The New Landscape for Nonprofits

by William P. Ryan
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The entry of for-profits into social services raises fundamental questions about the mission and future of nonprofits.

THE NEW LANDSCAPE FOR NONPROFITS

by William P. Ryan

On September 15, 1996, just months after President Clinton made good on his 1992 promise to reform welfare, the front page of the New York Times carried an article that sent shock waves through the nonprofit community. Lockheed Martin IMS—a division of the defense giant Lockheed Martin—Electronic Data Systems, and Andersen Consulting were each preparing to bid for the management of $563 million in welfare operations in Texas. True, most nonprofit leaders were already accustomed to the idea of profit-seeking hospitals, proprietary day-care centers, and for-profit trade and technical schools. But the entry of William P. Ryan is a consultant to foundations and nonprofits, including Pew Charitable Trusts, the Rockefeller Foundation, and the Hauser Center for Nonprofit Organizations at Harvard University. He is based in Cambridge, Massachusetts, and is coauthor of High Performance Nonprofit Organizations: Managing Upstream for Greater Impact (John Wiley & Sons, 1998).
The real message is that just about everything affecting the provision of social services has profoundly changed.

best served when nonprofits aim to compete on for-profit terms?

Nonprofit stakeholders will be sorting out these questions for years. But the greatest peril is not that nonprofits may ultimately be driven out of the social service marketplace. Rather, the danger is that in their struggle to become more viable competitors in the short term, nonprofit organizations will be forced to compromise the very assets that made them so vital to society in the first place.

This much is already clear: however the struggle between providers ultimately plays out, the nonprofit sector cannot return to a halcyon time when charities were “uncontaminated” by the market. That, at least, is the sentiment I hear in my work as a consultant to the nonprofit sector and in my interviews with 30 participants in the social service environment. I interviewed both for-profit executives who are expanding their companies into social service market and the investors who analyze these companies’ performance and prospects. In addition, I talked with leaders of nonprofit organizations that collaborate with for-profit companies in joint ventures. Overall, the interviews demonstrate that the debate over the roles of for-profits and nonprofits has been drawn too narrowly. The point is not whether nonprofit organizations can survive opposition from for-profits. In fact, many are adjusting to the new competitive environment quite well. The real issue is whether nonprofits can adapt without compromising the qualities that distinguish them from for-profit organizations.

Indeed, nonprofits are now forced to reexamine their reasons for existing in light of a market that rewards discipline and performance and emphasizes organizational capacity rather than for-profit or nonprofit status and mission. Nonprofits have no choice but to reckon with these forces—forces that were unleashed and that continue to be shaped not by the private sector but by government itself.

Why Are These Changes Occurring?

For most of this century, society’s caring functions were the work of government and charities. Government provided some services, and philanthropists filled in the gaps. Since the Great Society days of Lyndon Johnson, nonprofits and government have worked together in a deliberate partnership.
Nonprofits are no longer considered automatically entitled—or even best qualified—to provide social services in the United States.

Outsourcing Is Growing Fast

The greatest change in service delivery comes from a change in the public sector. Over the past two decades, government officials have taken to heart the central tenet of the “reinventing government” movement—that is, setting policy and letting others deliver the services. Thus, although big government may be fading away as public policy shifts from big spending on social services, it is still outsourcing to private providers, which creates abundant opportunities for those that know how to take advantage of them. One analyst at SunTrust Equitable Securities believes that “the growth of outsourcing is unstoppable.”

Indeed, more than half of all government spending already goes toward the purchase of goods and services in the private marketplace. The practice enjoys nearly unanimous political support. On the right side of the political spectrum, free market adherents praise the benefits of competition among providers, while other conservatives tolerate outsourcing as a necessary way station on the road to a much smaller welfare state. On the left side of the spectrum, liberals find the policy of outsourcing to small, community-based organizations appealing because they hope to empower marginal groups to deliver services from within the community. Moreover, politicians of all persuasions can use outsourcing to satisfy the public’s conflicting demands for more services and a smaller public workforce. The fact that most politicians cannot estimate the costs and benefits of outsourcing only proves that the commitment to outsourcing is often more emotional than rational.

Whatever the justification, there is more outsourcing today than ever before, and for-profit executives are bullish about their prospects for growth in social services. Outsourcing has expanded the scope of the social service marketplace. And although nonprofit observers are inclined to look for clues about their future environment by tracking the moves of competitors like Lockheed Martin, savvy for-profits are following the public agencies that influence market trends. These corporate pioneers understand that the real news is not the appearance of a few high-profile for-profit players on the field but rather the underlying changes that have made their entry and rapid growth possible. While many nonprofits are still reeling from cutbacks on social spending, for-profits are celebrating the fact that government outsourcing is still growing in so many areas.

For-profit companies have documented this rise in government spending. Maximus, for example, a provider of welfare-to-work services, informs investors in its prospectus that the administration of social programs is a $21 billion market. SunTrust Equitable Securities also understands the economic potential of providing social services. It recently published a report on government spending in child welfare, juvenile corrections, and special education entitled “At-Risk Youth...A Growth Industry.” Understandably, nonprofit providers find the juxtaposition of social problems and the profit motive profoundly troubling—for clients, to be sure, but for themselves as well. The perspective raises unsettling questions for nonprofits. Can they compete? And at what cost?

Government Is Adopting a Business Mind-Set

The real opportunity for for-profits, however, does not come from increased outsourcing alone. The real revolution is that the social service market is now accepting providers that have a decided for-
profit bent. In marked contrast with earlier years, when for-profits were excluded from the social services—frowned upon as unfit partners for government—the public sector now sees business not as a pariah but as a role model. This radical transformation in public-sector attitudes has spurred—even dared—for-profits to move into the social-services delivery system. (See the exhibit “Who Are These Companies?”)

The new tolerance of for-profits undoubtedly reflects an increasingly conservative political climate that values the power of markets and the profit motive to create efficiency. It also underscores the new culture of performance among public managers—a culture that has its roots in business principles and concepts. The language of the “reinventing government” movement self-consciously reflects this business worldview. Businesspeople cannot fail to notice that the same government managers who once treated them as outcasts now share their language and mind-set. Government officials now talk about performance contracts that have provisions for risk sharing, pay-for-performance, and bonuses—another welcome development among for-profits. Unlike more traditional cost-reimbursement contracts, which protect providers of services by covering their costs regardless of outcomes, performance contracts shift the risk to providers, which only get paid for successfully completed assignments. Although few social-service contracts are totally performance-based, the tougher spirit of the new approach gives for-profits an edge in the bidding process. For-profits can use their generally greater supplies of working capital to assure governments that they can cover the risk if they fail to deliver on their contracts. The implications for nonprofits, which cannot follow suit, are disturbing. As Holli Ploog, a senior vice president at Lockheed Martin, has argued, “Small players...do not have the ability to indemnify the state the way a large corporation would. The larger states want to make sure they can hold you accountable and can dip into your pockets if there’s a problem.” Clearly, for-profits already have a strategy for competing in a market-

Who Are These Companies?

In addition to Lockheed Martin, here are some examples of for-profits doing work in the social services.

**America Works**
New York, New York
America Works is a job placement specialist with contracts in several locales, including New York City and Indianapolis, Indiana. Its services help people cope with the pressures and demands of the real world. Although clients are dropped from the program for tardiness and unexcused absences, those who persevere get assistance with résumé writing and interview skills, and support in resolving workplace issues such as how to deal with a new boss and how to find child care.

**Children’s Comprehensive Services**
Nashville, Tennessee
With revenues of more than $90 million in 1997, CCS is one of the largest and fastest-growing for-profit social service providers in the at-risk youth market. Founded in 1985, it provides treatment and education services to youths with emotional, behavioral, and learning problems. CCS offers its services in both residential and nonresidential settings—for example, it organizes an Outward-Bound-style “therapeutic wilderness” program for juvenile offenders.

**Maximus**
McLean, Virginia
David Mastran, a former official at the U.S. Department of Health, Education, and Welfare, founded Maximus in 1975. It has served as a management and information systems consultant to hundreds of local, state, and federal human-service agencies in the United States and several other countries. In addition to providing job training, Maximus offers training in so-called soft and life skills. In other words, it teaches people everything from how to dress well to how to manage a household budget. Today Maximus operates welfare-to-work programs in 18 jurisdictions. Its 1997 revenues totaled $128 million.

**Youth Services International**
Owings Mills, Maryland
YSI operates detention programs for adjudicated youth by operating “boot camps,” which subject juvenile offenders to an intense, physically demanding regimen. It also runs reform schools and sex offender programs. With contracts in 13 states, YSI’s revenues in 1997 totaled $108 million. Founded by Jiffy Lube entrepreneur and one-time delinquent youth W.James Hindman, it will become a wholly owned subsidiary of Correctional Services Corporation of Sarasota, Florida, under a deal announced in September 1998.
driven world. Now nonprofits must analyze whether and how the changing marketplace can work to their advantage.

What Business Brings to the Table

The changing landscape of social services has been influenced by expanding markets and a new business zeitgeist. In addition, both for-profits and nonprofits attribute the recent growth of for-profits to four interdependent factors: size, capital, mobility, and responsiveness.

Big is beautiful. Size confers several benefits on an organization: economies of scale, opportunities to manage risk across contracts, the ability to compete for contracts that require a wide range of services, and even the ability to recruit good employees with the promise of advancement in a growing organization. Moreover, the larger companies become, the easier it is for them to expand. Lockheed Martin and other corporate giants boast of their ability to launch an entire operation—with new offices, staff, technology, and programs—within a few weeks of signing a contract. Size has enabled for-profits to make aggressive acquisitions in the youth-services field. In the first quarter of 1998, for example, Youth Services International acquired providers with annual revenues approaching $200 million. By contrast, many nonprofits believe that their mission of serving a local community is completely at odds with national expansion. Their intentions may be praiseworthy, but the competitive ramifications of their decision to stay small are not trivial.

Capital means capability. Throughout my interviews, for-profit and nonprofit experts highlighted the importance of capital for delivering social services. For-profits seem to have a decided advantage in this area. Maximus's 1997 initial stock offering, for example, raised more than $66 million. ResCare, a provider of services to at-risk youth, has raised more than $120 million since 1996. Similarly, Youth Services International and Children's Comprehensive Services each raised close to $40 million during the same period. Backed by this capital, these for-profit companies were able to expand into new markets. They invested in new services, equipment, and facilities; acquired smaller organizations; and covered expenses through periods of low cash flow. Nonprofits generally lack such funds; they have to supplement their contract fees with philanthropic grants.

Those grants, however, are usually earmarked for specific purposes—to deliver certain services, not to build up capacity. Moreover, according to the Foundation Grants Index, general operating grants, which function like working capital for many nonprofits, have been drying up since the early 1980s. Further aggravating the situation is the fact that nonprofit stakeholders often view money invested to build competitive capabilities as money diverted from social service clients. In the interest of protecting clients and donors, for example, watchdog groups like the National Charities Information Bureau expressly fault nonprofit organizations that accumulate substantial reserves.

Mobility matters. Mobility gives for-profits advantages that most nonprofits, mainly single-site operators, lack. Large for-profits have the luxury of choosing the markets in which they want to work because profits are high and their services are well suited to government needs or because the contracts will be relatively easy to administer. At the same time, they can and do quickly pack up and leave markets when conditions become unfavorable. By contrast, single-site nonprofits must contend with local policy and contract practices whether they like them or not. Many nonprofit leaders see their mission as one of developing long-term community resources. These nonprofits would not expand to a more favorable environment even if they could. Consequently, if government contracts don’t pay well enough to cover the services that these single-site nonprofits want to offer, they have little alternative but to limp along.

Responsiveness is rewarded. Government outsourcing forces providers to deal with two clients: the individual clients they serve and the government clients who award them contracts. Because for-profits are dedicated to the bottom line, they can respond very quickly to their government client. When public policy switches from talk therapy to pharmacology, for example, or from community-supervised rehabilitation of youths to incarceration, for-profits implement the new policies without deliberating over the impact on society. Nonprofits, by contrast, consider not just the government but society to be their client. As a result, they often dis-
agree openly with government policies—as many did with welfare reform—and may therefore be slower to implement government policies they don’t believe in.

**Who Performs Better?**

For-profits obviously have an advantage in acquiring new contracts, but do they actually perform better? Research on this question has not yet yielded a definitive answer. Some studies—in child and home care, for example—conclude that there are no overall significant differences in performance between the for-profit and nonprofit sectors, even though there appears to be some correlation between better-paid employees and more satisfied clients. Moreover, despite the fact that government agencies have been awarding more contracts to for-profits—seeking to express their satisfaction—little is known about the satisfaction of the actual client: the beneficiary of the services.

In the absence of hard evidence, nonprofits are no longer given the benefit of the doubt. In fact, the capacity and effectiveness of nonprofits are increasingly doubted. In *Holding the Center: America’s Nonprofit Sector at a Crossroads*, nonprofit expert Lester Salamon termed the phenomenon a “crisis of effectiveness.” It seems naïve to believe, however, that for-profits in search of profitable business opportunities will voluntarily serve the interests of the common good. In any case, government officials are not waiting around for more evidence on which type of organization does the better job. In the short term, they will almost certainly award their contracts according to narrow criteria that tend to favor for-profit providers. This much is sure: as long as government agencies demand the kind of contracts that can best be executed by well-capitalized, technologically sophisticated companies like Lockheed Martin, nonprofits will be at a decided disadvantage.

**How Nonprofits Are Responding**

Nonprofit organizations have adapted to new marketplace realities in various ways, ranging from subcontracting to partnership to outright conversion to for-profit status.

Consider “single signatory contracts,” which allow government agencies to execute a master con-

tract with a single provider. Essentially, the government outsources the outsourcing: the provider delivers the services and manages the service delivery system. Under this kind of arrangement in Dade County, Florida, for example, Lockheed Martin hired nearly 30 agencies to supply various welfare-to-work services— including transportation, child care, mental health services, and treatment for drug and alcohol abuse, not to mention job readiness, skill training, and job placement services. The administration of this project—the creation of sub-contracts, the billing, and the management of information across systems—is itself daunting. Government agencies don’t want the burden, and many nonprofits are incapable of handling it. Therefore, for-profits that are already experienced in managing complex projects, generally corporations with excellent management-information systems, will fully assume the role when and if the price is right. Ironically, for-profits need good nonprofits with programmatic expertise and access to hard-to-reach neighborhoods in order to deliver on these contracts. Many nonprofits are happy to subcontract for for-profits because this piggybacking allows them to participate in huge contracts they could not handle alone. Such collaboration will go a long way to ensure that even small nonprofits continue to have substantial opportunities to provide social services.

Even more striking, perhaps, are the nonprofits that have been willing not only to go along with for-profits but to seize the initiative. Consider the YWCA of Greater Milwaukee. Large and sophisticated by any nonprofit standard, this YWCA concluded that it could not go it alone. To handle the demands of a comprehensive, $40-million welfare-to-work contract, it created a for-profit limited liability corporation with two for-profit partners. According to its executive director, Julia Taylor, if the group had chosen not to compete for the new welfare-to-work contract, it would have lost up to 40% of its public funding, which was being reorganized into the welfare program. The YWCA of Greater Milwaukee needed scale and managerial capacity to compete for the contract, so it sought two for-profit partners. The new company, YW Works, provides services from 7 A.M. to 7 P.M., staffs a 24-hour resource line, provides transportation assistance, emergency loans, and job-site clinicians, and has better assessment and placement programs.
To respond to new marketplace realities, nonprofits will have to reconfigure their operations and organizations.

with improved information technology. In short, YW Works provides almost every service needed to help someone find a job.

Abraxas, a nonprofit organization with a 25-year track record in the field of at-risk youth, went even further. CEO Arlene Lissner wanted to increase the organization's access to capital. She assessed Abraxas's future and estimated that the risks of staying independent were greater than the risks of being acquired by a for-profit. Specifically, Lissner believed that a conversion deal would enhance Abraxas's access to capital while preventing it from being driven out of the market by a larger competitor. She concluded that only an outright acquisition by a hand-selected for-profit could ensure Abraxas's survival. Her board agreed, so they hired SunTrust Equitable Securities to find for-profits that might want to acquire the organization. Nine for-profits were interested in this win-win situation: a new infusion of capital and scale for Abraxas and a demonstrated program capacity and scale for the for-profit. Abraxas struck a deal with Cornell Corrections, a leading prison-management company. Lissner was given a seat on the Cornell board, and the Abraxas Group, as it is now called, retained its own identity, staff, and board.

Lockheed Martin, YWCA, and Abraxas are examples of organizations that took action in response to
Nonprofits now share territory with for-profits, sometimes as competitors and sometimes as collaborators. The delivery of social services. And even though the growing visibility of for-profits in social services will likely lead to greater public scrutiny—and perhaps even to a temporary backlash—an abrupt reversal of public policy is implausible. In fact, complaints about the tensions between the needs of the clients and the profit motive, along with occasional high-profile scandals, may lead to better contract standards and enforcement, not to a radical rejection of for-profits. And as the field increasingly learns to discriminate between “good” and “bad” for-profits, respectable for-profits will continue to gain legitimacy.

Although there will not be any immediate large-scale, for-profit takeover, a creeping takeover is, in some ways, worse. A sweeping takeover by for-profits would at least alert society and policymakers to the fact that for-profits are beginning to play a substantial role in the provision of social services. This is not inherently right or wrong, but there are hazards associated with the change, and the future of nonprofits may be at stake. Some observers already see a conflict between the provision of service and the quality of service by for-profits. Consider the welfare-to-work provider who places someone in the first available job instead of holding out for a job that is likely to lead to more rewarding and remunerative work. For-profits are more likely than nonprofits to advocate public policies that favor profitability in the short term rather than policies that help communities over the long term. If for-profits operate juvenile detention centers, for example, they may advocate get-tough juvenile sentencing policies to increase business. Both the juveniles and their communities, however, might fare better with a more community-based approach.

The issue, then, is this: How does society fare when nonprofits attempt to adapt in order to compete? In this respect, there are four basic questions that we must ask.

Who provides better service? Although nonprofit providers can no longer say, “We’re the only ones to provide this service,” they may still be the best providers. Many nonprofits have more expertise and experience in delivering social services, and they have effective and refined program strategies. Nonprofit employees, moreover, often believe that they bring special values and commitment to their work that few for-profits demonstrate. They feel they care more: they are willing to spend more
time, have more patience, and interact more humbly with clients.

Now nonprofits have to worry about whether these values are consistent in a marketplace where performance-based contracts are the norm. Some providers have already felt the pressures of managed care—physicians and therapists are often forced to limit the amount of time spent with patients, the options they present to patients, and the use of special technology and other resources. With their similar focus on productivity and results, performance-based contracts are likely to create similar conflicts.

Who offers unsubsidized services? Unlike their for-profit counterparts, nonprofit providers usually reinvest their surplus revenues into more services for the community. Typically, nonprofits either provide services to individuals who are ineligible under government contracts, or they improve services for those who are eligible. A nonprofit provider of welfare-to-work services, for example, might fulfill its obligations under a government contract and then use the surplus to offer more than the government is willing to provide. Or it may provide additional training to people already placed in entry-level jobs, thus helping them move into higher-paid jobs that could lift their families out of poverty. These “extra” programs honor both the letter and the spirit of the contracts. In this way, nonprofits deliver not only on their contracts but also on their missions.

Nonprofits that must compete with for-profits on price, however, are in danger of ending up with smaller surpluses to extend their services. According to many nonprofit managers, this problem will be compounded by a second one: whenever for-profits and nonprofits compete for government contracts, for-profits will end up seeking the clients who are easier to serve. One result may be that nonprofits will find themselves with a greater proportion of the harder and more expensive cases, with few surplus revenues to spend on the services they have traditionally offered. Although it is true that nonprofits can use private donations and foundation grants to extend the depth and reach of their services, such funding may not be enough to cover an overextended nonprofit completely. So a few nonprofits have spun off revenue-generating businesses to supplement their incomes. Given the demands of any start-up business, however, this path entails a new set of risks. In other words, nonprofits dedicated to “filling in the gaps” are going to find their jobs harder in the new environment.

Who promotes civic virtues? Nonprofits argue that even if they offer the same services as for-profits, they provide an additional benefit: an opportunity for citizens to become engaged in community affairs. By providing a venue for volunteers and trustees to contribute their time in service or governance, nonprofits contribute to a healthy civil society and democracy. This is a job that the market and for-profit providers are simply not equipped to handle. But even this fundamental quality is endangered when a nonprofit seeks to become a more competitive provider. In most cases, nonprofits are not being funded to strengthen society but to provide social services. As the market pressures them to become more competent at jobs such as project management and more attentive to the strategic demands of their industry, how committed can they remain to this civic dimension? Some observers note that the makeup of hospital boards has already begun to change in response to competitive pressures. Well-intentioned, community-minded individuals are no longer good enough. To be effective, boards need businesspeople with the ability to understand and govern a complex industry. To be sure, some sophisticated nonprofits can remain dynamic civic resources and effective, competitive providers. But clearly, managing the tensions in the two roles is presenting new risks and challenges.

Do we need advocates? Many nonprofits see their mission as more than the delivery of services. They also act as educators, advocates, and vigorous agents of social change, challenging society to respond to human problems in new ways—particularly through public policy. The mission of most nonprofit job-training and placement providers, for example, is not simply to offer high-quality services to clients but also to help them out of poverty and into self-sufficiency. This goal is likely to require a policy agenda in addition to service delivery. Indeed, nonprofits have long struggled to reconcile their service delivery functions with their larger missions. It can be difficult for those holding public contracts to criticize the policymakers who issued their contracts.

Nonprofits are likely to find this balancing act especially difficult in a more competitive environment.

Nonprofits will be forced to reconfigure their operations in ways that could compromise their missions.
Many will be competing with for-profits that have no policy conflicts and that are eager to supply whatever the government wants. Fortunately, many communities have attracted advocacy-only nonprofits that are free of these conflicts. But their resources may not offset the decline in the advocacy capabilities of those nonprofit providers that have traditionally combined both roles.

This vulnerability comes at exactly the moment when the entry of for-profit providers should prompt nonprofits to be more vigilant in monitoring government management of contracts. Although social service clients can be short-changed by poorly run or corrupt nonprofits, they may face greater risks when social services and the profit motive come face-to-face. Some of the most sensational abuses in recent years—in for-profit juvenile detention centers in Louisiana and at for-profit psychiatric facilities—suggest what the worst-case scenario looks like. Designing and enforcing contracts that promote efficient services while protecting the individual client's need for humane and high-quality service is an enormous challenge. Both nonprofit and for-profit providers tend to agree that government contract administrators are not yet up to the challenge. Many agencies and their employees are still in the early stages of a transition from "rowing to steering," in the slogan of the reinventing government movement. Their staffs are often overextended and trained as providers, not as contract administrators. The job of lobbying for better government funding, staffing, and enforcement—and the design of standards that will protect clients' interests—is by nature a nonprofit job. If nonprofits are consumed by the challenges of becoming competitive providers, that job may be in jeopardy.

Is Winning Losing?

Social services in the United States are in a period of transition. The demands of a new marketplace are offering opportunities to for-profits but creating hazards for nonprofits. Resourceful nonprofits, especially the larger ones, will very likely get the capital and technology they need to deliver what the new government contracts demand. But because their government partners have changed the rules of the game so dramatically, nonprofits may be retreating from their mission in order to gain market share. Thus, nonprofits can win and lose simultaneously. Can nonprofits win contracts and still be responsive to their clients and communities? Unlike their for-profit counterparts, nonprofits may conclude that winning isn't everything.