil, changes in governmental regulation or economic crashes (Haverman, 2001).

From either perspective, it is clear that changes impacting the ethos of nonprofit organizations are perilous. The process and the content of such change tend to immobilize long-lived nonprofit organizations dominated by dependent stakeholders, who value maintenance above all else. While in theory changes in the makeup of governance can redress this immobility, in fact decision makers in organizations have limited ability to gather and process new information and solve complex problems (Bruneel, 2020). Consequently, board members will seek solutions through the perceptual filters and preexisting knowledge structures of the dominant board coalition, which is rarely comprised of its newly elected members. For this reason, from an ecological perspective, resolution of permanent failure awaits the creative destruction wrought by inevitable innovations whose timeline is unpredictable.

END

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