DEBT AND MORTAR DECISIONS:
NONPROFIT BORROWER (AND LENDER) DECISION-MAKING MECHANISMS,
FACILITIES FINANCING, AND NONPROFIT CAPITAL STRUCTURE

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Submitted to the faculty of the University Graduate School
in partial fulfillment of the requirements
for the degree
Doctor of Philosophy
in the Paul H. O'Neill School of Public and Environmental Affairs
Indiana University

October 2022
Accepted by the Graduate Faculty of Indiana University, in partial fulfillment of the requirements for the degree of Doctor of Philosophy

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September 16, 2022
ACKNOWLEDGEMENT

I owe an extreme debt of gratitude to Dr. Kirsten Grønbjerg, my adviser. It is her deep dedication to the nonprofit sector – as a leader, scholar, and teacher – that has motivated my studies and career. Throughout my entire graduate education, she has actively fostered my development as a researcher. She gave me endless opportunities to participate in research projects and encouraged my own pursuits; she challenged me to answer the hard questions. I am deeply thankful that Dr. Grønbjerg has also supported me both professionally and personally through some of my best and worst times. She is the true definition of a mentor and an inspirational role model.

This dissertation would not have been possible without the encouragement and patience of my doctoral committee. Dr. Grønbjerg’s constant encouragement and wise guidance have been invaluable. I am thankful to Dr. Leslie Lenkowsky, who helped me find funding opportunities throughout the program and shared his practical experience with nonprofit debt. I thank Dr. Justin Ross, whose encouragement and prior collaboration helped me understand the intersection between public finance and the nonprofit sector. I am grateful to both Dr. Joanna Woronkowicz and Dr. Jamie Levine Daniel as well, for helping me navigate some of the difficult aspects of this research.

I would also like to thank the late Dr. Chaman Jain, who introduced me to the study of nonprofit finance. I also thank the late Dr. Robert Agranoff, who first taught me grounded theory methodology. I am appreciative of the research team at the Indiana Nonprofits: Scope and Community Dimensions project for helping me understand the nonprofit sector more deeply, and to the faculty at the Institute for Qualitative and Multi-Method Research at Syracuse University for helping me develop multi-methods research skills. I’m thankful for my work at the IU Center for Survey Research where I developed my methodological and data management skills with my colleagues. I am also grateful for all the study participants and practitioners I have had the pleasure of working with over the years.

Finally, I could not have done this without the unwavering support of my family and friends. I thank Kevin Bohan for his resolute and unrelenting belief in me. He along with Brian McGiverin, Chantalle LaFontant, and Erin Medeiros kept me sane and gave me inspiration when I needed it most. My Open Coworking Hive officemates kept me focused. And my dogs, Tiberius and Gibson, kept me grounded.
Many nonprofits need facilities to carry out operations essential to their missions. However, facilities can be costly to acquire and maintain, and many nonprofits will face a day when their revenues and reserves are insufficient. In that situation, large nonprofits could conduct a capital campaign, but that is an untenable option for most nonprofits. If these nonprofits need facilities, they will ask themselves, “Should we borrow?”

We know many do. We know nonprofit debt is linked to other financial measures, like revenue and asset size. To study these connections, we have used and adapted capital structure theories from business finance. Our findings have been interesting but persistently ambiguous. To resolve this, we have repeatedly said we need to know the causal factors behind these numbers. We need to understand how nonprofits decide to borrow.

In my dissertation, I help fill in that research gap. First, to answer, “How do nonprofits decide to borrow?” I analyze case study interviews against perspectives expressed in the scholarly research and “best practices” from practitioner literature. Second, nonprofits need a lender to borrow from. To answer, “How do lenders decide to work with nonprofits?” I analyze lender interviews and “best practice” literature. Third, I study how the larger debt marketplace and other environmental factors affect nonprofit and lender decisions.

My findings show that we must question our assumptions about borrower and lender decision-making mechanisms (e.g., debt’s basic definition and connotations, nonprofit/lender
relationships, and what information is most important to these decision-makers). In the conclusion, I offer new testable propositions and hypotheses to aid future nonprofit debt research.

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CHAPTER 1: INTRODUCTION

STATEMENT OF THE PROBLEM

Almost all charities face a moment when the equipment and facilities necessary to fulfilling their missions entail expenses that exceed cash on hand – e.g., purchasing a new delivery van for a meals-on-wheels program, replacing an old gym floor at a youth center, fixing the roof of an emergency shelter, or purchasing a building for an alternative high school. Such scenarios require tough decisions. A charity might ask itself: Can we reallocate funds or free up any of our current net assets to cover these expenses? In many cases, the answer is no, especially if a charity uses all of its revenue to fund mission-related programs. What about a capital campaign? Again, the answer is probably no. These days only large, high-capacity charities (e.g., universities, hospitals, major cultural institutions) can carry out a successful campaign.

At which point, a charity must ask itself: Should we borrow? Can we borrow? These are challenging questions for all charities. In most, staff probably have limited professional nonprofit

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1 Throughout I use “nonprofit” and “charity” to refer to “public charities” under 26 U.S. Code § 501(c)(3).

2 Capital campaigns have become more complex (Pierpont, 2011). Planning is a multiyear process that requires highly skilled staff and an actively interested board. The normal, basic steps are: assessing institutional readiness (2-3 years before going public), testing for readiness (1-2 years before), pre-campaign activities (1-2 years before), in-house fundraising (6 months to 1 year before), and the advance gift phase (1 year before), launching the campaign publicly, and wrapping it up. Without this planning, capital campaigns risk asking for gifts beyond what donors already do to support the nonprofit’s normal programs and operations. If not planned carefully and strategically, capital campaigns can “cannibalize” normal donations. Furthermore, large nonprofits have more access to high-net-worth donors (i.e., the one percent) and pursue “new philanthropy” (e.g., wills, contracts, bequests, trusts, charitable gift annuities, retained life interests, charitable mutual funds, donated IRS and life insurance policies, donated stocks, and bonds, etc.).

3 Here, too, large nonprofits have an advantage. They have staff dedicated to capital funding and projects, more experience, credit ratings, many reliable revenue streams, assets to use as collateral, and more debt options.
finance experience and/or training, because they must fulfill many different roles. While the board might include bankers and business leaders, they might not help find options or help with decisions; some might even oppose nonprofit borrowing on moral grounds. Plus, a charity might be hard pressed to find a loan, when lending to small businesses is more profitable and familiar to most banks. So given the circumstances, most charities might face many complex challenges and high hurdles when they consider borrowing.

I keep saying “might” because we still know little empirically about how most nonprofits make decisions about debt and building projects. In recent decades, scholars have made great progress answering the “what” questions about nonprofit debt. For example, we know that nonprofits borrow – over 70 percent do (Tuckman & Chang, 1993). We know what types of long-term debt nonprofits use (mostly loans, except for large charities that have access to municipal bonds) and what they use it for (mostly capital assets, e.g., buildings and land). Sixty percent have mortgages, and the average debt-to-net asset ratio is 0.5 to 1, with debt playing a bigger role in smaller charities (Yetman, 2007). We also know there are relationships between debt, revenue, and expenses. For example, a charity is more likely to have a mortgage

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4 Most charities are small. Looking at staff size, 56 percent of nonprofits have fewer than 10 employees (39 percent fewer than 5) according to the Bureau of Labor Statistics QCEW data (2017). The Urban Institute’s annual Nonprofit Sector in Brief, which measures nonprofit finances, consistently shows small nonprofits dominate the sector. In Chapter 2, I show that 66 percent of nonprofits with mortgage debt, have less than $5 million in total assets.

5 Their bank might discourage nonprofit lending; it’s just not as profitable, and riskier, compared to other options.

6 Please note this project does not include decisions about bonds. Nonprofits employ mortgages more frequently than municipal bonds, even though bonds account for the majority dollar amount (Denison, 2009). Nonprofits with municipal bond issues tend to be large, such as hospitals and universities (Denison, 2009), which are outside the scope of this study.

7 This means for every $1.00 in net assets, there is $0.50 to $1.00 in debt. While debt-to-net assets is a common measure, I prefer sometimes to use debt/total assets, which is a more intuitive: 25 to 50 percent of all the assets are debt.
the more donative revenue it has or the more it pays its executives (Denison, 2009). Also, a nonprofit is likely to have more debt if its revenue is more diversified and/or when it relies more on government funding (Yan et al., 2009).

In addition to the prevalence of debt, we also know many nonprofits have unmet capital investment needs for buildings and land. In particular, human service facilities have a difficult time finding funds to make necessary repairs and upgrades (Grønbjerg & Nagle, 1994). In one study, three out of every four nonprofits said they needed facilities funding, but only 58 percent found such funding over the past three years (Salamon & Geller, 2007). Of those that did, over 65 percent said the process was fairly to extremely difficult.

We also believe that debt makes nonprofits more financially vulnerable (Trussel, 2002; Tuckman & Chang, 1993). For example, donations and grants are not always as predictable as fee-for-service revenues. Grantors can reject applications. When nonprofit revenue drops, mortgage payments still must be paid during these lean months. If not paid, the lender may foreclose. For nonprofits that need facilities to provide services – e.g., youth centers, shelters – this puts their primary programs at risk. And we also know capital asset investment entails both opportunities (e.g., expanded ability to meet missions) and risks (e.g., loss of capital and financial hardships).

In all, we know the “what’s” of nonprofit debt (its relevance to nonprofit financial activity), but we still do not quite grasp the “why’s” and the “how’s” (the decisions, rationales, and causal mechanisms) underlying whether a nonprofit has debt (and if so, why that amount). That is not for want of trying. Scholars have cleverly experimented with many different approaches, like using modified capital structure theories, but the results have been ambiguous/mixed (e.g., Calabrese, 2011; Calabrese & Grizzle, 2012; Denison, 2009; Wedig,
1994; Charles et al., 2018). Because of this, many papers end with a call for new qualitative nonprofit finance research (e.g., Bowman, 2002; Yetman, 2007; Charles et al., 2020; Garcia-Rodriguez et al., 2021). The new testable propositions and hypotheses generated by such research could reinvigorate nonprofit debt research. Moreover, the findings could help us aid the sector. For as Bowman (2002) explains, “The sad fact is that despite a growing literature advising nonprofit managers about finance, we know very little about how they make decisions.” (p. 308)

To address this concern, in this dissertation I investigate the decision-making process behind nonprofit debt numbers. First, I answer the question: How do nonprofits make borrowing decisions? Second, because lenders play a role, I answer: How do lenders decide to work with nonprofits? And finally, I answer: How does the nonprofit capital marketplace – specifically aspects of borrower and lender organizational ecology – affect these decisions? Therefore, my research goes beyond the constraints of traditional capital structure theory to focus on the decision-making behaviors and external influences that leads to these ratios.

**LITERATURE REVIEW**

In this literature review, I include both economic and organizational theories. As Williamson (1985) explains, “Economics should both speak and listen to organizational theory” (p. 402). The two buttress each other and together can further both nonprofit organizational and financial research. First, I cover the capital structure theories (specifically tradeoff and pecking order) we have used in previous nonprofit debt research. The second section covers decision-making theory, since my research focuses on how key actors/participants make decisions about nonprofit debt. I review three major theories: rational choice, bounded rationality, and incrementalism. The rational approach is particularly important in capital structure theories and
the nonprofit “how to borrow” guides. However, we do not know how decisions are actually made, so I explore variations on this approach.

Third, I review other organizational theories that may explain nonprofit capital structure decisions. Principal-agent and transaction cost theories are organizational theories used in tandem with capital structure theories. For example, agency theory can explain why business owners use debt to control managers, since debt service payments tie-up any free cash that could spent at the managers’ discretion (Jensen & Meckling, 1976; Kochhar, 1996). Transaction costs can help organizations weigh the costs and benefits of different sources of debt (e.g., the time, research, and work going into finding a loan compared to how useful it will be to the organization) (Kochhar, 1996; Williamson, 1979).

In this section, I also include resource dependency theory, which helps explain the relationship between nonprofits and their lenders. Finally, ecological theories shed light on the larger environment, such as the diversity of lenders available to nonprofit borrowers and changes in governmental finance that can influence borrowing/lending decisions and outcome.

**Capital structure**

Capital structure is the general financial strategy used by a firm to finance its growth and operations through a combination of liabilities and other assets (Baker & Martin, 2011; Bessler et al., 2011; Swanson et al., 2003). The modern concept of capital structure emerged from the Modigliani-Miller (MM) Theorem of Capital Structure Irrelevance (1958). They proposed that

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8 The theorem is based on two propositions – one in a world with taxes and one in a world without. This is important because debt is tax exempt while equity is not (the tax shield). The model is elegantly simple…in part because all the huge assumptions they hold as constants.

9 The Modigliani-Miller theorem predated capital structure theories proper, although the nonprofit literature does not usually make the distinction (notable exception being Bowman (2002), although he technically cites the Miller and Modigliani (1961)). It is the foundation for the capital structure theories that follow, some of which were published by the same authors.
a firm’s capital structure is irrelevant to the firm’s market value (just as the name says). To explain, a firm’s total assets could be any mix of equity and debt; but that ratio should not affect investors’ decisions (e.g., buying stock). Each investor can use personal arbitrage – i.e., “homemade leverage” – to replicate how much debt they think the firm should have. It does not make the investment more or less risky to their personal portfolios. Say the investors look at the firm and conclude it is not using enough debt; they can replicate the capital structure they think the firm should have by using personal loans to buy the firm’s stock.10

Generally speaking, economic theories develop differently than organizational theories. For example, Modigliani and Miller (1958) used a series of mathematical and logical proofs that are expressed as equations. Models are simple, direct, and focus on one idea. To do this, the models block out other factors and list them as assumptions (e.g., “ceteris paribus”). For example, it is assumed that when individuals and firms borrow money, they put in the same amount of work, pay the same expenses, and get the same interest rates. Obviously, this is not realistic. But the assumption is necessary nevertheless for the model to illustrate the main concept. To test these sorts of models, scholars violate some of the assumptions, add in variables, and use real-world data. If the core idea in the model still holds, it develops into a predictive theory. Predictive theory looks to the future and looks for “what could happen.”11

10 I cannot find a citation, but I heard Miller in interview once. He was known for his food analogies. He was trying to explain the concept as simply as possible. Finally, he came up with the idea of using pizza. The pizza is the firm’s total assets. The pizza pie is sliced in two. Sometimes the two pieces will be equal 50/50 but they could also be 10/90, 70/30, etc. Maybe it is not sliced at all. This represents the firm’s debt-to-equity ratio or capital structure. When someone eats the pizza, how the pizza is sliced does not matter. If the two halves are equal, that does not mean they have to eat half. Instead, they are going to eat until they are full. That represents homemade leverage. Therefore, how the pizza is sliced is irrelevant. A person will eat however much they want. (The analogy was documented in (Miller, 1995.))

11 For profit capital structure research studies generally ask: Does the statistical model show support for tradeoff or pecking order theory? To find out, the researcher can look at the well-
In contrast, organizational theory explains “why or how something happened” (descriptive theory) or “why or how it should have happened” (prescriptive/normative theory). Organizational theories do not begin as logical proofs. Instead, they begin with observations of the real world, which are generalized into propositions, which then are tested against more real-world data to eventually become a theory. Because nonprofit sector research relies heavily on organizational theories, many of us (especially those without an economics background) think along those lines – i.e., capital structure theories explain organizational behaviors like why nonprofits choose to borrow – which capital structure theory does not and cannot do. Capital structure theories apply to markets not individual organizational behaviors. Capital structure can help us predict trends in nonprofit sector asset composition, but not much more by themselves.

Next, I explain the two capital structure theories we commonly use: tradeoff and pecking order. For each, I cover the original theory with more detail than we generally see in our nonprofit debt research papers (probably because journal length limits). Then I cover how we have adapted these business theories into the nonprofit context paying attention to these details.

**Tradeoff Theory**

Kraus and Litzenberger (1973) developed the static tradeoff theory by addressing some of the large assumptions in the Modigliani-Miller (1953) theorems. Its basic tenant is that firms try to balance the tax benefits of debt and the costs of financial distress (e.g., bankruptcy) through established predicted signs (positive or negative, +/-) of key coefficients in their statistical model. For example, tradeoff theory is supported when: (+) asset tangibility, (+) firm size, (-) growth opportunities, (+) profitability, and (-) volatility. When the model supports pecking order theory, the coefficient signs are different: (-) asset tangibility, (-) firm size, (+/-) growth opportunities, (-) profitability, and (-) volatility (Bessler et al, 2011). These predicted signs are based on substitutions and adjustments of the original theoretical model.

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12 There are economic theories based on observation, just not capital structure theories.
their debt-equity balance. One such benefit deals with income taxes. Federal tax code encourages firms to use debt by allowing an interest deduction (i.e., the tax shield) see Publication 535 (2019)). In contrast, equity related expenses (such as dividend payouts) have no such tax benefits. This interest expense deduction can help the firm increase its market value (Frank & Goyal, 2009; Modigliani & Miller, 1958).13

Additionally, debt can ameliorate principal-agent problems. It constrains the cash managers could spend on projects that benefit them, not the owners – the free cash flow hypothesis (Jensen, 1986). Plus, using debt can send a positive signal to shareholders/creditors that the firm is confident about positive returns on investment (Baker & Martin, 2011; Frank & Goyal, 2009; Kraus & Litzenberger, 1973). This rosy outlook can attract investors and increases firm market value. Considering these benefits, debt can increase firm value.

Yet, debt has its costs – both direct (e.g., legal fees, restructuring costs) and indirect (e.g., losing customers and employees) (Scott, 1976). Too much debt can increase a firm’s chances of bankruptcy and financial vulnerability. That means investing in the firm is riskier, so shareholders/creditors will demand a higher rate of return (Baker & Martin, 2011; Frank & Goyal, 2009; Kraus & Litzenberger, 1973). As a result, debt can decrease firm value.14 But while the theory points to a benefit-cost calculation, it does not directly address how firms actually make these choices (Baker & Martin, 2011; Frank & Goyal, 2009).15

13 This is a vast topic and scholars have researched variations and effects of the debt tax shield. Here, I am looking only at the theory, since that is what is referenced in nonprofit finance research.

14 Economists can use this benefit/cost logic to calculate the firm’s optimum debt use. But they have found many firms use much less debt than the optimum – the so called “low leverage puzzle” (Graham & Harvey, 2001). We have yet to address this problem in nonprofit debt research. Generally, we think nonprofits avoid debt, because of the stigma (i.e., too risky, donors do not like it, too businesslike, etc.). However, my findings indicate this is not always the case.

15 Static tradeoff theory comes with a methodological challenge. It measures the firm’s value
The market value of the firm plays a pivotal role in tradeoff theory, but much of it is predicated on book values from periodic, publicly available financial statements. The firm’s book value is less accurate than its market value, which fluctuates with investor preferences and perceptions. It is “static” because it looks at a single point in time. Therefore, some business scholars have explored “dynamic tradeoff” theory, acknowledging that firms are constantly rebalancing their capital structure toward its optimum (e.g., mean reversion). Using longitudinal and market data, these researchers suggest firms have a target “debt corridor” rather than a specific figure in mind (Baker & Wurgler, 2002; Brennan & Schwartz, 1984). But while the theory points to a benefit-cost calculation, it does not directly address how firms actually make these choices (Baker & Martin, 2011; Frank & Goyal, 2009). It assumes rational decision-making.

In nonprofit finance, researchers have used static tradeoff theory to help explain capital structure, but not dynamic tradeoff theory. The latter looks more promising for nonprofit research, but like business, we struggle with a static dataset (IRS 990s). Neither do these scholars directly address the “low leverage puzzle.” Nonprofit research says organizations should aim for an optimum debt level based on the costs and benefits of using debt (Bowman, 2002; Calabrese, 2011; Garcia-Rodriguez & Jegers, 2017). Since nonprofits cannot issue stock like firms, scholars suggest the tradeoff is between “debt or capital campaigns,” and postulate that excessive debt discourages donative revenue. But these are assumptions that have not been tested.
The rub is that capital structure theory is entirely about assets and market firm value – not revenue. Capital campaigns provide revenue, not assets, although nonprofits can count the funds as net assets. Retaining revenue increases total assets. The corollary in business finance would be that firms have a choice between generating more profit (e.g., selling more things) or using debt. A firm can choose to add the profits to their retained earnings (nonprofits also have retained earnings – revenue they choose to keep instead of spending).16

In nonprofit research, the costs of debt focus largely on financial distress and adverse effects on revenue. For example, highly leveraged nonprofits may have less access to subsequent borrowing, leaving them particularly vulnerable in emergency situations, like needing a loan to replace a damaged roof (Calabrese & Grizzle, 2012). Additionally, nonprofit watchdog groups evaluate organizational finances; for example, Charity Navigator dings a nonprofit’s score if it uses any debt (see Chapter 5).17 The assumption is that this discourages donations.18

16 Terms are tricky in business finance. For example, debt and liabilities are used synonymously, but are not. Debt is a subset of liabilities. Similarly, equity includes both owner’s equity and retained earnings. Retained earnings are like net assets – money the firm keeps from revenue after it pays all expenses. Owner’s equity is investor ownership (e.g., stock). I talk about these technical differences more in my conclusion chapter.

I should probably mention again that before I started collecting data, I had planned to rely mostly on the nonprofit literature. I did this deeper dive into economic theory while I was analyzing my data and found the nonprofit capital structure concepts did not quite match my observations. This is part of the grounded theory methodology, which I explain more in Chapter 2. The relevance to findings I explain in Chapter 6.

17 Charity watchdog groups assign scores to nonprofit organizations to help donors make their decisions. They use a combination of benchmarks. One is capital structure. In general, if a nonprofit has 5 percent debt or less, it gets a score of 10 out of 10. It gets a score of 2.5 if debt is between 40 – 100 percent. This is relevant in my sample selection, explained more in Chapter 2. In short, I chose organizations that would have a 0 – 2.5 score – Charity Navigator’s way of saying they have too much debt.

https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=48#PerformanceMetricSeven

18 This is hard to say with certainty because we do not have much behavioral data that examines the relationship between charitable giving and Charity Navigator ratings. When Szper and
Bankruptcy risks are exceptionally low for nonprofits, even in organizations running periodic deficits; lenders cannot force a nonprofit into bankruptcy, unlike other types of firms (Denison, 2009).\(^{19}\) Plus, foreclosing on a nonprofit can be a public relations nightmare (see Chapter 5). However, if the nonprofit itself chooses to go bankrupt, it faces both direct and indirect costs, just like for-profit firms. The direct costs include legal fees, restructuring costs, and impact on creditworthiness, while the indirect costs can include loss of stakeholder confidence (particularly donors), deteriorating relationships with partner organizations, and loss of employees (Haugen & Senbet, 1978).

Unlike for-profits, nonprofits do not get the benefit of a tax shield. Since they have no income tax, generally speaking, there is no tax deduction for using debt financing.\(^{20}\) Some nonprofits, however, have for-profit ventures providing “unrelated business income,” which is taxed. Nonprofits with such revenue might weigh the costs of using taxable revenue from their “for profit” enterprises against debt financing costs (Denison, 2009). Otherwise, the financial benefits of debt (in terms of tradeoff theory) are much less nebulous for nonprofits. Debt may help the organization expand or fund the launch of new projects, but these are not capital structure decisions, they are project-by-project decisions. Capital structure strategy is a top-level

\(^{19}\) I have yet to find data on how many nonprofits actually go bankrupt.

\(^{20}\) Revenue unrelated to the mission is taxable, commonly called UBIT (unrelated business income tax). The IRS lists exemption for some activities, like certain bingo games or selling donated merchandise (IRS Form 990-T instructions).
decision – whether to expand a firm through liabilities or issuing new equity. It applies to the entire organization, not to a particular project.

A study of hospital capital structure supports tradeoff theory for all types of hospitals relying on fee-for-service revenue, whether nonprofit or for-profit (Wedig et al., 1988). Of specific relevance to my research, they found that tradeoff theory helped explain nonprofit indirect arbitrage – borrowing at low tax-exempt rates for capital projects, while investing unrestricted assets in endowments or other funds.

**Pecking order theory**

In the 1980s, pecking order theory came onto the capital structure scene. It also seeks to understand the relationship between capital structure and firm value (Myers & Majluf, 1984; Myers, 1984), but posits that a firm ranks capital options according to cost, and then chooses the least costly option. They assume firm managers make their decisions based on the firm’s current financial health, potential risks, and future prospects. Investors, however, do not have full access to this information. They can only infer it by observing the firm and watching for signals. The firm’s debt-equity choices are one such signal. Based on this signal, investors make a risk-reward calculation about investing in the firm. This in turn influences the costs of the firm’s capital options. Furthermore, the cost of financing tends to increase with information asymmetry between the firm’s stakeholders, including shareholders, executive staff, etc. (Baker & Martin, 2011; Harris & Raviv, 1991; Myers & Majluf, 1984). With less information, there is more risk, thus investors require a higher return, since they have less certainty. Like tradeoff theory, pecking order addresses the interaction between firm capital structure decisions, investor reactions, and effects on firm market value.
In pecking order theory, firms can choose between two broad options – internal or external financing. Of the two, the theory says that firms think internal financing is least costly, because of how investors react to the signal it sends – that managers think the firm is healthy and has good future prospects. Investors therefore think that a firm must be very profitable, to be able to retain so much of its earnings; also, the managers must not be too worried about the future, since this spare cash is not going into a rainy-day fund or other reserves. While the investors do not know all this directly, it seems the logical choice for the firm to make if those conditions exist. Therefore, investing in the firm looks to be pretty low risk, and because of this, investors do not demand as high of a return. This keeps the costs of financing low for the firm (Baker & Martin, 2011; Harris & Raviv, 1991; Myers & Majluf, 1984).

The alternative to internal funding is of course external financing, of which there are two options for business firms: debt or new equity. Pecking order suggests that after internal financing, debt is the second-best choice. As before, it is all about the signal that using debt sends to the investors. The signal here is that managers must think the opportunity for growth is worth the risk of financial distress and bankruptcy. To investors, all of this is a positive signal - maybe not as good as internal financing, but still pretty good. This in turn affects the stock price and firm market value. Here again, information asymmetry, signaling, and investors’ perceptions affect the firm’s capital structure (Baker & Martin, 2011; Harris & Raviv, 1991; Myers & Majluf, 1984).

The other type of external financing is issuing new equity (stock). Firm managers generally do not like issuing equity, because it comes with a lot of costs (in the economic sense

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This is different than a capital campaign. Issuing new stock (increasing the number of shares on the market) is selling off bits of company ownership. It is no more difficult than borrowing, logistically speaking. Publicly traded firms have the skills to do either with equal facility.
of the term). For example, more equity means the current investors lose power over the firm, since the new investors can influence the company’s mission and other decisions. Just like with internal financing or debt, issuing new equity is also a signal to investors: Managers must think the firm is overvalued to be willing to dilute the stock pool. This increases the risk of investing in the firm, in turn raising the cost of firm funding options (Baker & Martin, 2011; Harris & Raviv, 1991; Myers & Majluf, 1984).

Considering these basics of pecking order theory, applying the original corporate version to nonprofits definitely has its challenges. Just like with tradeoff theory, nonprofits neither have owners nor equity. When used in the nonprofit context, scholars generally substitute net assets for equity. For example, in terms of information asymmetry and its costs, they consider donations, comparing individual donors to institutional grant makers. Individual donors require less information (although also care and attention) than grantors, which require nonprofits to submit (sometimes extensive) reports and oversight (financial reports, outcome updates, etc.) to reduce information asymmetry between grantor and grantee. As a result, grants are more costly, demanding more labor hours and higher skilled employees (Bowman, 2002; Calabrese & Grizzle, 2012; Denison, 2009; Yan et al., 2009; Yetman, 2010). But funding may also come in bigger chunks than from individual donors.

Support for pecking order theory (and tradeoff theory) for nonprofits has been mixed. Several authors have found support for pecking order theory (Bacon, 1992; Yetman, 2007) when applied to nonprofits, but others think tradeoff theory better explains nonprofit capital structure. So, some nonprofit scholars have tried to merge pecking order and tradeoff theories (Calabrese,

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22 Equity and net assets are tricky terms. Corporations do have net assets – the net of total assets minus total liabilities – just like nonprofits do. When a company makes more money, it has more net assets…until it decides to either spend them as dividends or keep them in retained earnings.
For example, Calabrese (2011) proposes as “modified pecking order theory” to explain why debt and earnings are not perfect substitutes for one another. In this theory, nonprofits do prefer internal financing over external financing, if that internal financing does not deplete rainy-day founds or other critical internal resources. This means they do not just look at their current financial circumstances, but also include predictions for future financial needs, opportunities, and risks.

Scholars also acknowledge that donations are revenue, not capital funding for assets. As I noted earlier, capital structure is the financial strategy a company uses to finance its growth and operations through a combination of liabilities and other assets (Baker & Martin, 2011; Bessler et al., 2011; Swanson et al., 2003). In corporate finance, pecking order and tradeoff theory are competing theories that cannot be combined. Rather than combining theories per se, it seems to me that nonprofit scholars are trying to draw on the “forces” underlying capital structure theory, namely agency theory and transaction costs related to information asymmetry.

However, agency theory is not capital structure theory. It is about understanding the relationships between two groups, where the agent is supposed to act on behalf of the principal, but sometimes does not, creating problems for the principals. It is not a theory of the marketplace. As Weston (1966) put it, “The economic theory of the firm is designed to answer a set of questions that have relevance and importance for the operation of an economic system. Important questions about the internal operations of the firm and the processes by which decisions are reached were never intended to be handled by the economic theory of the firm.”

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23 Some nonprofits do not keep rainy day funds, since they have pressures to spend everything they make on services.

24 This conclusion/observation is especially relevant since it helps explain why nonprofit debt
**Decision making**

Economists are well aware that capital structure theories are predictive – i.e., using current information to forecast the future – and do not describe behaviors like decision-making. Myers (1993, pg. 6) reflects, “[The static tradeoff model] may be a weak guide to average behavior. It is not much help in understanding any given firm’s decisions.” For that, we need to know why the forecast works – i.e., the borrowing decisions. As Simon (1979, p 489) explains, economists rely on descriptive organizational theories to understand “the ways decisions are made, not just decision outcomes.”

In the analysis of my data, I found that financial *management* theory can help explain nonprofit debt levels better than economic and finance theories. For example, not all types of decisions use the same process; they might be strategic or simply a back-office routine operation. While not thinking about finance specifically, Perry and Kraemer (1983) discussed a framework of decision-making processes related to the “level” of the issue addressed. They list three types of problems: operational, programming/management, and developmental planning. I found the Perry and Kraemer (1983) framework useful, since nonprofit leaders and lenders describe decision making that fits all three categories. I will reference their categories in the next sections.

decisions seemed truly a bad fit with capital structure theories. In my interviews, borrowers and lenders rarely used terms related to capital structure strategy (e.g., how donors may react) in their decision-making, keeping in mind that capital structure is technically an overall organizational financial strategy (i.e., not a project-by-project choice). While nonprofit scholars have called for more financial management research (decision-making), they have not explicitly addressed (to my knowledge) whether to apply economic theories instead of organization theories when seeking to understand management decisions and other nonprofit behaviors. I discuss this more in my findings and conclusions.
**Rational choice**

Rational actors have a clear goal in mind and perfect information – everything they need to know to make the perfect choice. They also analyze all this data and measure benefits and costs objectively. They know the risks with certainty. With this information, they can identify the optimum solution. From problem identification to solution implementation, the process follows an orderly path (Lein, 1997). While all actors follow this decision-making procedure, not all reach the same conclusions, because each act in order to maximize their own personal benefit. I include rational choice here, because it is a fundamental premise in capital structure theory (and in many other economic fields).

When we use capital structure theories in nonprofit research, we tacitly assume nonprofit actors also make rational decision in order to maximize their own individual benefits. In doing so, we assume nonprofits use extensive financial analysis to make their debt decisions. Practitioner-oriented publications (e.g., “how to” guides directed at lenders and borrowers) also have the rational choice model at their core. Financial analysis, with all its quantitative data, lends itself to this approach. According to Perry and Kraemer (1983), rational decision-making is best used for “operations” issues (i.e., day-to-day efficiency, such as inventory control) that have easily defined objectives and solutions. Because of this, quantitative methods is usually a good way to get actors to agree on the decision. Simon (1979) similarly explains that scientific management and operations research work well for decision-making for military management and logistics, because of the command structure and culture.

Decisions about debt could be operational in certain situations. The financial management project evaluation methods taught in undergraduate management courses rely heavily on quantitative assessments of projected cash flows from operations, capital investment,
and net working capital. Therefore, nonprofit decision makers at some level may evaluate facilities funding problems with a rational choice approach in mind, especially if they see certain financial decisions as secondary and “back office” tasks when compared to mission-related activities and programs. In my findings, some nonprofit leaders were so unconcerned about their debt loads, as compared to other financial issues, that debt decisions did have a rather “operational” feel.

Overall, rational choice might not explain decisions underlying nonprofit debt directly. But it does illustrate an ideal that underlies our research. Additionally, it reflects critical assumptions in capital structure theories. Simon (1997) explains it well when he says that decision-making “is intendedly rational, but only boundedly so.” (p. 88). For example, my study participants talked about doing more analysis and working with more quantifiable data as something they “should” do.

_Bounded rationality_

Bounded rationality takes a more realistic approach. Actors cannot possibly meet the assumptions of rational choice. Knowledge has limits, clearly identifying goals can be challenging in complex environments, and it takes time and workhours to analyze possible alternatives. While actors might work toward rationality (at least procedural rationality) as an ideal, realistically they satisfice – make “good enough” decisions. Ultimately, decision makers may choose the first solution that satisfies the bare minimum criteria deemed necessary (March et al., 1993).

Heuristics help. With mental shortcuts (e.g., past experience, advice from others), actors can make faster, less resource intensive decisions. For example, in my findings both borrowers and lenders wished they had more formal training and background knowledge when it came to
nonprofit debt. Instead, they relied on accumulated experience, which can be rather limited.25 But heuristics come with cognitive biases (e.g., group bias, failed consensus, availability heuristic, primacy/recency effects, etc.) (Simon, 1946; Yoder, 1999). Actors may rely on past experience. The decisions that had the greatest consequence would be forefront in their minds, and influence how they make decisions in the future. A negative experience may have had more impact, creating a cognitive bias that shifted heuristics. Early initial information tends to anchor all subsequent information (Tversky & Kahneman, 1974). For example, in my research, one lender told me her department stopped working with nonprofits for a while, because one loan contributed to the demise of the borrower. “We are not going to lend to nonprofits just to see them fail,” was a common sentiment at the bank for a time, even though most other loans had positive outcomes.

Bounded rational decision-making aligns with the “programming and management” problems identified by Perry and Kraemer (1983). In such cases, quantitative models fall short, and finding a solution requires qualitative analysis as well. For example, one nonprofit leader in my study was considering building an additional facility. Rather than relying heavily on a quantitative analysis and using financial tools, such as net present value calculations, he used a series of heuristics based on his past experience in a family business. The lender, who collaborated significantly in the decision-making process, did the same. The question of borrowing was neither a back-office function, nor a larger governance issue, but fell in-between.

25 In my observations, leaders at nonprofits that have successfully used debt attributed this to their personal background in for-profit business.
Incrementalism

Both rational and bounded rational decision-making assume the actor is making just one decision and is following a standard sequence of steps: identify the problem, set goals, look at alternative solutions, implement the best solution, and attain the goal. But this top-down approach does not work in all circumstances. Sometimes situations demand a more incremental approach – many small, successive decisions over time that are “good enough” at the moment. Actors “muddle through” rather than make full-blown decisions (Lindblom, 1959; 1979).

Incrementalism works well when a decision is very risky because small, incremental decisions reduce that risk. It accommodates situations with a mix of ends and means. These gradual, flexible changes may not follow one strategic plan; rather, successive decision-makers may have different experience, information, perspectives, and aims. Incrementalism can lead to an organization’s continuous improvement or a “punctuated equilibrium” sequence in policy decisions. Decision-making also tends to be incremental when there are many diverse stakeholders, with various levels of risk tolerance (Lindblom, 1959, 1979; Wimberley & Morrow, 1981). Avoiding radical changes avoids conflict.

Incrementalism can also be logical and part of a larger strategic, routine approach. Organizations can anticipate the circumstances associated with this decision-making process, and plan for it. This can lead to a more collaborative process (Innes & Booher, 2010; Quinn, 1980).

In public finance, a good example is the budgeting process. Rather than a zero-based budget,

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26 My case study analysis showed that nonprofit borrowers and lenders made borrowing decisions based on the project. This is an incremental process compared to capital structure theory, which assumes borrowing is a top-down, organization-wide financial strategy (i.e., the firm borrows with the total firm value in mind, not the outcomes of individual projects). Incrementalism, project-based decision-making violate a fundamental premise in for-profit capital structure theory.
where the entire budget is built from the ground up, budgets change with successive, marginal, incremental adjustments. In many situations, this makes sense when programs stay relatively unchanged from year to year, such as fire management or policing (Wildavsky & Caiden, 1996). Through incrementalism, financial managers can cultivate a general approach for evaluating and establishing budgeting priorities. But this primarily applies to operations budgets, rather than capital budgets (Miranda & Hillman, 1996), since capital budgeting decisions tend to have fewer recurring programs and financial demands. For example, when an organization decides to purchase a building, this likely is a major or one-time change (Pagano, 1984) and not something the organization would do again for quite some time.

Capital budgeting decisions align with Perry and Kraemer’s (1983) “development/planning” problems, which are complex and nebulous. Buying or building a facility seems like one major decision, but the decision-making process leading up to that final outcome may be more incremental, especially if many stakeholders are involved. For example, nonprofits typically have staff, board members, volunteers, clients/customers/members, public and private grantors, individual donors, etc. In this context, incrementalism may be a way to resolve (and/or avoid) conflicts in an environment with diverse goals and values. Or risk adverse organizations may take an incremental approach to borrowing (small successive loans over time, building up to major borrowing) in order to test the waters and reduce risk before undertaking a significant debt for a facility. Instead of constructing a new facility from the ground up, a nonprofit might choose to make a series of renovations to their current facility. Or, as in the case with one nonprofit in my study, the directors chose to rent facilities before purchasing them to “test them out” before purchasing/constructing a building.
**Organizational theory**

In addition to economic and decision-making theories, organizational theories can also help explain nonprofit debt levels. Economics and organizational theory have always had a close relationship. As Williamson (1985) explains, “Economics should both speak and listen to organizational theory.” (p. 402). Agency and transaction costs theories are both embedded in traditional capital structure theories, because they help explain the internal organizational dynamics that influence financial decisions, such as struggles among stakeholders and information transfer (Myers, 1993).

Resource dependency, another organizational theory, also helps explain nonprofit debt decisions. Nonprofit debt is the product of interactions between two organizations – the lender and the borrower. Debt connects the two organizations in a contract and creates a resource dependency between them. In my findings, lenders have more control over nonprofit activities and finances when the nonprofit has only a few (or one) lenders available. If a lender works with only one nonprofit, that nonprofit has considerable influence over the lender’s reputation. If the lender treats the nonprofit harshly, (e.g., threatening to foreclose), it can make the lender look greedy and anti-community. With a bad reputation, the lender could lose customers. Having more nonprofit clients reduces dependency, so penalizing one nonprofit does not have as severe an effect.

Finally, both lenders and borrowers operate in the larger organizational ecology. For example, the Community Reinvestment Act and other government policies incentivize banks to lend to more nonprofits. Additionally, nonprofit borrowers and loan officers explained that when larger financial institutions buy up smaller community banks, nonprofits have less access to loans. Such ecological shifts influence nonprofit capital structures.
In the following sections, I highlight key aspects of principal-agent theory, transaction costs, resource dependency, and ecological theories of organizations and how they apply to the processes by which nonprofits acquire debt.

**Agency Theory**

Agency theory has deep roots in economics and organizational studies (Bendickson et al., 2016). In a principal-agent relationship, one actor (the principal) delegates to another actor (the agent). The agent is expected to function as if the principal’s preferences and motivations are their own. Because the agent actually makes the decisions, they have more information about the situation and circumstances compared the principal (asymmetric information). Taking advantage of this, the agent may prioritize their own goals over the principal’s, hence the principal-agent problem (Fama, 1980; Fama & Jensen, 1983).

In publicly traded firms, this problem arises because self-interested owners want to maximize the return on their investments, while self-interested managers have different priorities, such as job security and compensation (Jensen & Meckling, 1976). For example, owners may be more interested in risky, high return investments that are very profitable in the short-term but also adversely affect firm managers (e.g., layoffs, shutting down projects, etc.). If they are able to, the managers will prioritize their own goals (e.g., increased salaries). Jensen’s (1986) free cash flow hypothesis explains how owners can use debt repayment expenses to reduce discretionary funds managers could use to their own ends.

In contrast, organizational theory does not adhere to this theoretical abstraction. For nonprofits, agency theory takes on additional complexity, since there are no clear owners and managers. In some research, scholars have suggested that the board is the principal, and the manager is the agent, using staff wages and expenses to proxy the distance between the two
(Calabrese, 2011; Yan et al., 2009). Scholars know, however, that this approach (while the best possible with the given data) glosses over the wide variety of stakeholders that each nonprofit may have (e.g., foundations, government grantors, major donors, local governments, clients, partner organizations, etc.). Without owners, many different stakeholder groups can have conflicting goals and claim priority, and/or try to control one another – the result is many principals and many agents (Anheier, 2005; Jegers, 2008; Steinberg, 2010). The diverse relationships, power, and abilities among these stakeholders can make decision-making much more complex (Hodge & Piccolo, 2005; Jegers, 2011).

Complex stakeholder systems for nonprofits, however, does not mean these groups are adversarial as in the business world. For example, business theories assume managers use their more in-depth knowledge to take advantage of owners (i.e., asymmetric information). In contrast, synergy and goal alignment between nonprofit boards and staff (not control) is an ideal and a core capacity as evidenced by copious literature and training materials for nonprofit leaders (Brown et al., 2012; Chadwick-Coule, 2011; Minkoff & Powell, 2006; Pynes, 2008). Staff strive actively to increase the board’s knowledge of nonprofit finance (Williams, 2000); although it may be difficult to keep boards up to date. Nevertheless, these information asymmetries could impede optimal decisions about capital structure (IU Center for Philanthropy, 2012; Lang, 2009). Boards and managers that distribute decision-making (e.g., boards deciding on the capital budget, and staff deciding on the funding sources) may make more prudent financial choices (Fama & Jensen, 1983). The success of this arrangement, however, is entirely contingent on the aptitudes of the stakeholders and their relationships with one another (Hodge & Piccolo, 2005).

Considering all of this, agency theory (in terms of the principal-agent problem) might not be best suited to the nonprofit context (Steinberg, 2010), lending support to alternative theories,
most notably stakeholder theory. For business firms, success depends on meeting the aims of many stakeholders, although owners outrank others in terms of formal power (Donaldson & Preston, 1995; Lewis, 2001; Freeman, 1984; Freeman & Read, 1983; Hansmann, 1980). In nonprofits, stakeholders can be grouped into both internal (e.g., board, management, employees) and external (e.g., funders, competitors, partners, clients) groups that each have interests in the organization and its mission (Van Puyvelde et al., 2012). Both of these groups are important to the organization, in contrast to principal-agent theory in which the owners are paramount (e.g., the investors in capital structure theories).

A related perspective, stewardship theory posits that stakeholders are intrinsically motivated, pro-organizational, and collaborative. Rather than being self-interested owners, stewards take responsibility for and nurture organizations because of their shared concern for the overall mission and goals of the organization (Sundaramurthy & Lewis, 2003; Van Puyvelde et al., 2012). Several nonprofit and lender participants described these kinds of stakeholder and stewardship relationships, but there was also evidence the lenders can wield power through loan covenants.\(^\text{27}\)

**Transaction Costs**

Both agency and transaction theories operate on the assumption of rational choice, but transaction costs theory includes interactions with the larger environment. While agency theory focuses on goal alignment between two self-interested parties, transaction cost theories address

\(^{27}\) Lenders use covenants to reduce the risk that the borrower will not be able to repay the loan. Specifically, the lender wants to make sure the nonprofit can repay the loan in the future, even if the nonprofit falls into financial hardship (e.g., losing a grant that is a major source of revenue). Some examples of covenants include: making sure current assets always are 130 percent more than current liabilities; prohibiting any new long-term debt until the loan is repaid; maintaining a rainy-day fund large enough to cover six months of expenses (especially debt service payments); etc.
how two parties reduce their costs in an uncertain environment by establishing agreements with one another (Valentinov, 2008; Williamson, 1975, 1979; Scott & Davis, 2008).

As noted earlier in my discussion of capital structure theory, one of Modigliani and Miller’s core assumptions was a frictionless market. Firms can acquire debt or equity without facing the costs of setting up securities sales, finding lenders, drawing up contracts, etc. That means they can maintain a steady debt-equity balance rather easily. Dynamic tradeoff theory, however, takes such costs into account; rather than targeting one specific number, firms use a debt corridor (a debt-to-equity range) sufficient to meet their financial strategy, but not as costly. The theory explicitly considers the types of costs involved in making these decisions.

Transaction costs can be classified into three broad groups: search and information, bargaining, and policing/enforcement (Mahoney, 2004). For example, my observations indicate lenders incur costs from: assessing a nonprofit’s creditworthiness, negotiating the terms and conditions of the loan, and reducing the risk of default by monitoring the nonprofit’s financial health over the course of the loan. Since nonprofits do not fit the normal “small business” financial structure, they need additional financial capacity and knowledge (e.g., ratio analysis, in depth annual financial reports, and other benchmarks) to convey their creditworthiness. If a bank cannot get this information or does not know how to analyze it, it may determine that it is too risky to make a loan to a nonprofit at all.

Alternatively, the lender could use an information broker (e.g., ratings from Dun & Bradstreet or Charity Navigator). My findings indicate that practitioner-oriented guides put a heavy emphasis on nonprofits reporting key information in a way a lender can easily understand (e.g., ratios, financial statements, etc.) in a format similar to a small business (the lender’s usual clientele). Correspondingly, lenders are advised to learn more about nonprofit finance, such as
not considering endowments as collateral, or understanding they cannot force a nonprofit into bankruptcy.

The premise of transaction cost theory is that for-profit firms want to keep costs low in order to maximize profits. Because of this, Williamson (1985; 1999), who created the theory, explained it might not apply to government and nonprofit organizations, which want to maximize their mission attainment. They do face transaction costs when they contract out for services, but do not have the profit motivations. Also, for-profit contractors may have very different (profit maximizing) motives than public organizations, which increase the costs (e.g., time and energy spent on reporting, managing, evaluating, etc.) for one or both organizations (Brown & Potoski, 2003; Witesman & Fernandez, 2013). With nonprofit contractors, however, costs are lower, since both have a public service focus. As a result, collaboration between public and nonprofit organizations can be more efficient than each going it alone (Ben-Ner, 1986; Fama & Jensen, 1983; Hansmann, 1980).28

In addition to contracting research, the transaction cost theory may apply to the relationships between grantors and their nonprofit recipients. For example, a foundation can stipulate the grantee submit reports on how the funds are spent and the mission-related effects of the grant. The funder’s aim is to ensure that the nonprofit does not divert funds from the specific projects for which the grant was received by using the money to cover administrative expenses. Research indicates that foundations which stipulate more reporting requirements tend to give larger grants with fewer upfront restrictions (Thornton, 2006; 2010). Also, the more the funder and recipient know each other, and the more they share the same mission, the lower the costs

28 Because of this difference, I tacitly assumed that nonprofit borrowers would prefer to work with CDFIs, which often are nonprofit themselves. Instead, my findings indicate that certain nonprofits reduce their transaction costs when they work with community banks.
(Grønbjerg et al., 2000). But grants come with costs (e.g., apply, managing, reporting), so “free money” is not really a free as one might expect.

These findings have implications for lender/borrower relationships. Nonprofit lenders may offer nonprofits larger loans, but these come with extensive application and reporting requirements, although also a fair amount of financial technical assistance (see Chapter 4). The minimum loan amounts offered by these lenders can far exceed the needs of the average human service organization (according to one study participant). Much of the practitioner literature said nonprofits needed to act (or at least) look like small businesses when they applied for loans; commercial lenders have more experience with these types of borrowers, so this reduces information asymmetry. Generally, the nonprofits in my case studies worked with community banks or banks in the local area. In some cases, bank and nonprofit leaders shared close personal and interorganizational ties (e.g., kids on the same soccer team, philanthropic relationships), resulting in fewer application costs. Additionally, these lenders did not necessarily expect to make a profit on these loans, but rather aimed to strengthen human services in the community – a mission alignment of sorts.

Overall, transaction cost theories focus on interorganizational relationships, the frictions created by them in an uncertain environment, and related effects on governance. To reduce risks, each party tries to find the best agreement/contract/relations while trying to keep their costs minimal. Trust between actors reduces friction.

Resource dependency theory

Unlike agency and transaction cost theories which assume rational actors, resource dependency theory has a naturalistic approach; but like transaction cost, it considers the organization’s larger environment. While transaction cost focuses on costs organizations face
when making transactions with other units, resource dependency addresses the power and control dynamics in interorganizational relationships (Blau & Scott, 1962; Evan, 1965; Pfeffer & Salancik, 2003; Scott & Davis, 2008). These relationships form because organizations need resources (both tangible and intangible) to survive but cannot collect these from the environment directly. Instead, organizations must exchange resources. The exchange creates dependencies, which in turn create power dynamics. Resource dependency theory assumes that organizations try to control their future and avoid dependency problems, but realistically that is not always possible. When resources are scarce, and the operating environment is uncertain, entities compete for those resources and adapt to survive (Froelich, 1999; Hodge & Piccolo, 2005).

These power dynamics develop in a couple of ways. When one organization controls most of the resources, it has power over organizations that depend on that resource. But organizations can also increase their power by creating interdependencies. For example, in a symbiotic interdependency both organizations rely on each other by each producing a limited-supply resource the other one needs (Herman & Heimovics, 1991; Pfeffer & Salancik, 2003). Additionally, organizations have coalitions (both internal and external) that emerge from social interactions and aim to influence organizational behaviors (e.g., the contract negotiated between the nonprofit and lender). In the larger environment, the resources that organizations need to operate and survive are scarce, creating inherent uncertainty (e.g., availability of capital funding). To reduce uncertainty, organizations try to minimize their dependence on resource

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29 The relationships aspect is so important that some scholars have suggested organizations are not the proper unit of analysis, but organization sets or dyads (i.e., the relationship itself), although data limit that type of research design (Blau & Scott, 1962).

30 The classic definition is A has power of over B equal to how much B is dependent on A. B’s dependence is higher contingent up on how much B cares about the advantages A gives to it. It is less dependent on if B can meet similar goals outside of its relationships with A.
providers (e.g., being dependent on a bank). To also reduce uncertainty, they can also aim to maximize how much other organizations depend on them.

As I show, nonprofit borrowers and their lenders create a relationship through debt. In one of my cases, the lender exerted enormous control over the nonprofit, since the latter had no alternative sources of capital. Another nonprofit, however, found an alternative lender who took over the debt and freed the nonprofit from the (largely destructive) bank covenants. I had originally assumed nonprofits would have wider access to lenders, but many had few (or only one) choices. This largely depended on the nonprofit’s timeline and also its geographic location.31 Does it need funding now (e.g., a repair) or have the leisure to look at a variety of options (e.g., renovation) – reactive versus proactive? Such resource dependence, especially in regard to large debt loads, can lead to financial vulnerability (Greenlee & Trussel, 2000; Trussel, 2002; Tuckman & Chang, 1991).

Most nonprofit finance research focuses on revenue and fund development, that – while different than capital structure – do apply. Nonprofits risk financial vulnerability when they rely too much on one source of funding.32 Instability in individual contributions, withdrawal of

31 The larger ecology also influences these resource dependency relationships (e.g., increased community needs, changes in when or how governments reimburse nonprofits under contract, changes to banking regulations, etc.) I talk about this briefly in the next section starting on page 25) and much more in detail in Chapter 5. For more information about geography and borrowings, see page 125.

32 In our quantitative studies of IRS 990 data, we normally measure revenue diversity using a Herfindahl index. The inputs are Part I, lines 8-11: contributions and grants, program service revenue, investment income, and other. There are a couple of difficulties with this approach. For example, an organization could use a wide variety of donative income sources. This granularity is lost in the single “contributions and grants” measurement. Also, the IRS 990 lack information on how stable revenue sources are or how revenue diversity cost more than what it is worth. For example, one nonprofit in my sample planned to sell its building to reduce revenue sources. Government funds would not pay for the mortgage, so the nonprofit had to maintain a separate donor pool for just this expense. This revenue source did not fit in well with the nonprofit’s overall financial and mission-based structures. Therefore, if it rented space, it would not need to
government support, and lower demand for paid services all are examples of risks to revenue sources (Carroll & Stater, 2008; Shea & Wang, 2015). If one resource sours, the nonprofit can turn to others. But it is not always that straightforward in nonprofit lending. As I show, several lenders extended loans to nonprofits even when they knew the nonprofit could not repay them; this was not a malicious attempt to get the nonprofit to foreclose and give-up a property, but rather had more the flavor of impact investments or donations. These arrangements relied on close and trusting relationships between the lender and the borrower, like being members of the same small community (Grønbjerg et al., 2000).

Regardless of the relationship between organizations, resource dependency theory assumes managers can act in response to their environment, although realistically this might not always be possible. Nevertheless, organizations are still sensitive to the environment; for example, government organizations are more influenced by politics than market behavior (Meyer & Rowan, 1977). As I show, nonprofit borrowers noted market and political pressures (e.g., demand for services and reduced state budgets) as did lenders (e.g., local government priorities and nonprofit demand for loans). Additionally, lender-borrower relationships depended on the demography and types of lenders. I turn now to organizational ecology theories which address these issues.

**Ecological theories**

Like transaction cost and resource dependency theories, organizational ecology takes an “open systems” approach – i.e., organizations exist within and are influenced by the larger world. But in ecological theories, “types of organizations” (e.g., industries)\(^3\) are the unit of analysis maintain this donor pool.

\(^3\) The organizational theory literature often uses the term “industries” as defined by SIC (Standard Industrial Classification) or NAICS (North American Industry Classification System)
rather than individual organizations or organizational sets. In a sense, these theories are more akin to traditional capital structure theories that have a market-wide scope, and they help explain the larger dynamics affecting nonprofit debt levels.

Fundamentally, whether (or how much) nonprofits have debt depends on the lender. The lender decides if and how much a nonprofit can borrow. Not all lenders are the same. There are national banks, regional banks, commercial and community banks, credit unions, community development financial institutions, foundations, government agencies, etc. Some lenders will not work with nonprofits at all, while other only lend to nonprofits fitting certain specifications (e.g., industry, size, geographic location, amount of loan desired, etc.). Lender diversity and programs are influenced by changes in government policies, funding, and regulations (e.g., Community Reinvestment Act, Community Development Financial Institution Fund). These changes can also influence the human services sector. For example, one nonprofit leader explained his facility plans depended on the “politics” of the opioid crisis (i.e., government priorities change with changes in administration, which affects funding sources).

All of these circumstances indicate that organizational ecology theories can help us understand the broader context for nonprofit debt levels. Many of the theories I have previously mentioned tend to focus on what happens within organizations and a few between organizations. Ecological theories, however, focus on populations of organizations that share similar “forms” within the larger environment (Emery & Trist, 1965; Hannan & Freeman, 1977). These forms arise from an organization’s technologies, routines, activities, markets, culture, etc. The codes. Most nonprofit scholarship uses NTEE (National Taxonomy of Exempt Entities) codes that are specifically designed for nonprofits. These are mostly used in large-n studies as a variable of interest or control. See Chapter 2 for more information.

34 Sometimes nonprofit debt needs are below the minimum threshold for a loan.
dynamism and capacity of the environment forces competition among organizations for limited resources. While some environments may change gradually, others exhibit punctuated equilibrium (Dezhbakhs et al., 2003). For example, Pina and colleagues (2016) observed that competition increased and changed the Spanish banking industry when the Spanish government shifted from a nonprofit motivation to more of a political motivation. That deregulation increased competition.

Ecological theory predicts that when environments change, especially if the change is a shock to the system because it is both major and rapid (such as the invention of new technology, or the start of a pandemic), some existing organizational forms will disappear because they no longer fit the environment and new forms, better suited to the new environment, will emerge. These types of selection forces shape the founding and failure of different organizational populations depending on a variety of factors. Thus, niche theory posits that in a stable environment, specialist organizations thrive because they can exploit a narrow market segment intensively. But in a dynamic environment, generalists succeed because they work in multiple markets and do not put all their eggs in one basket.

In addition to this “resource competition and survival of the fittest approach” approach, some ecological theories focus on collaboration and community – symbiosis (Brittain & Wholey, 1988; Rao & Singh, 1999). Freeman and Audia (2006) explain how network relationships within the community affect organizational forms. Proximity is important to these organizational networks and communities. Additionally, while uneven geographic distributions of resources affect organizational mortality, community ideology also influences acceptable organizational forms. Social capital theory posits that relationships among organizations and individuals
increase the survival of organizations because members of the network are able to allocate, access, and share resources rather than compete for them (Putnam, 1995; Lin, 2002).

In my findings, I observed that nonprofit debt levels (borrowing and lending activities) depend on relationships among community stakeholders at both an organizational and individual level. For example, one banker explained he encourages his loan officers to identify capital funding needs at the nonprofits in their personal networks; based on this assessment, the bank offers loans, the goal being to enhance the community for all involved. He explained a bank should be like the “public house” or “pub” of the past – a hub for businesses and individuals to meet and work toward improving their community. In contrast, lenders outside the community (both nonprofit and for-profit) have more a focus on business development.

In the literature review, I have included three sets of theory that I have found helpful in developing my research design and analyzing my observations. When I began this study, my literature review primarily focused on debt research in the nonprofit literature. While some studies tend to be a- theoretical, others directly test tradeoff and pecking order theories. Some include agency theory as a separate theory, rather than as a force inherent in these aforementioned finance theories. Despite excellent scholarship, findings on capital structure are mixed. It is not clear what drives nonprofit debt levels. When the “signs are mixed” (i.e., some coefficients matching tradeoff theory predictions while others align with pecking order theory), some authors have proposed combining theories.

As part of my analysis, I took a deeper dive into capital structure theories. These theories address total assets and financial strategic planning; however, my initial data indicated more project-by-project decisions. So, I felt compelled to look at the assumptions and essential frameworks underpinning capital structure theories. If these did not fit, why? I have included this
additional information in the literature review. As I explain more in my findings, the poor fit goes beyond the typical caveats, like that nonprofits do not have owners and that one can (or cannot) substitute “net assets” for “equity.”

My literature review also includes decision-making and other organizational theories. The data we most commonly use in nonprofit finance research is tax data from the IRS Form 990. While it includes much financial information, these data provide little information other than basic organizational demographics. Decision-making is an organizational behavior, just as lender-borrower agreements take place between organizations. So far, the nonprofit literature has paid little (if any) attention to how lenders make decisions and how they interact with nonprofits.

In the next section, I introduce my research questions and how they build from my literature review.

**RESEARCH QUESTIONS**

Nonprofit debt research suffers from a problem common to all nonprofit finance research: “The sad fact is that despite a growing body of literature advising nonprofit managers about finance, we know very little about how they make decisions” (Bowman, 2002, p. 308). Without such information, it is a challenge to interpret the findings from our statistical models. What we do know mostly comes from quantitative work with IRS 990 data. While work with this dataset has generated a great amount of information, it has its limitations, as do all data. It lacks several key financial variables (e.g., breaking down direct public support categories) and has little organizational information aside from demographics (e.g., staff size, location, type of mission) or a few management structures, such as having whistleblower policies, etc.). Moreover, we cannot see the behaviors, motivations, decisions, and circumstances underlying financial figures. We do not know the causal mechanisms that led to the numbers.
As noted earlier, tests of traditional capital structure theories produce mixed results. In response, some scholars have worked on developing new theories. For example, Denison (2009) proposes a new theory of nonprofit borrowing. In this scenario, a nonprofit must choose between capital funding sources: unrestricted net assets, fundraising, or debt; the nonprofit then chooses the funding source with the lowest cost (e.g., opportunity costs, fundraising expenses, and interest on loans). Additionally, he proposes that a nonprofit choose only projects where the benefits outweigh the costs – calculations including financial as well as “softer” measures (e.g., social outcomes). Calabrese (2011) also posits a theory of nonprofit debt, called “modified pecking order theory.” While these do pick up on both tradeoff and pecking order theory, it is also normative – how nonprofits should borrow. Likewise, it assumes rational decision-making. And neither pecking order nor tradeoff theories really fit the findings from studies designed to test these theories.

While all authors acknowledge the challenge of fitting corporate finance theory to nonprofits or measuring nonprofit success, I argue there are deeper problems. Tradeoff and pecking order theory models are diametrically and fundamentally different in corporate and nonprofit finance. Combining them, as nonprofit scholars have done, is problematic from a research design angle. In part it is an ex post facto explanation since scholars attempt to combine them because the signs of the coefficients are inconsistent with expected directions. I understand this rationale, but it ignores the core underpinnings and definitions of pecking order and tradeoff theory.

More importantly, these new nonprofit debt theories are normative. Testing normative theories tells us whether or not nonprofits follow a prescribed, rational decision-making process. We know very little about how nonprofits make decisions, but it is probably not by making
rational choices. These normative theories assume utility maximization, which is a combination of financial and mission-related goals. It also assumes all nonprofits operate with the same goals. In short, normative theory only tests if nonprofits adhere to a prescribed normative framework, which arguably stands on weak foundations to begin with.

Denison, Yetman, Calabrese and other scholar’s foundational contributions to nonprofit finance research, and especially nonprofit debt research, are undeniable. Their theories have significant merit and go as far as they can with the data and theories available. However, while IRS Form 990, their primary dataset, contains substantial financial information, it includes little information about debt (e.g., sources and uses). More notably, the 990 dataset contains little management, governance, or other organizational variables needed to understand why nonprofits use the amount of debt they do.

In summary, my observation is that nonprofit finance research uses economic theories as if they were organizational. Therefore, I argue that not only do capital structure theories not fit nonprofit finance, but they more fundamentally do not fit the research question or design. Therefore, my research takes a novel approach to answering the broad question: How are decisions made about nonprofit debt? This includes how nonprofits make decisions, as well as the decisions their lenders make, and the larger organizational ecology that affects these choices.

**How do nonprofits make decisions about debt?**

Under the larger question (How are decisions made about nonprofit debt?) I ask several narrower, more specific questions, including How do nonprofits make decisions about debt? I deliberately say “how” nonprofits make decisions about debt instead of “why,” because we have some research on why nonprofits borrow. We can be reasonably sure, for example, that nonprofits use long term debt to finance facilities. Notably, Woronkowicz and her colleagues
(2012) conducted multiple case studies and compiled several datasets on major building projects among arts and culture nonprofits. They illustrated some of the organizational decisions underlying the debt decisions related to these construction projects. In one case, the board was so attached to the project, board members were unwilling to forego it despite the negative financial implications. This work contributes to what we know about decision-making process associated with debt in the context of large arts facilities.

My research focuses primarily on the decision-making process, including how nonprofits see the benefits and risks of using debt to further the organization’s mission. Instead of arts organizations, I focus on human service organizations. There are several reasons for this choice. Many human service organizations need facilities for their operations (e.g., shelters, childcare, and youth centers). However historically these nonprofits have struggled to secure the financing (e.g., loans) needed to keep buildings functional and accessible (Grønbjerg & Nagle, 1994). Even when a nonprofit secures financing, debt can increase its financial vulnerability (Greenlee & Trussel, 2000). If things go wrong, the nonprofit may lose facilities or even close; this can have an adverse effect on communities if they depend on these critical human services. For example, what happens when the nonprofit, which runs the only temporary shelter\textsuperscript{35} in the area, cannot repay the loans it needed to make critical facility improvements (e.g., replace a damaged roof)? In this scenario, the “why” behind the decision is apparent, but “how” the nonprofit weighs the risks is not. Moreover, the decision has broader implications and faces additional pressure, since these choices not only affect the organization, but many other lives, most notably clients who desperately need the services, and the broader community concerned about the housing crisis.

\textsuperscript{35} Commonly referred to “homeless shelters,” temporary shelter is the more compassionate and accurate term that is beginning to dominate conversations – just like “the housing crisis” is replacing “the homeless crisis,” as “homeless” has become more pejorative.
I am particularly interested in how small-medium human service organizations make decisions. Most human service nonprofits have only a handful of managerial staff members (See Chapter 2). Many need facilities for their programs and mission attainment; few have the capacity to mount capital campaigns and have sizeable in-house reserves. These nonprofits must take out mortgages. A successful debt-financed project can benefit an entire community, while failure also has potentially wide-reaching implications. Organizations with substantial levels of debt (e.g., over 50 percent of total assets) put themselves at risk according to studies on financial vulnerability. Therefore, I began this research assuming questions of capital structure and financial planning would be forefront in the mind of the managers of these nonprofits. Like borrowing “how to” guides suggest, I assumed they would have conducted a fair level of financial analysis before deciding to borrow and also apply for loans. To my surprise, this was frequently not the case.

Next, I discuss how lenders do decide to work with nonprofits, since loans depend on the decisions of both parties.

**How do lenders decide to work with nonprofits?**

It takes two to tango. A nonprofit cannot decide how much debt it has by fiat. Lenders decide if and how much the nonprofit can borrow and under what terms. The IRS 990 data tells us little about debt specifics, other than basic types: bonds, short-term notes (paid usually within the year), and long-term debt like mortgages. In my research, I am most interested in long-term debt associated with facilities. In my analysis, I found that the lender practitioner-oriented literature 36 focusses mostly on the latter, mortgages (e.g., Risk Management Association’s certification course in lending to nonprofits).

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36 These include lender trade journals, blogs, and other media that target a practitioner audience.
Hence my second research question, **how do lenders decide to work with nonprofits?**

Denison (2009) suggests that a lender is not going to care about the non-financial benefits or costs of nonprofit projects, since loans are a money-making product. At the same time, lenders have regular processes and procedures for working with small businesses, but nonprofits do not fit the small business profile (Yetman, 2007). For example, banks often want owners to co-sign on loans to reduce their risk, but nonprofits have no owners. Without owners, nonprofits usually are not eligible for Small Business Association (SBA) loans. Furthermore, nonprofit governance structures are more complicated (i.e., they have boards with fiduciary responsibilities, but executive staff manages the organization). There is no one point person; both staff and board may turnover regularly, compared to owners of small businesses. A lender may not want to deal with all these nuances and changes; when you’re not familiar with them, they pose risk.

Perhaps more importantly, nonprofit finance is not small business finance. It is thought that banks have rubrics and tests to judge a borrower’s creditworthiness, and nonprofits break the mold. Banks look at typical revenue and expenses to determine how capable a borrower is to pay back that loan. While nonprofits can have fees-for-services like small businesses, they also have donations and government grants – revenue streams less familiar to lenders. Similarly, if lenders do not understand nonprofit asset classes, they may incorrectly suppose that borrowers can draw on temporarily and permanently restricted funds to cover debt service payments.

Furthermore, a bank cannot legally force a nonprofit into bankruptcy (11 U.S.C. § 303(a)) or force nonprofits to liquidate their endowments, which the lender might have mistaken

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It also includes a training certification in nonprofit lending I took with the Risk Management Association (a banker professional association). I discuss this more in Chapters 2 and 4.

37 Except in natural disaster situations and COVID-19 relief programs.
for normal assets. Even if they could, foreclosing on the local youth center and/or robbing them of their endowment probably would generate bad press, maybe causing the bank’s other clients to leave. Yes, banks do need to pass Community Reinvestment Act tests, and lending to certain nonprofits fits the bill; but they can use low-income home mortgages instead – a more familiar product.

Given such nonprofits “oddities,” lenders could understandably shy away from working with nonprofits. In the end, all of these nonprofit nuances add-up to a large information asymmetry problem between lender and borrower. To combat the risk, lenders can impose strict covenants, high interest rates, and smaller loans…or they could simply not work with nonprofits at all. In my findings, I did see some evidence for both of these choices, but I also learned some banks specifically seek out nonprofits, and do not necessarily expect to make profit on these loans. In fact, one loan officer literally rolled her eyes when I asked about making profit from nonprofit loans, dismissing the idea entirely.

Banks, however, are not the only lenders in town. There are also Community Development Financial Institutions (CDFIs) and credit unions. In particular, CDFIs provide loans and other financial services to a variety of underserved communities and organizations, including nonprofits (McLenighan & Tholin, 1997). Like banks, they do hope to make returns on their investments, but they have specialized knowledge to assess nonprofit creditworthiness and

38 Well, metaphorically. In some cases, banks literally were the only lender in town, meaning accessible to nonprofit organizations.

39 They do not necessarily require as high of a return on investments. Profit is not their main mission, but they need revenue nevertheless. In part CDFI funding offsets additional risks of lending to nonprofits, so the interest rate can be lower than a traditional bank. When I spoke with lenders in the study, one explained this is not always the case; banks in the area were offering the best rates. Additionally, not all CDFIs are nonprofits. Twenty percent of CDFI lenders are for-profits but also have an economic and community development mission. There are also CDFI venture funds that can be for-profit. I talk amore about this nonprofit capital marketplace in
a deep understanding of nonprofit organizations. They use information like program impacts, financial management processes, board and governance structures, operations versus programmatic expenses, service demographics, net asset breakdowns, reliance and dependability of different types of revenue, and other nonprofit-related information. Unlike banks, which might be primarily interested in profits from lending, CDFI missions include educating and providing technical assistance. With this information, borrowers can make better decisions and manage their debt (Emerson & Carttar, 2003).

Estimates are that only 65 percent of CDFI funding goes toward a variety of businesses – not just nonprofits, but also minority-owned, tribal, and firms in blighted areas (CDFI Coalition, 2013). To some CDFIs, like the Nonprofit Finance Fund (NFF), nonprofits are only eligible if they have at least three years of operating history and unrestricted revenues of at least a million dollars annually. Others have minimum loan amounts, which exclude smaller borrowers. In my findings, I learned this can be a rigorous and costly process for small-medium nonprofits. From the lender perspective, the rigor helps build financial capacity in the nonprofit sector. However, the effect is that such benchmarks limit the amount of capital available for some nonprofits, especially smaller ones.

A review of this information on banks and nonprofit-specific lenders, suggests some obvious answers to the question of “How do lenders decide to work with nonprofits?” For example, lenders should only work with nonprofits if they know whether they can make a profit doing so. If they do not understand nonprofits, they should not lend to them. Additionally, nonprofits should find it easier to work with CDFIs, since they better understand nonprofit finance and do not just look for returns on investment but also want to support nonprofit

Chapter 5.
missions and community work. Both types of lenders assess nonprofit creditworthiness and make loans accordingly. But all this information is normative, not empirical. While I expected my data to mostly confirm these normative guidelines, some nonprofits and financial leaders made decisions very differently. In part, this is because of the larger ecology of nonprofit borrowing and lending.

**How does the environment affect borrower-lender relationships?**

Organizations exist in a larger, “open systems” environment, which shapes and is shaped by organizational decision-making. Hence my third research questions, “**How does the environment affect borrower-lender relationships?**” In some ways, I have already touched on organizational ecology; traditional capital structure theory addresses the larger market, not individual organizational behaviors. Knowing more about the larger borrower/lender ecology might help us better adapt capital structure theories to a nonprofit context.

The information we have about the nonprofit debt marketplace is largely descriptive. Salamon (2014) describes a “bewildering array of new instruments and institutions” that now finance social purposes, in which he includes investment capital, loans, and other debt and “equity like” related products. While many of these tools seem better suited for larger institutions, rather than smaller human service organizations, it does illustrate the development of nonprofit financial ecology. Banks, credit unions, CDFIs, governments, foundations and many other institutions provide nonprofits capital, although we do not have much information on how nonprofits “consume” these financial products.

However, the distribution and availability of capital resources likely affects both borrower and lender decisions. For example, Illinois has many more CDFIs than Indiana (and generally has a stronger nonprofit infrastructure overall). This would suggest that Illinois
nonprofits have access to a wider array of lenders and debt financing options. In contrast, Indiana nonprofits may struggle more to just find a lender, let alone pick the best one. Similarly, government programs, like CRA and CDFI, affect supply and demand by subsidizing borrowers and requiring lenders to serve at-risk communities, thus encouraging lending to nonprofits and suggesting that nonprofits should have more choices. While these may be interesting hypotheses, we do not have empirical evidence (e.g., linking IRS 990 data with wider ecological level variables). Even if we did, we still would be missing the causal piece – How these environmental factors affect decision-making. In my findings, I observed that supply and demand did affect decision-making, but access to CDFIs had little to no role.

In addition to the demography of the nonprofit marketplace, ecological consistency may affect borrower/lender behaviors. When organizations see inconsistent environments, they face uncertainty and that in turn affects decision-making. For example, we expect lenders to have standard rubrics to evaluate organizational creditworthiness; yet nonprofits do not fit the small business mold. This inconsistency makes their data harder to analyze; as a result, lenders might say no to nonprofit loans – too much risk and/or too much work. But information standardization can remedy consistency problems. For example, Charity Navigator has rubrics for grading nonprofit financial health, which include assessing debt. Other isomorphic pressures may have the same effect. Nonprofit financial management education encourages organizations to follow certain standards (e.g., strategic plans), which also increases consistency, and in turn increases access to debt (Baum & Oliver, 1996).

Next, I discuss the research methods I use to answer these three questions about nonprofit debt decisions. I rely heavily on a qualitative approach with data from case studies, and interviews with nonprofit leaders, lenders that work with nonprofits, and experts in nonprofit
debt. I also conducted a content analysis of practitioner literature (e.g., “how to” guides and advice on borrowing and lending). The former provides insight into the real world of nonprofit debt decisions, while the latter gives the normative perspective for comparison.

**METHODODOLOGY**

I use an explanatory research model, because it is well suited for “how” questions. Plus, it is appropriate when there is no full description of a phenomenon (nonprofit debt behaviors) and when there is insufficient data to construct one (limited behavioral or decision-specific datasets). I pair the explanatory model with an open systems framework; when nonprofits make borrowing decisions, they are not just internal decisions and closed off from the larger environment, but depend on decisions by lenders, and on broader ecological forces, such as information brokers, government programs, and changes in lender demographics/density.

I used qualitative methods to investigate borrowing and lending decisions from different perspectives: nonprofit borrowers, lenders which work with nonprofits, borrowing/lending “best practices”, and academic/theoretical. I have already reviewed the academic/theoretical work that guided my work. For the “best practices” data, I collected two sets of practitioner-oriented literature – one on nonprofit borrowing and the other on lending to nonprofits. These included articles from trade journals, websites, blog posts, and training seminars; if a nonprofit or lender was interested in debt decisions, this is the material they would use. For the most part, these consisted of best practice advice and cautionary tales (the normative perspective).40

The most extensive type of data included nonprofit/lender case studies and interviews. I purposefully selected small/medium human service charities that appeared to have made a

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40 The practitioner-oriented literature also oriented me on issues that could be important in the case study interviews. Like all qualitative analysis, I must be reflexive and recognize my experience/beliefs/knowledge/etc. affects how I analyze and understand the data.
critical/large facility-related borrowing decision and were financially vulnerable. My thought that these cases would provide the richest and largest amount of information, because debt decisions and management would require a great deal of management attention. For each case I created a financial profile based on publicly available information and conducted semi/loosely structured interviews with the leader most familiar with debt decisions (usually the executive director). For the lender’s perspective, I also interviewed loan officers and managers who had experience lending to charities.41

Data analysis relied heavily on a bottom-up, inductive, iterative data-driven coding process that is the bedrock of many qualitative methods. The general direction of analysis includes breaking down the data into the smallest components (e.g., actions, actors, places, etc.), observing patterns/relationships/categories/sequences, and then developing these into larger themes; the process itself is cyclical and iterative. Analysis and data gathering happen simultaneously until theoretical saturation is reached. Memoing and journaling documented the development of my analysis, and I paid close attention to how my perceptions influenced the analysis. The process allowed me to observe that the definitions and connotations of debt varies substantially across perspectives as did decision-making elements. To pursue this theme, I included the theoretical and academic perspective as part of analysis, rather than just background information. To aid my analysis, I read research from outside my disciplines including business finance capital structure, banking demography and types of lending, and sociology.

41 I supplemented the borrower/lender data with ecological-level information, particularly for Chapter 5. The information sources included: governmental banking files, legislation and regulations, and financial/credit ratings.
FINDINGS

My research aimed to identify the causal mechanism underlying nonprofit debt numbers, in particular capital structure. Here I highlight some of my findings. Each major topic is discussed in detail in chapters 3, 4, and 5 respectively.

How do nonprofits decide to borrow?

- In several cases, nonprofit leaders said they did not know how previous debt decisions were made, because they happened before their tenure at the organization. Debt strategies and preferences can change with administrative turnover, indicating an inconsistent capital structure strategy (if there is a strategy beyond project-based decision-making). We cannot assume organizations have a planned and long-term capital structure strategy, as suggested by traditional business theories.

- Debt has many meanings and connotations to nonprofit leaders. There is: being in debt, having debt, and using debt. Even when a nonprofit has a “dangerous” amount of liabilities, it may say it does not have debt, because it is not “in the red.” This depends on financial priorities. For example: Do debt service payments rob money that could be spent on programs?

How do lenders decide to work with nonprofits?

- Like the nonprofit practitioner literature, there are many cautionary tales on lending to nonprofits. These focus particularly on the differences between small businesses and nonprofits (e.g., foreclosing, bankruptcy, no owners, etc.). Loans to nonprofits are risky. Only a couple of pieces suggested nonprofits were an untapped market.

- Relationship lending is more common than other types of lending, such as credit-based assessments. Diving more into the business finance empirical literature, it
appears that relationship lending is more common and successful when most
decision-making factors are qualitative.

**How does the environment affect borrower-lender relationships?**

- Both lenders and borrowers explained that lending is switching from relationship
  lending (based on qualitative evaluation) to more standardized credit assessment
  (quantitative evaluation). The business finance literature documents this shift, as
  community banks are bought-up by larger, publicly traded banks that do not know (or
  perhaps do not care) about local community nuances
- Professional lending trade associations, like the Risk Management Association, are
  pushing to standardize nonprofit lending practices. This standardization makes
  lending more efficient (less time spent on tailoring each individual nonprofit loan)
  and ensures higher equity and ethics (e.g., loan officers cannot play favorites or be
  tempted to use company funds for personal charitable actions).

**DISCUSSION**

As documented by many researchers before me, capital structure theories paired with IRS
990 data do not tell us much about how nonprofits make financial decisions. Because of this,
calls have been made for more qualitative research, not just to further academic studies, but also
better inform and support the field. Through my dissertation, I contribute to field, theory,
methodology and practice.

Some of these contributions to the field are pragmatic. For example, I have demonstrated
the importance of bridging different disciplines. Most notably, financial theory and
organizational perspective complement each other, but are not substitutes. While this is nothing
new, it helps explain why capital structure theories of markets do not align with organizations
(i.e., unit of measurement challenges). We could benefit from using the business finance and organizational research more. Most of my conclusions had already been documented in small business research. While I was a bit disappointed my findings were not as novel as I believed, I am comforted that these other findings validate my work. The field of public affairs has a strong tradition of interdisciplinary collaboration and cross pollination of ideas. Capitalizing on this could be productive (pun intended).

Some contributions are more methodological. We all have a love-hate relationship with the IRS 990 data, our major source of nonprofit finance data. My findings indicate we can use this data to study best practices in financial analysis, but it cannot enlighten us on financial management and the decision-making that goes with it. For example, nonprofit leaders sometimes concentrated on months instead of years and were concerned about cash flows instead of asset composition. They focus on the numbers most meaningful to them, and often their practices remind me of personal finance rather than corporate finance. Larger nonprofits with dedicated financial analysts might have the capacity to follow best practices and approach rational decision-making (in economics, some scholars assume companies on average act rationally for this reason). But do they represent the majority of nonprofit organizations? They may in terms of dollars, but not so much in numbers.

My findings also indicate that nonprofit financial decisions open opportunities to study intersectoral relationships. While some nonprofit leaders reported battles with lenders, other spoke of collaboration, mission alignment, all with hints of networked service provision and community capitalism. On a higher level, large banks provide capital to CDFI’s in exchange for their expertise in lending to nonprofits, so the lenders can more easily pass their CRA tests as
required by the federal government. As the demography of the nonprofit capital marketplace shifts, so too do these intersectoral developments.

When I was perplexed at times, I found theory from sociology helpful in explaining my observations. Most notably, debt means different things. This is not so surprising; Sulek (2010a, 2010b) found the same when he studies the meaning of philanthropy. Social capital theory also helped explain my observations regarding the close relationships in some lender/borrower interactions, and the animosity in others (Galaskiewicz & Bielefeld, 1998). Loans seems to range along a spectrum from gifts to investments. Finally, sensemaking theories shed light on how decision-making shapes organizational identity, as the organization seeks to understand events and conditions (Brown et al., 2015; Gilstrap et al., 2016; Weick, 1995)

My findings also contribute to the field of nonprofit practice. News stories document at least some level of public interest, if we assume that newspapers publish stories of interest to their readership. Prior to gathering data, I found that nonprofit debt affects local government and community concerns. In March 2016, the Norwich Bulletin reported that a youth organization (“NOW”) decided against acquiring a new building because, “If NOW went and borrowed money and defaulted on the loan, it would come back to the town and the taxpayers would be on the hook” (Kefalasm, 2016). Working with city government, Housing Vermont was using a combination of private loans and public grants to construct a new facility for their homelessness/family services. In contrast, some worry that SHARE/WHEEL’s decision to close a homeless shelter due to unsustainable debt is “just an advocacy move” to gain more governmental funds (Groover, 2016). Similarly, the YMCA of Greater Carbondale felt forced to take on major debt after capital campaigns fell short – a debt that they said was unsustainable without greater community financial support (Grace, 2016). These examples indicate the
decision to take on debt depends on not just internal operational concerns, but cross-sector and community relationships.

With my research contributions, I take a small step toward us better understanding nonprofit financial management. My hope is that my findings encourage further qualitative studies of nonprofit behavior.
WORKS CITED


CHAPTER 2: METHODOLOGY

INTRODUCTION

My research design and methods are intended to answer the question: What decisions underlie nonprofit debt? I address this broad question by focusing on three more specific questions. The first two focus on those directly involved in the nonprofit loan decisions. The last question focuses on the broader ecological context in which those decisions take place.

- **How do nonprofits decide to borrow? (Chapter 3, page 99)**
  To address this question, I examine nonprofit attitudes toward debt, how organizational decisions are made, how are current debts managed, and how is debt used in the organization.

- **How do lenders decide to work with nonprofits? (Chapter 4, page 156)**
  I examine lender attitudes toward nonprofit loans, decision-making procedures, and policies.

- **How does the organizational ecology and capital marketplace affect borrowing/lending? (Chapter 5, page 187)**
  Borrowers and lenders are part of an open ecological system of organizations. This chapter explores the environmental factors that influence lender and borrower decisions, including governmental regulations and programs, information brokers, changes in the lending industry, and changes in the nonprofit capital marketplace.
RESEARCH MODEL AND METHODS

Explanatory research models (like the one I employ in this research design) are used when a full explanation of a phenomenon is not available, and when the current data are not sufficient to explain why something happens (Singleton et al., 2005). In the context of nonprofit debt research, we neither know how borrowers and lenders make decisions, nor does the primary source of financial information on nonprofits, IRS 990 data, contain the type of behavioral and organizational information needed; therefore, an explanatory research model fits my study design. Explanatory models are used to create causal narratives and develop frameworks that can help build new theory (Stebbins, 2001; White, 2001). For example, Allison’s (1969) “Essence of Decision: Explaining the Cuban Missile Crisis” did not merely describe events, but also analyzed “the how and why” decisions were made by Soviet Union and US decisions during the crisis.

For the most part, we have used quasi-experimental models and statistical methods to study nonprofit debt. A common approach is to adapt business finance capital structure theories and test them against the IRS 990 financial data. But this method cannot tell us how nonprofits decide to borrow. Those are predictive theories (i.e., Does x input lead to y output?), not explanatory. Instead, we are faced with a black box between inputs and outputs. (Figure 2). It is a black box because no one knows what is inside. Looking inside the box shows us the mechanism

1 This contrasts with the general stereotype of qualitative research as simple descriptive case studies. Miles and Huberman (1994) assert that qualitative research is better than quantitative methods in identifying events and processes that lead to particular outcomes, what they term “local causality.” Creswell and Clark (2017) also assert that explanatory research models using qualitative analysis can give greater depth and explanations to previous findings from quantitative studies – one of my research goals.

2 In public affairs scholarship, this is a classic article often cited and used in classes.
that takes inputs and creates outputs – i.e., how and why the model works. Capital structure theories are black box models.\(^3\)

In contrast, a systems approach is more nuanced. It looks at the relationship of inputs and outputs, but in an open instead of a closed system. Inputs come from surroundings and outputs emerge into the same space. Instead of the causal mechanisms being hidden in a black box, they change in a semi-transparent space – the open system. Instead of a stark boundary, like the black box, the lines are porous, since the environment and system interact. Overall, the systems approach is designed to investigate the relationship between two things in a complex, open system (Maxwell & Mittapalli, 2008). Consequently, the systems approach complements the explanatory research model and is included in my research design. Through this framework, I develop a causal narrative of borrower/lender decision-making (Chapters 3 & 4) and the larger environment that influences it (Chapter 5).

Explanatory research models often require qualitative research methods. Accordingly, my data includes nonprofit case studies. I also include interviews with lenders, so could analyze both perspectives. Additionally, my data include practitioner-oriented literature (PL) (e.g., trade journal articles, blogs, guides, etc.) targeting potential nonprofit borrowers and lenders. The rationale is that decision-makers would use resources like these to help inform their choices.\(^4\) Like most qualitative studies, I used an iterative and reflexive coding, analysis, and data

\(^3\) The introduction chapter explains this in more depth. Capital structure theories suppose the black box holds organizational theories like rational decision-making to maximize individual utility, principal-agent relationships, etc. The black box does not always contain the most recent organizational theories, unless there is a bridge between the two disciplines.

\(^4\) Many of these were normative “how to” guides that emphasized the risks of borrowing/lending if an organization was underprepared. These authors painted nonprofit debt as intimidating…if not scary. I explain this more in Chapters 3 and 4.
collection process. When conducting qualitative research, Maxwell (2005) recommends developing and maintaining a research framework that connects my research questions, study goals, conceptual framework, methods, and validity (Figure 1).

I had planned to use grounded theory methods to help develop new theories of nonprofit debt. By the end of the study, my focus had shifted. My efforts to examine how nonprofits acquire debt confirmed the importance of using qualitative methods to develop explanatory models, as it became clear that the PL’s description of borrowing/lending did not match many of my case study findings. For example, the PL emphasized risk and the distinction between nonprofit mission versus lender profit motivations. In contrast, many case study participants talked about collaborative borrowing/lending relationships centered on shared goals and ideals. There was clearly an academic-practitioner communication gap. So, I chose to step-back from theory development and instead analyze the essential concepts and semantics in the case study, PL, academic and theoretical sources used in my study. Identifying those differences furthers nonprofit finance research and is arguably a pre-requisite for theory development and study research designs.

During my analysis, patterns I observed encouraged me to revisit theories and concepts from other disciplines, like sociology.5 I had begun my dissertation with a literature review of research done in my discipline (public affairs) and interest area (the nonprofit sector). I had expected to help the development of new nonprofit-native finance theories to shed light into the black box.6 But seeing sociological concepts surface in the data encouraged me to look for a

5 Organizational theory is partially an outgrowth of sociology. Economics and sociology also have a long history together.

6 I could see what decisions corresponded to what financial ratios, and then have a tool to test in
much broader array of disciplines to help give us answers to nonprofit debt research. This approach had validity; it is public affairs tradition to use theories from other disciplines to answer our questions and develop the field. The same goes for nonprofit sector research. And after all, financial decision-making is one of those discipline-cross-cutting concepts.

Additionally, my analysis made clear that while nonprofit scholars emphasize annual capital structure measures, the concept is not particularly salient in the PL and not much at all in the case studies. Because of this, I read more deeply about capital structure theory’s development and current research on the topic. I had to be sure I fully understood concepts embedded in the theory. I asked, how did capital structure theory perceive debt? How does that compare to other perspectives?

My explanatory model expanded beyond just how nonprofits make debt, although that remained a strong element. In the next section I discuss the data collection process followed by analysis tools and processes.

**DATA COLLECTION**

In Chapters 3 (borrowers) and 4 (lenders), the data consist of a textual analysis of the PL and case study data (including interviews). Chapter 5 specifically draws on PL and interview references to the nonprofit loan market/environment from that dataset and adds information on government policies, industry trends, etc. The interviews conducted began with a loosely semi-

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7 Some examples include psychology, marketing, political science, sociology, ecology, philosophy, etc.

8 These are the kinds of questions that came-up when I was writing memos to myself about observations and possible explanations. As I discuss later, memoing (of all kinds, from napkins to voice memos, to traditional journals) is invaluable in qualitative research.
structure survey, which I expected to change (and did) throughout the study as new themes arose in the analysis. I used NVivo to store and analyze the qualitative data, but the app does not include all the methods a researcher can use, so I also used handwritten research notes and drawings.9

**Nonprofit data**

To analyze perceptions on nonprofit debt decision-making, I used two primary sets of data. First, the practitioner-oriented literature includes articles, news stories, and guides targeting professionals working in the field. Second, the case studies which included interviews with nonprofit leaders. I discuss each in turn in this section.

**Practitioner-oriented literature**

The “practitioner literature” (PL) includes secondary sources that are aimed at nonprofit practitioners in the field including (but not exclusively) executive directors, board members, financial staff, and other nonprofit professionals. If a nonprofit needs to make a borrowing decision, this is the material they would most likely read if they wanted more information. My analysis found that it also tends to be normative – advocating best practices and how nonprofit leaders should make decisions.

To assemble as comprehensive dataset as possible, I used Google and IU OneSearch10 to search for terms like: nonprofit, non-profit, not-for-profit, charity, debt, capital structure, mortgage, loan, borrowing, bank, lender, banker, debtor, bankruptcy, and loan officer. Once I

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9 For example, I played “card games,” during which I wrote concepts on cards, arrange them on a flat surface, and then took pictures for later reference.

10 This is an IU library system that searches multiple resources and references many databases at once. https://libraries.indiana.edu/onesearchiu
identified popular trade journals (e.g., *The Nonprofit Times, Chronicle of Philanthropy*) I searched within those publications specifically. The PL also includes guides on websites (e.g., the Nonprofit Finance Fund), blogs, consulting firm publications, whitepapers, webinars, etc. Essentially, I pretended to be a nonprofit manager, whose organization is considering whether or not to borrow and wants some advice. In total, I identified 45 pieces from the 1990s (the earliest pieces) into the mid-2010s (right before my analysis).

The first level of coding of the PL was done prior to the case study interviews. Pragmatically, I needed to have some grounding in how professionals made and talked about decisions. If I went into the interview only talking in academic terms and about academic concepts, that would be a surefire way to shut down participants. It would seem like I was testing them against my expectations, disinterested about they actually made borrowing decisions. I discuss more about my interview methods later in the chapter. 11

**Case selection**

As in most qualitative studies, my case selection is purposeful (Corbin & Strauss, 1998; Maxwell, 2005; Ragin, 1987; Miles & Huberman 1994; Boddy, 2016.). With the goal of analyzing the “how and why” of the decisions behind nonprofit debt, case selections had to

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11 Because I planned to interview nonprofit professionals, I needed to be aware of any such disconnects. A sure way to shut down participants is to come into an interview using “academic speak” and seeing how professionals compare to our expectations. If you use such a hegemonic approach, you likely will not learn anything about actual behaviors. While I was an academic survey research project manager, I ran often encountered these situations. Well-intending scholars did not realize survey participants would not understand them. For example, one study used the word “secular” in a question, assuming that professionals with college degrees would understand this word in a question. They did not and were frustrated which affected the response rate.
balance the generalizability of the findings against the qualities needed to answer the research question. In this section, I describe how purposely selected my cases.

Identifying and selecting cases. The scope of the nonprofit sector is huge and organizations range in size from tiny groups with neither assets nor staff, all the way up to goliaths like the American Red Cross with over $3 billion in total assets and highly professional financial staff. Because I was undertaking case studies of a small number of nonprofits, my cases had to be selected with care to allow for in-depth analysis and randomly selecting nonprofits would not make sense. So, I began identifying cases by sifting through and analyzing the 2013 National Center for Charitable Statistics (NCCS) Core dataset. This dataset comes from IRS Form 990 tax data. While one of the better and most common datasets used by

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12 Nonprofits also include a wide array of industries (e.g., healthcare, arts and culture, and education). At the extreme, 17 percent (n=216,522) have more than $5 million in total assets and 18 percent have under $100,000 (less than one percent have no assets) in 2013. Including organizations with this degree of variation would obscure the critical qualities of decision-making processes (e.g., how they decided which options were best by what metrics).

13 This was the most recent dataset at the time I was selecting cases. At the time, one of the larger challenges with the IRS 990 dataset is the time taken to process the files once they are released. I used Stata to manage and analyze the data.

14 To understand the selection process, we must understand this dataset. The NCCS created data dictionaries for the raw rich text format (rtf) IRS data and enhanced it by imputing some missing data, undertaking some verification work, and adding National Taxonomy of Exempt Entities (NTEE) codes, FIPS county codes, etc. I have substantial familiarity with the IRS 990 datasets from scholarly work presented at conferences and personal projects. This includes not only constructing and analyzing financial ratios (and dealing with many fields of missing data), but also merging files across years, when each year’s dataset includes different information and variable names. These data exceed the capacity of the software usually used by financial scholars (e.g., Stata, SPSS, MS Access), so I began a personal project to use my data structure skills to create a complete multi-year Core file database with the support of IU’s Research Analytics team. I plan to resume this project after I complete my dissertation. I have a fondness for constructing and managing large datasets – a hobby. My experience analyzing IRS 990 financial information (e.g., ratio analysis) was built on master’s level financial management coursework (including my Capstone project on financial trends during the dot.com bubble), personal education in nonprofit accounting (including attending seminars by professional organizations) and teaching financial management courses. While the NCCS Statistics of Income dataset
financial scholars, the IRS 990 has a variety of well-known limitations, which could have affected case selection. I used a combination of Stata (creating my own dictionary and coding files to create variables, such as financial ratios), MS Access (with SQL coding to concatenate), and Excel (for quick visuals and tables) to manage the data.

For researchers, the most serious IRS 990 data limitations are incomplete cases and incomplete data. Not all organizations incorporate (done with the state attorney general) or register with the IRS to receive exemptions (Grønbjerg et al., 2010). Some types of organizations do not have to register or file (e.g., religiously focused organizations), and some organizations do not have to provide much information at all (small nonprofits). For the nonprofits that give the IRS financial information, only part of it makes it into the common datasets. If you want the greatest number of financial variables, you have to turn to datasets a couple of decades old (Digitized Data 1998-2003) or that focus on large organizations. Even the most complete datasets are not completely dependable, because the IRS does not regularly audit nonprofit returns for accuracy, and accuracy appears to vary depending on governance structure (e.g., Yetman & Yetman, 2011; McDougle, 2015; Froelich & Knoepfle, 1996; Lampkin & Boris, 2002). Despite such blemishes, the NCCS’s datasets are the most complete and accessible files available. The IRS datasets are valuable; but need to be respected for their perks as well as their pitfalls.

 includes more comprehensive financial information, it only includes a sample of organizations, weighted toward the largest nonprofits and hospitals. In Chapter 6, I further discuss these limitations with respect to studying nonprofit debt. For example, monthly cash flows are the most important financial measure when making borrowing/lending decisions. However, that information does not appear in the IRS 990 data.
Fundamental case attributes. I narrowed the list of potential cases to human service organizations primarily for two reasons. First, they are the largest nonprofit industry, making-up 36 percent of nonprofit organizations (the next largest industry being education at 16 percent) (Table 1). To target nonprofits that most likely had facility mortgages, I selected organizations with “land, buildings, and equipment” (Part X, Line 10a) and “secured mortgages and notes payable to unrelated third parties” (Part, Line 23) (Table 2). Out of all these organizations, human service organizations make up 49 percent. Furthermore, I wanted to exclude large nonprofit outliers, which could have unusually high financial capacity and skilled staff. Considering all nonprofit organizations with any assets, 82 percent had less than $5 million in total assets; looking just nonprofits with mortgages, it is 79 percent (Table 2). I narrowed my criteria to focus on smaller-medium sized human service nonprofits with less than $5 million in total assets. This includes 82 percent of all human service organizations nationwide (Table 3).15

I also selected human service organizations because of their reliance on facilities and role in communities. Often, they provide essential community services (e.g., daycare, assistance to persons with disabilities, sheltering the unhoused, family services, etc.) at specific locations and in specialized facilities (e.g., temporary shelters, community centers, etc.), where clients come to receive services (with few exceptions). Frequently, human service nonprofits tend to be small and closely connected to the communities they serve (Boris & Steuerle, 2006). So, when a human service organization makes a critical decision about debt, it can affect the larger community, not just the nonprofit.

15 One exception is my “pre-test” case, which had total assets between $5-7 million. In my analysis, I found this organization reported decisions similar to those I found with my other cases, so I used its data as well.
Furthermore, research indicates that human service organizations struggle to find funds for facilities. For example, in 2006 over 80 percent of family service organizations said they needed capital improvements to their facilities, yet only 30 percent found funding (Geller & Salamon, 2007). This is consistent with findings about human service facility financing challenges documented in the 1990s (Grønbjerg & Nagle, 1994). There is no evidence that these challenges have disappeared in recent years. My analysis of the case studies indicates this problem still persists.

Based on this information, I winnowed down the potential pool of cases to nonprofits with large amounts of debt—specifically where debt comprises over half of total assets. According to scholars and practitioners, which amount of debt can make nonprofits financially vulnerable (e.g., higher credit risk to banks, less appealing to grantors, etc.). Correspondingly, I selected cases where land/buildings/equipment made up over half their total assets. I also searched for publicly available information (e.g., organizational newsletters, newspaper stories, blogs, etc.) that indicated the nonprofit made a major borrowing or capital decision in the past few years.

These characteristics would point to nonprofits that had made large, critical, important, salient, memorable borrowing decisions. And that likely meant they could give me more information than organizations in other situations. At this time, I wanted to lay a strong foundation for future qualitative studies, which could look at a greater diversity of situations and decisions and also include organizations that decided not to borrow.16

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16 There is a pragmatic element, too. The IRS 990 data has no information that would indicate the nonprofit decided against borrowing. Those would only be apparent in survey data. My long-term research plan includes survey research and asking participants if they would be willing to
**Comparative Case Attributes.** I also needed cases with comparative attributes. For example, revenue could affect a nonprofit’s access to loans. Commercial lenders, concerned about receiving financing payments in addition to payback of the principal, may judge nonprofits that rely largely on fee-for-service revenue as more creditworthy than their donation-reliant peers. Not only are commercial lenders likely to be more familiar with such revenue streams from their for-profit clients, but program revenue tends to create a predictable and regular cash flow that matches the timing of monthly debt service payments. In contrast, grant and donation revenue can be irregular. Grants may be only awarded once a year, and individual donations may mostly come in around the holidays or during a fundraising drive. Furthermore, total grant and donation revenue may vary from year to year. I therefore wished to select nonprofits that relied primarily on donative revenue\textsuperscript{17} or on fee-for-service revenues (as identified in the IRS 990).

Another comparative attribute was the nonprofit’s reported state location. I wanted to include Indiana, since I had several years of experience working with nonprofit organizations through the *Indiana Nonprofits: Scope and Community Dimensions* project at Indiana University; I also had work and volunteer experience at Indiana charities.\textsuperscript{18} Logistically, I also had travel budget constraints; I had thought participants would want me to visit for interviews (a couple did, but in the end most asked for phone interviews).

\textsuperscript{17} The Core IRS 990 dataset groups all public support (individual donations, private grants, and government funding) into one number, because having public support has been one of the traditional tests of whether a public charity can provide greater tax benefits to donors. A public charity is subject to fewer IRS regulations than a private foundation.

\textsuperscript{18} Volunteering and later an AmeriCorps placement with Terre Haute Catholic Charities foodbank, Ryves Hall youth center, and Bethany House a temporary shelter for unhoused people.
However, nonprofit infrastructure and resources vary from state to state. For a comparison, I planned to select cases from Illinois and Indiana. The two states share some key attributes. They are both Midwestern states with similar per capital state and local welfare expenditures ($1,500-2,000), poverty rates (13.5 and 12.6 percent respectively, Urban Institute 2017), and about a third of all IRS-registered nonprofits are human service providers (IRS Form 990 Data, 2013). The states were also similar on nonprofit financial attributes (e.g. percentage of human service organization comprising all nonprofits with facilities-related mortgages or asset ranges) (Table 4 and Table 5). However, the two states also differ on key nonprofit infrastructure. Illinois had substantially more nonprofit infrastructure, including over three times the number of Community Development Financial Institutions (CDFI Fund - 36 compared to only 10 in Indiana). Also, Illinois twice (1.9 times) the number of the number of human service organization than Indiana.19

Based on the basic fundamental and comparative attributes, I had a pool of about 300 organizations from the IRS 990 dataset for the two states. From there I read through historical records to identify nonprofits that likely made important decision about debt in recent years (e.g., a nonprofit going from very little debt to 90 percent debt without much change in expenses and no increase in revenue) or where debt could be problematic. I began with 5 cases and expanded eventually contacted 28 nonprofits total, until I reached saturation (i.e., no new themes appeared).

19 Later during interviews, I learned that Illinois had budget crises that substantially affected human service nonprofits and influenced their debt decisions and how they managed their debt decisions. See more in the next chapter. Additionally, I found differences between rural and urban area nonprofits and capital access: In smaller communities, lenders and borrowers had more informal decision-making relying more on relationships and the affect the nonprofit had on the local, shared community. Chapter 5 includes findings about capital ecology.
As I collected data, I included other comparative attributes when analysis indicated there might be a theme, but most of these were not confirmed (e.g., religion, surrounding ruralness). I have included them in my case description tables nevertheless, because they could be useful to include as comparative attributes when selecting cases in future studies, depending on the research models and rationales.

**Pre-interview case profiles**

For these cases, I constructed pre-interview profiles, which served several purposes. First, detailed information would help me prepare for interviews. Mostly based on the IRS 990 data and geographic information, these included a financial analysis using the ratios and other measures (and their interpretations) commonly found in nonprofit finance studies (and textbooks that likely influenced the scholars). When available, I also included publicly available information from websites and news articles (e.g., announcements of recent capital campaigns, cities forgiving loans, etc.). Finally, I researched the executive staff’s names, titles, education and experience through organizational bios and sites like LinkedIn since the staff’s background and education could influence borrowing decisions.

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20 ElmGrove, one of my case study organizations, exemplifies this observation. The annual data show that it might have trouble paying its bills (based on accounts receivable, payable assets, and low liquidity). It operates “on the margin” with no rainy-day funds (retained net revenue). At the end of the year, expenses exceeded revenues – paying more money out than taking in. (In my analysis, I learned this was because Illinois had stopped reimbursements during a financial crisis.) The total amount of mortgages (long term debts) exceeds the estimated value of the tangible assets it owned (land, buildings, and equipment.) a couple of years ago, ElmGrove’s website said it was conducting a capital campaign, while the organization still had substantial debts (as of a couple years prior). Capital campaigns for ambitious new facilities can fall short, especially when construction costs exceed expectations. In such cases, nonprofits might turn to debt to complete projects (Woronkowicz et al., 2014), but ElmGrove already had so much debt, that might not be an option.

21 From a more logistical standpoint, I needed names for when I contacted organizations. I did not rely on the IRS 990 forms for contact information since they can be dated and/or incorrect.
**Interview data**

I collected data through a semi-structured interview that evolved as new salient themes arose in my concurrent analysis. Nonprofit financial decision-making has rarely been studied from the behavioral or explanatory perspective (Levine Daniel & Galasso, 2018). A semi-structured interview guide includes a list of questions and topics to guide the interview. The topics are targeted, but not tightly limited to predefined response options, in order to balance staying on topic with the flexibility to pursue emerging ideas (Maxwell, 2005). This allows researchers to pursue not only the “what” but also the “why” and “how.” I focused on capturing the informants’ story and language to avoid “contaminating” the interview with my preconceptions (Charmaz, 2006). I was interested in their perceptions, not in confirming nor denying my own.

For example, when I originally designed my semi-structured interview questions, I had expected participants to use more “financial” language (e.g., ratios like debt-to-net assets, cost-benefit calculations) based on the empirical and practitioner literature. Additionally, I assumed the leaders participating would be very familiar with their organization’s debt. But, in the early interviews I observed that participants rarely mentioned ratios or specific financial numbers. A few were aware of large liabilities but did not consider their organizations to be “in debt.” Therefore, the interviews began more with what participants wanted to tell me about their debt, although I probed deeper on particular topics when they came up in the discussion.

During my analysis, I also found that staff tenure was an important factor, since some current nonprofit leaders were not familiar with their predecessors’ work. Apparently, the institutional knowledge left with the staff members, which is interesting, too.

22 I did not use structured interviews or surveys. (Those are appropriate for testing a priori hypotheses since standardized instruments work best with well-established topics.)
**Fielding**

Data collection and analysis continued until theoretical saturation (i.e., no new concepts emerged from new data), as common in qualitative methods. I staggered fielding, so I would have time between interviews for analysis, processing, and identifying future cases that would allow me to pursue newly emergent themes.²³ To encourage responses, I used elements of the Dillman Tailored Design Method (Dillman et al., 2014).

To set up interviews, I sent introduction letters; everyone’s email inbox is overflowing these days, and I thought a letter would be more attention grabbing. The letter included an explanation of the project; it also explained I would be calling in a few days about the project. They were also welcomed to call me at any time. I slightly tailored letters to the organizations (e.g., briefly noting the nonprofit’s recent accomplishments, known facility acquisitions, mission, etc.). Additionally, I used several methods well known in survey research to increase visibility and responses, such as: addressing the letter specifically to the executive director (and chief financial officer when possible); using preferred business names, rather than the one listed in the IRS 990 database; using Indiana University letterhead with personal signature in blue ink; and using a flat 11x8.5” envelope hand addressed in blue ink.

To make follow-up phone calls, I used VoIP (voice over IP) to set up a specific study phone number and caller ID with my full name. In the letter, I gave participants both the project line and my personal cell number, as well as my email. Some called me soon after they received the letter. If not, I waited a few days after the nonprofit would have received the letter and called to explain the study further and set-up and interview time. A couple volunteered to do the

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²³ I had a pre-test case. I contacted additional organizations in groups: the week of 3/20/17, 5/8/17, and 6/26/17. I did not contact new cases in April, because of health limitations.
interview immediately. I left voicemails when I did not reach an executive. When I was unable to
reach anyone, I followed-up with alternating emails and calls spaced several days apart and made
at different times of the day (morning, afternoon, weekend). I quit after five attempts or upon
receiving an informed refusal. Out of the 28 organizations, two had inoperable phone numbers
and did not respond to email; one organization declined to participate, not explaining why.

Twelve organizations completed interviews, at which point the sample reached
theoretical saturation. I was not observing new themes in the analysis of my interview data.
The themes that had emerged included: differing definitions of debt (i.e., cash flow vs balance
sheet definitions), mortgages as loans for operations to sustain them through financial crises,
cooperative/relationship versus collateral/credit risk-based loans and lack of institutional
knowledge about historical debt decisions.

24 I always tried to avoid Mondays, since those days tend to be the busiest in organizations –
something I learned analyzing fielding data from my survey research jobs.
25 The organizations that did not respond might have thought the survey did not apply to them;
later during interviews I learned that organizations will say they have no debt even when they
have a lot of liabilities (+50% of total assets); their definition depends on the debt being a
problem (i.e., being in the red and struggling to make monthly service payments). I discuss this
more in the next chapter.
26 In my experience as a survey research project manager – and according to Boddy (2016) and
Morse (2000), interviewers with more experience usually need fewer interviews. From prior
experience, they know how to encourage and guide the participant – put them at ease, make
questions more conversational, and generate trust quickly. I have considerable experience
interviewing diverse groups of people on diverse topics that require quick trust building. For an
example of the need for quick trust building, I have worked on projects where I ask people in
Indiana about their drug usage, sexual practices, and comfort with people hearing their bathroom
habits back in the late 1990s and in socially conservative areas. I have interviewed individuals
about intensely emotional experiences (e.g., non-custodial parents about relationships with their
children), and vulnerable/special populations (e.g., teens aging out of the foster care system). I
successful appeared non-biased for interviews about controversial topics, like gun control laws in
Indiana, since any hint of bias would hurt our sample. And, I also have experience interviewing
nonprofit leaders about management and organizational topics, which would be most applicable.
Lender data

Like the nonprofit data, the lender data included two primary sets of information: the practitioner-oriented literature and lender case studies, I next discuss each in turn in this section.

Practitioner literature

To gather the lender PL, I used the same process as the nonprofit PL (see page 66), with an emphasis on terms like bank, loan officer, etc. When I came across a popular trade journal (e.g., The Risk Management Association (RMA) Journal, Banker and Tradesman, and the American Banking Association Journal), I specifically looked for articles in them. Data also come from the few blog posts (e.g., The Nonprofit Banker) I could find. In all, the dataset includes 42 source documents from the 1990s (the earliest pieces) into the mid-2010s (right before my analysis).

In addition to the PL, I completed a certification course in 2016 on Lending to Nonprofits taught by the Risk Management Association (RMA) - a professional association for lenders. I included the course materials as well as lecture notes in the PL. At the training, I was able to talk with other lending professionals about their opinions and perspectives on the class; I include that data in participant interviews, since these comments (very short informal interviews) captured practitioner experiences and perspectives.

Participant selection

I concurrently interviewed both lenders and borrowers, so I could cross check topics brought up by both groups. For example, while the practitioner literature had made me anticipate more transactional relationships with commercial lenders (e.g., applying for a loan and then being rejected/accepted), I observed more collaboration (e.g., lenders and borrowers sitting
together and hashing out the feasibility of projects and funding options). Moreover, nonprofit leaders explicitly encouraged me to talk to lenders sooner rather than later.

With selecting lender cases, I had to use a different method than I had with nonprofit borrowers, because there no publicly available data that list lenders that work with human service organizations. They are a more “hidden” population, so I used a chain referral method. As the name suggests, the researcher asks participants for referrals to other people, who may have relevant experiences and interest in the study. Colleagues and professors also connected me to people working in nonprofit lending. I also spoke with lenders who authored some of the practitioner pieces on their experiences with nonprofits and a few individuals I found through internet searches. Through this process, I spoke with loan officers, who worked one-on-one with nonprofits, bank presidents and executives, executives at CDFI lenders, and experts in nonprofit lending.

Some participants focused on their work in their current institution and fit into a “CDFI” or “traditional lender” category (Table 7 and Table 8). But the distinction was not always clear-cut. Many participants had experience both at CDFIs and traditional banks. In interviews, they compared and contrasted their experiences among different types of organizations. While these crossover experiences made it difficult to undertake theoretical sampling based on organization type (i.e., traditional lender or CDFI), it increased the data’s richness (Table 7 and Table 8). In total, I spoke with twelve individuals. (In a couple of cases, two participants from the same organization contributed to an interview.) These interviews covered the themes of different lending criteria, views of nonprofit borrowers, lender-borrower relationships, etc.

27 I had experience with this process from my previous survey research work.
Ecology and environment of the nonprofit marketplace

The third data chapter covers the ecology of nonprofit borrowing and lending. I began with borrower and lender perceptions of the nonprofit capital marketplace. I built on these and used empirical and theoretical research in the analysis and identified three major topics. I divided these into actor groups. I analyzed the primary actors – the borrowers and lenders – in terms of supply and demand for loans. The secondary actors are information brokers, like GuideStar and Dunn & Bradstreet that reduce information asymmetry between actors and influence what the most important information is for lending/borrowing decisions. Tertiary actors affect the entire nonprofit capital marketplace through governmental rules and regulations.

In short, I argue that nonprofit debt is the product of interorganizational relationships in a larger economy. To understand how nonprofit managers make decisions about debt, we need to know their decision-making environment, its constraints, and its opportunities.

DATA ANALYSIS, CODING, AND MEMOING

Data analysis relied heavily on a bottom-up, inductive coding process that is the bedrock of many qualitative methods. Reflexivity was exceptionally important, because my mind is the primary measurement devise, without the mathematical tools I could use in large-n studies. My aim was to let the data speak for itself, without the hegemony of preconceived codes and normative beliefs. I specifically say “aim,” because preconceptions are unavoidable in behavioral

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28 For example, one theme that emerged was that bank culture had changed. Some participants explained it was not like the old days where the lender and borrower knew each other and shook hands on a deal; instead, all they care about now is meeting particular number goals (see Chapter 4).

29 When I began this research, I thought I had a pretty good grip on nonprofit debt, but I knew to keep my mind open. For example, like everyone who uses statistics, I know they can lie. I also knew about numerosity perception and how numbers cast a glow of objectivity.
Some qualitative research methods include processes that help keep the researcher’s mind open. For example, grounded theory uses a rigorous, regimented coding process. And hermeneutics (particularly double hermeneutics) incorporates the researcher’s unavoidable biases explicitly into the research design, where the researcher analyzes their perception of the actor’s perceptions of a phenomenon. I was mindful of both during the coding process.

Per my explanatory research design, I used data driven coding. The first step is to break down the data into its smallest, most basic, observable components. To do this, coding happens line-by-line using methods like in vivo and open coding. As coding progressed, some helpful sensitizing questions I asked myself were: What is the author/speaker trying to convey to me? What emotions come through? What did they mention first and what are their main points? Who

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30 The observer effect is often tied to the Hawthorne effect or observer bias. But variations have been talked about in physics and computing, too. Our perceptions are measurement tools, and measurements affect what is being measured. A large part of measurement science is to create instruments that act more “objectively,” like spectrophotometers versus human eyesight and color recognition. But even tools like the latter still have inherent biases, since we measure what we think we should measure.

31 Like many people who study finance, much of my background and work includes financial analysis – studying numbers from financial statements and budgets that are constructed through accounting methods (e.g., debt-to-asset ratios, cash flows, etc.). In finance it is common to use “debt” and “liabilities” synonymously when they are not. The terms have different definitions in accounting. As my findings show, debt has even more meanings and connotations in financial practice/behaviors. Moreover, my perception of nonprofit finance has been heavily influenced by the IRS 990 dataset – more than I realized. This is not a surprise per se.

32 If I had used a top-down approach with preconceived categories, my research would have yielded very little valid information and missed the mark. There have been nonprofit finance surveys that assume nonprofits follow certain normative financial practices, but usually these normative practices are not empirically based and often borrowed from business finance (e.g., certain types of ratio analysis and benchmarks).

33 Except when the participant did not want to be recorded, my interviews were transcribed verbatim (including filler and hedge words).
are the actors? What were the conditions? Hundreds of codes emerged (416) during my initial coding (see Table 9 for examples).

When analyzing these codes, I looked for relationships; I amalgamated some similar codes into categories, and then into constellations of codes that pointed toward concepts not directly evident in the data. Through this secondary coding process, I observed connections among the strategies actors used, the conditions under which decisions or definitions formed, factors that led to borrowing/lending, outcomes, the relationships and communication among actors, decision-making contexts, patterns of causation, beliefs that influenced what information actors chose, and how they analyzed it, etc. For example, my analysis showed:

- Participants who said the nonprofit did not have debt also used phrases such as: is not in debt, is in the black, no trouble paying the bills.
- Participants who immediately talked about financial debt also worked at nonprofits struggling with debt. For example, they knew the nonprofit will not be able to pay back the debt – indicating financial vulnerability. They talked about “being in debt.”
- Alternatively, some participants recently had a lot of recent success using debt skillfully to meet mission-related goals. In this case, they explained debt in terms of “using debt” rather than “being in debt.” To them, debt was a tool, rather than a burden.
- From the lender interview perspective, participants talked less in terms of investments and selling products (as they would with small businesses), but more in terms of community investments and furthering missions.
- From the lender practitioner literature, lending to a nonprofit was the apotheosis of someone who educated themselves on nonprofit finance and are confident taking a risk
working with an unfamiliar type of organization, because they see opportunity in the market.

- From the nonprofit practitioner literature, getting a loan represented high financial and management capacity (a highly professionalized and skilled nonprofit), able to satisfy the requirements of lenders ignorant of nonprofits, and with a solid plan to use debt in order to bring in additional revenue and serve more clients.

Data collection and analysis was iterative. I would take notes on interviews as soon as they were finished and analyze them moving onto the next interview. When I observed a curious pattern/relationship/concept, I would especially watch for it in the subsequent interviews. If a participant mentioned any of these topics, I would neutrally probe for them to elaborate. This was not to confirm my analysis so far, but rather to pay attention to how the patterns did or did not emerge in the data analysis. In some instances, for example, I realized further analysis could not confirm particular statements. At others, additional data added to the complexity of the picture or affirmed it. This iterative process kept me close and grounded in the data.

My analysis also drew on studies from disciplines other than my own. For example, a few participants (and the PL) compared nonprofit to small business borrowing decisions. Interviewing small business owners was outside the scope of this research project. So, to pursue the topic, I read the empirical literature on small business debt decisions and asset

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34 One such theme was attributing good borrowing decisions to God. Maybe more borrowers would attribute their successful borrowing to divine intervention, rather than the outcome of rational decision-making. I stayed alert for the theme but did not ask about it specifically. My analysis indicated this gratitude to God was not specific to debt, but rather an overall worldview. They were grateful to God for many good things in their lives, borrowing decisions just being one of those numerous things.
compositions. From this, I learned that capital structure theories (the ones we used in our research) did not appear to explain small business debt; however, nonprofit financial researchers did not cite these studies; only the original theorists. That raised the question of whether we think about capital structure theories differently than their original conceptualization (i.e., conceptual drift)? What does that mean for our research when we compare nonprofit and business financial behaviors in general? All of this is important to how we study nonprofit debt.

Memoing made this kind of analysis possible. Writing memos is an essential reflexivity exercise that helped me understand how my own beliefs and experiences affected my analysis. This is a process akin to the double-hermeneutic method when the researcher is an acknowledged subject within the study. “The analyst must write out memos because unwritten inspired theorizing at night wafts away, the morning it is gone, and the grounded theory never materializes” (Stern, 2010, p. 410). While I was not precisely following grounded theory in all aspects, the statement still stands.

So throughout the study I had kept extensive notes. These included my initial impression after interviews or a coding session; writing letters to myself to track how my subjectivity influenced the analysis; drawing pictures of potential relationships among concepts; summaries of conversations that I had with people totally outside the field, bouncing ideas off of fresh minds; video memos of myself documenting my reflections, questions, concerns of the research so far; summarizing experiments where I pretended to be actors in the study (e.g., the authors of the practitioner-oriented literature) responding to various prompts; etc.

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35 My doctoral minor was in business (organization theory and entrepreneurship), so I was not entirely unfamiliar with the literature, but I had not read any of the finance research.
36 I also kept my research in the back of my head, which influenced how I perceived and
For example, a news story about poverty and “scarcity mindsets” reminded me of nonprofit scarcity, so I wrote a memo. Main points from this memo included:

- Scarcity mindset: The mindset that there will never be enough; this will always be scarce. This brings up nearly primordial fears and anxieties. In contrast, people with an “abundant” mindset tend to feel more self-worth and security. Low-income people sometimes reinforce their poverty by doing things like playing lotteries, failing to enroll in assistance programs, and saving instead of borrowing. (Mullainathan & Shafir, 2013; Shah et al., 2012)

- Could this help explain some of my findings? Cognitive economy is limited, and executive leadership faces many competing demands. Many of the organizations had very few (or only interacted with my personal experiences. For example, I found parallels when watching “The Quest for the Sea,” a living history documentary series about cod fishing in remote Canadian villages in the 1930s. Families had to borrow money from the merchant to pay for supplies and equipment before the season began (Episode 1). When times were tough, the families could not repay the merchant. In these cases, the merchant sometimes forgave the debt, because it was not useful to carry it from year to year. It did not help fishers work harder or increase the merchant’s profits (Episode 4). This is an example of debt forgiveness depending on the economic context and the relationship among borrowers and lenders.

Similarly, during a visit to the Grant County (OR) Historical Museum, I saw an exhibit for a banker who forgave many loans, when borrowers could not make their payments during the Great Depression. Because of this, the family is still well-known for being good banks who cared about small time ranchers and farmers. I talked with the museum curator about the exhibit, and she mentioned the banker also forgave the loans, since no one could pay them back anyway. She did not want to include that cynicism in the exhibit, however. While I had observed similar topics in my data, I realized my preconceptions from my nonprofit scholarly background (e.g., stereotyping lending as a cold transaction, motivated by profit), were interfering with my sensitivity to community-oriented and more philanthropic lending motivations. This reflexivity helped me go back and explore these topics more in depth. Later, I revisited this memo when I observed banks (and local government lenders) forgiving nonprofit loans. These “write-offs” can count toward Community Reinvestment Act credit, but also make the lender philanthropic. As my Risk Management Association instructor explained, no bank wants to foreclose on a church or community center. It validated my observation and conclusion that cultural-cognitive institutional frameworks influence nonprofit borrowing/lending (i.e., community bank culture along the lines of a George Baily rather than a Mr. Potter). Similarly, a piece from The American Banker I saw compares modern banking risk management and culture with It is a Wonderful Life (Cohn, 2013).
one) executive staff members making high level decisions. A debt is not “a debt” if it is not a priority and not a problem or drain on the organization.

- With limited financial background, could nonprofit decision-makers be pulling more from a personal finance mindset? Where do their heuristics come from? How does this change the organizations debt strategies and culture with turnover? This seems almost like an agency problem (like pecking order theory references to why firms might choose capital structures); however, it is agency theory over time. The decisions of past leaders constrain the decisions of subsequent leaders.
- Could this be a viable alternative to “permanently failing organizations” or a complement? Unlike PFOs, the workforce is motivated, and relationships are strong…
- If directors personally feel the environment to be scarce, do their decisions reflect their personal mindsets? For example, the collateralized loans that will never be repaid. People, not organizations, make decisions.
- Consider links here with relationship lending…look at the banking literature…
- Maybe the scarcity mindset explains why I found 72 pairs of jeans when I cleaned out my relative’s house…
- Consider capital structure theories. They assume organizational decision-making in publicly traded firms, likely with finance departments that can “rationally” analyze decisions with some personal detachment.

In the end, the scarcity mindset concept did not become a dominant theme in my analysis, but the memo was useful nevertheless in spotting new patterns and development of themes related to the definition of debt and individual versus organizational decision-making.
Furthermore, some memos gave me ideas for future studies and preliminary research designs. I also used themes to help analyze whether or not I had reached saturation.

In other memos, I focused on the potential relationships among my fundamental and comparative case selection characteristics before I began data collection (Figure 3). This includes the intersections of nonprofit revenue sources (donation vs fee-for-service), purpose for the facilities project (augment vs correct), lender type (commercial vs non-commercial), construction project (new vs renovate), cash flows (punctuated vs regular), and state (Illinois vs Indiana). These efforts gave me a reference point to help determine whether some characteristics became less important, and others more, and thereby helped guide my case selection and management. In another example, I drafted a decision tree based on my preliminary lender data analysis (Figure 4). In the end, I found this structured model did not reflect the more organic decision-making process undertaken by lenders and borrowers even though many elements remained important.

**PROPOSITIONS AND TESTABLE HYPOTHESES**

In the end, I developed five key propositions and several testable hypotheses related to each, to aid future nonprofit debt research. The final model integrates the different elements of debt decision-making from the borrower, lenders, and ecological perspectives. I discuss the full model in the conclusion chapter, but some examples include:

- Nonprofit capital structure is an accumulation of many different decisions, based on a particular nonprofit leader’s preferences and project choices. This contrasts with business finance that sees capital structure as an organization-wide strategy for the entire firm, creating policies that affect individual project financing decisions. The former is bottom up. The latter is top down.
• Some lending is relational while some is credit-based. Personal, relationship-based lending relies on trust. Relationship-based lending is best analyzed using more qualitative information, since it involves examining the ongoing relationships between borrower and lenders, their mission and roles in the community, etc. By comparison, capital structure theories and the practitioner literature place a high emphasis on risk management based on the analysis of quantitative financial data. Economic sociology theories are more useful in this latter context.

In the next three substantive chapters, I describe my findings that address my three research questions: How do nonprofits decide to borrow? (Chapter 3) How do lenders decide to work with nonprofits? (Chapter 4) How does the environment affect borrower and lender decisions and relationships? (Chapter 5)
Works Cited


### TABLES

#### Nationwide data

Source: NCCS Core 2013 PC Full 990 Data Extract (Accessed 11/23/15)

Table 1: Percentage of nonprofits nationally with assets; land, buildings, and equipment (LBE); and secured debt, 2013, by field

<table>
<thead>
<tr>
<th>Field</th>
<th>All (%)</th>
<th>Have assets</th>
<th>And LBE</th>
<th>And secured debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arts, culture, and humanities</td>
<td>9.2</td>
<td>9.2</td>
<td>9.6</td>
<td>6.8</td>
</tr>
<tr>
<td>Education</td>
<td>15.7</td>
<td>15.8</td>
<td>13.6</td>
<td>13.3</td>
</tr>
<tr>
<td>Environment</td>
<td>4.3</td>
<td>4.3</td>
<td>4.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Health</td>
<td>14.8</td>
<td>14.7</td>
<td>15.7</td>
<td>16.0</td>
</tr>
<tr>
<td>Human services</td>
<td>36.0</td>
<td>36.0</td>
<td>39.9</td>
<td>49.3</td>
</tr>
<tr>
<td>International</td>
<td>2.2</td>
<td>2.2</td>
<td>1.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Mutual benefit</td>
<td>0.3</td>
<td>0.3</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Public and societal benefit</td>
<td>11.4</td>
<td>11.4</td>
<td>9.2</td>
<td>6.7</td>
</tr>
<tr>
<td>Religion</td>
<td>6.1</td>
<td>6.0</td>
<td>5.6</td>
<td>4.6</td>
</tr>
<tr>
<td>Unknown</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Number of organizations</td>
<td>216,924</td>
<td>214,852</td>
<td>147,698</td>
<td>44,495</td>
</tr>
</tbody>
</table>

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1 The “Full” file includes more financial variables (297), but fewer records (216,924) than the 2013 “regular” PC (148; 382,401). Note that only nonprofits filing full financial information with the IRS are included in the “full” dataset. The “regular” dataset includes smaller nonprofits that file much more limited financial data. Both exclude the many nonprofits not required to file any financial information at all.

2 “Nonprofits” in this context are 501(c)(3) public charities (no foundations)
Table 2: Percentage of all nonprofits nationally with assets; land buildings and equipment; and secured debt, 2013, by size of assets

<table>
<thead>
<tr>
<th>Size of Assets</th>
<th>Have assets</th>
<th>Have assets &amp; LBE</th>
<th>Have assets, LBE &amp; mortgage</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>0.8</td>
<td>0.0</td>
<td>2.0</td>
</tr>
<tr>
<td>$1-$100K</td>
<td>18.3</td>
<td>9.5</td>
<td>4.1</td>
</tr>
<tr>
<td>$100K-250K</td>
<td>12.7</td>
<td>10.9</td>
<td>8.0</td>
</tr>
<tr>
<td>$250K-500K</td>
<td>11.8</td>
<td>12.0</td>
<td>15.2</td>
</tr>
<tr>
<td>$500K-1M</td>
<td>14.8</td>
<td>16.2</td>
<td>37.6</td>
</tr>
<tr>
<td>$1M-$5M</td>
<td>24.6</td>
<td>29.5</td>
<td>12.3</td>
</tr>
<tr>
<td>$5M-10M</td>
<td>6.4</td>
<td>8.0</td>
<td>17.1</td>
</tr>
<tr>
<td>$10M-100M</td>
<td>8.8</td>
<td>11.2</td>
<td>3.5</td>
</tr>
<tr>
<td>Greater than $100M</td>
<td>1.9</td>
<td>2.6</td>
<td>2.0</td>
</tr>
<tr>
<td>Total number</td>
<td>216,522</td>
<td>147,702</td>
<td>44,495</td>
</tr>
</tbody>
</table>

Table 3: Percentage of human service nonprofits nationally with assets; land buildings and equipment and secured debt, by size of assets

<table>
<thead>
<tr>
<th>Size of Assets</th>
<th>Have assets</th>
<th>Have LBE</th>
<th>Have LBE &amp; mortgage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-$100K</td>
<td>18.0</td>
<td>9.0</td>
<td>1.6</td>
</tr>
<tr>
<td>$100K-250K</td>
<td>12.9</td>
<td>11.0</td>
<td>3.8</td>
</tr>
<tr>
<td>$250K-500K</td>
<td>11.8</td>
<td>12.1</td>
<td>8.1</td>
</tr>
<tr>
<td>$500K-1M</td>
<td>15.7</td>
<td>17.7</td>
<td>17.4</td>
</tr>
<tr>
<td>$1M-$5M</td>
<td>27.3</td>
<td>32.7</td>
<td>42.5</td>
</tr>
<tr>
<td>$5M-10M</td>
<td>6.6</td>
<td>8.1</td>
<td>12.7</td>
</tr>
<tr>
<td>$10M-100M</td>
<td>7.1</td>
<td>8.7</td>
<td>13.3</td>
</tr>
<tr>
<td>Greater than $100M</td>
<td>0.5</td>
<td>0.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Total number</td>
<td>77,442</td>
<td>58,895</td>
<td>21,925</td>
</tr>
</tbody>
</table>
**Illinois and Indiana nonprofits**

Source: NCCS Core 2013 PC Full 990 Data Extract (Accessed 11/23/15)

**Table 4: Indiana and Illinois nonprofits: Percentage by type (NTEE)**

<table>
<thead>
<tr>
<th>Type</th>
<th>All (%)</th>
<th>Has assets (%)</th>
<th>And LBE (%)</th>
<th>And secured debt (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>IL</td>
<td>IN</td>
<td>IL</td>
<td>IN</td>
</tr>
<tr>
<td>Arts, culture, and humanities</td>
<td>8.9</td>
<td>8.0</td>
<td>8.9</td>
<td>8.0</td>
</tr>
<tr>
<td>Education</td>
<td>15.6</td>
<td>12.9</td>
<td>15.6</td>
<td>12.9</td>
</tr>
<tr>
<td>Environment</td>
<td>3.1</td>
<td>3.3</td>
<td>3.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Health</td>
<td>16.3</td>
<td>14.7</td>
<td>16.3</td>
<td>14.7</td>
</tr>
<tr>
<td>Human services</td>
<td>35.1</td>
<td>39.3</td>
<td>35.1</td>
<td>39.4</td>
</tr>
<tr>
<td>International</td>
<td>1.9</td>
<td>1.5</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Mutual benefit</td>
<td>0.4</td>
<td>0.2</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Public and societal benefit</td>
<td>12.5</td>
<td>13.2</td>
<td>12.6</td>
<td>13.1</td>
</tr>
<tr>
<td>Religion</td>
<td>6.1</td>
<td>6.8</td>
<td>6.1</td>
<td>6.9</td>
</tr>
<tr>
<td>Unknown</td>
<td>0.1</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td># Of nonprofits</td>
<td>8,266</td>
<td>4,352</td>
<td>8,195</td>
<td>4,313</td>
</tr>
</tbody>
</table>

Notes: This table is comparable to Table 2, but it only includes Indiana and Illinois organizations. Out of all nonprofits with assets in Illinois, 35 percent are human service organizations compared to 39 percent in Indiana. Of all nonprofits with facilities-related mortgages, human service organizations comprised 48 percent in Illinois and 52 percent in Indiana.
Table 5: Percentage of human service nonprofits in Illinois and Indiana with assets; land buildings and equipment and secured debt, by size of assets

<table>
<thead>
<tr>
<th></th>
<th>All (%)</th>
<th>Has assets (%)</th>
<th>And LBE (%)</th>
<th>And secured debt (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>IL</td>
<td>IN</td>
<td>IL</td>
<td>IN</td>
</tr>
<tr>
<td>0-$100K</td>
<td>16.8</td>
<td>15.6</td>
<td>8.3</td>
<td>8.3</td>
</tr>
<tr>
<td>$100K-250K</td>
<td>12.0</td>
<td>11.6</td>
<td>10.3</td>
<td>10.4</td>
</tr>
<tr>
<td>$250K-500K</td>
<td>12.1</td>
<td>11.9</td>
<td>12.2</td>
<td>12.2</td>
</tr>
<tr>
<td>$500K-1M</td>
<td>14.5</td>
<td>17.0</td>
<td>15.1</td>
<td>17.9</td>
</tr>
<tr>
<td>$1M-$5M</td>
<td>25.5</td>
<td>26.0</td>
<td>29.6</td>
<td>29.0</td>
</tr>
<tr>
<td>$5M-10M</td>
<td>6.8</td>
<td>6.3</td>
<td>8.3</td>
<td>7.4</td>
</tr>
<tr>
<td>$10M-100M</td>
<td>9.9</td>
<td>9.5</td>
<td>12.7</td>
<td>12.0</td>
</tr>
<tr>
<td>Greater than $100M</td>
<td>2.6</td>
<td>2.1</td>
<td>3.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Total</td>
<td>8,195</td>
<td>4,313</td>
<td>5,338</td>
<td>3,180</td>
</tr>
</tbody>
</table>

Notes: This table is comparable to Table 2, but it only includes Indiana and Illinois organizations. Out of all human service organization with assets, 30 percent have $500,000 to $1 million in Illinois compared to 29 percent in Indiana. Out of all human service organizations with facilities related mortgages, 26 percent had assets between $1-5 million in both states.
### Case detailed demographic information

#### Table 6: Case demographics (continues on next page)

<table>
<thead>
<tr>
<th>Name</th>
<th>NTee</th>
<th>Description</th>
<th>Age</th>
<th>Religious</th>
<th>State</th>
<th>Rural-ness</th>
<th>Participants</th>
<th>Decision?</th>
</tr>
</thead>
<tbody>
<tr>
<td>NewDream</td>
<td>O,B,X</td>
<td>A small, religious group home (residence) for troubled female teenagers. Activities, education, and therapy are tailored to each client needs.</td>
<td>&lt;10</td>
<td>Christian</td>
<td>IN</td>
<td>0-25%</td>
<td>CEO/Founders</td>
<td>Yes</td>
</tr>
<tr>
<td>CareHub</td>
<td>P</td>
<td>Childcare referral, education, and resource agency.</td>
<td>20-30</td>
<td>Secular</td>
<td>IN</td>
<td>0-25%</td>
<td>CEO/Pres VP Ops</td>
<td>No</td>
</tr>
<tr>
<td>Fundamentals</td>
<td>P</td>
<td>Childcare center with a focus on children from lower income families</td>
<td>&lt;10</td>
<td>Secular</td>
<td>IN</td>
<td>0-25%</td>
<td>ED/Founder</td>
<td>Yes</td>
</tr>
<tr>
<td>Better-Tomorrows</td>
<td>P</td>
<td>Provides services (training, transitional services, lodging) for recovering addicts.</td>
<td>40-50</td>
<td>Secular</td>
<td>IN</td>
<td>0-25%</td>
<td>ED</td>
<td>Yes</td>
</tr>
<tr>
<td>ElmGrove</td>
<td>P</td>
<td>Service provider for people with disabilities and the elderly (e.g., wellness, prevention, employment, crisis services, etc.)</td>
<td>50-60</td>
<td>Secular</td>
<td>IL</td>
<td>50-75%</td>
<td>ED</td>
<td>No</td>
</tr>
<tr>
<td>RiseFree</td>
<td>P</td>
<td>Senior care services including nutrition, transportation, care management, caregiver support, etc.</td>
<td>40-50</td>
<td>Secular</td>
<td>IN</td>
<td>25-50%</td>
<td>Pres/CEO VP Finance</td>
<td>No</td>
</tr>
<tr>
<td>Good-Shepherd</td>
<td>P</td>
<td>Shelter for people experiencing homelessness. Services include shelter, food, education, clothing, counselling, etc.</td>
<td>70-80</td>
<td>Christian</td>
<td>IN</td>
<td>0-25%</td>
<td>COO</td>
<td>Yes</td>
</tr>
<tr>
<td>LakeSide (pretest)</td>
<td>P, B</td>
<td>Services for persons with developmental disabilities: family support, residential, employment training and placement, etc.</td>
<td>50-60</td>
<td>Secular</td>
<td>IN</td>
<td>0-25%</td>
<td>CFO</td>
<td>No</td>
</tr>
<tr>
<td>YouthFirst</td>
<td>L, P, O</td>
<td>Services for youth experiencing homelessness: shelters, education programs, health programs, crisis intervention, training and job placement, mental health and substance use treatment, childcare, etc.</td>
<td>40-50</td>
<td>Secular</td>
<td>IL</td>
<td>0-25%</td>
<td>CEO</td>
<td>Yes/No</td>
</tr>
<tr>
<td>Aspire</td>
<td>P</td>
<td>Social service provider: foster care, parent education and health programs, residential programs, childcare, education, counselling, special education, etc.</td>
<td>10-20</td>
<td>Christian</td>
<td>IL</td>
<td>50-75%</td>
<td>Pres/CEO &amp; CFO</td>
<td>No</td>
</tr>
<tr>
<td>PlowShares</td>
<td>P</td>
<td>Services for veterans experiencing homelessness: employment assistance, housing, counselling, etc.</td>
<td>&lt;10</td>
<td>Secular</td>
<td>IN</td>
<td>0-25%</td>
<td>ED/Founder</td>
<td>Yes</td>
</tr>
<tr>
<td>Skyward</td>
<td>J</td>
<td>Neighborhood development services: housing, education, transitional services for youth aging out of foster care, etc.</td>
<td>30-40</td>
<td>Christian</td>
<td>IL</td>
<td>0-25%</td>
<td>ED</td>
<td>Yes/No</td>
</tr>
<tr>
<td>Participant alias</td>
<td>Total assets (TA)</td>
<td>Total liabilities / Total assets (TL/TA)</td>
<td>Δ TL/TA from previous year</td>
<td>Long-term liabilities / Total liabilities (LTL / TL)</td>
<td>LBE /Total Assets</td>
<td>Primarily Donative (D) or Fee-for-service (FFS)</td>
<td>Total revenue / Total assets (TR/TA)</td>
<td>Debt acquisition</td>
</tr>
<tr>
<td>-------------------</td>
<td>------------------</td>
<td>-----------------------------</td>
<td>---------------------------</td>
<td>--------------------------------</td>
<td>------------------</td>
<td>--------------------------------</td>
<td>------------------</td>
<td>------------------</td>
</tr>
<tr>
<td>NewDream</td>
<td>&lt;$500K</td>
<td>75-100%</td>
<td>+&lt;50%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>FFS</td>
<td>75-100%</td>
<td>Recent</td>
</tr>
<tr>
<td>CareHub</td>
<td>&lt;$500K</td>
<td>&gt;100%</td>
<td>&lt;10%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>D</td>
<td>&gt;400%</td>
<td>Old</td>
</tr>
<tr>
<td>Fundamentals</td>
<td>&lt;$500K</td>
<td>75-100%</td>
<td>+50%</td>
<td>75-90%</td>
<td>50-75%</td>
<td>FFS</td>
<td>100-200%</td>
<td>Recent</td>
</tr>
<tr>
<td>BetterTomorrows</td>
<td>$500K - 1,000K</td>
<td>75-100%</td>
<td>NC</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>FFS</td>
<td>50-75%</td>
<td>Recent/ &amp; old</td>
</tr>
<tr>
<td>ElmGrove</td>
<td>$1,000K - 3,000K</td>
<td>50-75%</td>
<td>NC</td>
<td>50-75%</td>
<td>50-75%</td>
<td>FFS</td>
<td>200-400%</td>
<td>Recent &amp; old</td>
</tr>
<tr>
<td>RiseFree</td>
<td>$1,000K - 3,000K</td>
<td>75-100%</td>
<td>+&lt;10%</td>
<td>10-50%</td>
<td>&lt;50%</td>
<td>D</td>
<td>&gt;400%</td>
<td>Recent &amp; old</td>
</tr>
<tr>
<td>GoodShepherd</td>
<td>$1,000K - 3,000K</td>
<td>75-100%</td>
<td>+&lt;10%</td>
<td>50-75%</td>
<td>&gt;75%</td>
<td>D</td>
<td>50-75%</td>
<td>Old</td>
</tr>
<tr>
<td>LakeSide (pretest)</td>
<td>$5,000K - 7,000K</td>
<td>50-75%</td>
<td>+&lt;10%</td>
<td>&lt;10%</td>
<td>50-75%</td>
<td>FFS</td>
<td>200-400%</td>
<td>Recent &amp; old</td>
</tr>
<tr>
<td>YouthFirst</td>
<td>$3,000K - 5,000K</td>
<td>50-75%</td>
<td>+&lt;10%</td>
<td>90-100%</td>
<td>50-75%</td>
<td>D</td>
<td>50-75%</td>
<td>Recent &amp; old</td>
</tr>
<tr>
<td>Aspire</td>
<td>$1,000K - 3,000K</td>
<td>75-100%</td>
<td>+&lt;10%</td>
<td>75-90%</td>
<td>50-75%</td>
<td>D</td>
<td>200-400%</td>
<td>Recent &amp; old</td>
</tr>
<tr>
<td>PlowShares</td>
<td>&lt;$500K</td>
<td>50-75%</td>
<td>+&gt;50%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>D</td>
<td>&lt;25%</td>
<td>Old</td>
</tr>
<tr>
<td>Skyward</td>
<td>$3,000K - 5,000K</td>
<td>50-75%</td>
<td>+&lt;10%</td>
<td>90-100%</td>
<td>&lt;50%</td>
<td>FFS/D</td>
<td>&lt;25%</td>
<td>Recent &amp; old</td>
</tr>
</tbody>
</table>

Notes: Not all these variables were used for sampling purposes. Some became evident and important as I conducted interviews with borrowers and lenders. The latter includes the organization’s age, religiousness, participant roles and whether or not they made the debt decision, whether or not the decision was made recently, and other information not available in the IRS 990 data. These data represent only some of the pre-interview case analysis, which also included information from newspapers, financial statements, and other publicly available information. The document with these pre-interview case studies is very long.
**Lender participant information**

Table 7: Lender organization participant profiles

<table>
<thead>
<tr>
<th>Participant alias</th>
<th>Type</th>
<th>Asset size range (bankrate.com)</th>
<th>Special Nonprofit Services</th>
<th>Service Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Metro bank</td>
<td>Community bank</td>
<td>$1 - $5bil</td>
<td>Special division</td>
<td>Midwest state</td>
</tr>
<tr>
<td>City credit union</td>
<td>Credit union</td>
<td>$5mil - 1bil</td>
<td>Specialized staff</td>
<td>Midwest state</td>
</tr>
<tr>
<td>Midwest bank</td>
<td>Regional bank</td>
<td>&gt; 10bil</td>
<td>Specialized staff</td>
<td>Midwest area</td>
</tr>
<tr>
<td>Business bank</td>
<td>Regional bank</td>
<td>$1 - $5bil</td>
<td>No</td>
<td>West coast</td>
</tr>
<tr>
<td>Midwest development fund</td>
<td>Nonprofit lender</td>
<td>$10 - 50mil</td>
<td>Primary Mission</td>
<td>Midwest state</td>
</tr>
<tr>
<td>Nonprofit finance excellence</td>
<td>Nonprofit lender</td>
<td>$10 - 50mil</td>
<td>Primary Mission</td>
<td>Midwest state</td>
</tr>
</tbody>
</table>
### Table 8: All named participants, experts and organizational representatives

<table>
<thead>
<tr>
<th>Participant alias</th>
<th>Most recent role</th>
<th>Former experience</th>
</tr>
</thead>
<tbody>
<tr>
<td>B-Kelly</td>
<td>CEO, CDFI</td>
<td>Education</td>
</tr>
<tr>
<td>G-Jacobs</td>
<td>CEO, CDFI</td>
<td>VP Bank</td>
</tr>
<tr>
<td>J-Davidson</td>
<td>Board chair, regional bank</td>
<td>Bank CEO</td>
</tr>
<tr>
<td>J-Day</td>
<td>Educator, Nonprofit finance consulting group</td>
<td>Non-financial nonprofit</td>
</tr>
<tr>
<td>K-Jansen</td>
<td>VP Commercial Lending, Regional bank</td>
<td>Director of Lending CDFI</td>
</tr>
<tr>
<td>L-Turner</td>
<td>Board president, CDFI</td>
<td>CDFI</td>
</tr>
<tr>
<td>M-Andrews</td>
<td>Senior vice president, Regional bank</td>
<td>Bank VP</td>
</tr>
<tr>
<td>M-Jenkins</td>
<td>VP, Credit Union</td>
<td>Not available</td>
</tr>
<tr>
<td>M-Smith</td>
<td>Senior VP Commercial Lending, Regional Bank</td>
<td>various roles at other banks</td>
</tr>
<tr>
<td>O-Johnson</td>
<td>Vice President, Lending</td>
<td>Non-financial nonprofit</td>
</tr>
<tr>
<td>R-Sterns</td>
<td>VP, Credit Union</td>
<td>Not available</td>
</tr>
<tr>
<td>S-Thompson</td>
<td>Educator, Nonprofit banking</td>
<td>Bank manager</td>
</tr>
</tbody>
</table>
Table 9: Examples of open codes

<table>
<thead>
<tr>
<th>Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term relationship between a borrower and a particular lender</td>
</tr>
<tr>
<td>Nonprofits saying they do not use debt or are not in debt (even though financially they are).</td>
</tr>
<tr>
<td>Cash flows and being in the black monthly</td>
</tr>
<tr>
<td>Community support</td>
</tr>
<tr>
<td>Mission alignment lender and borrower</td>
</tr>
<tr>
<td>Revenue droughts</td>
</tr>
<tr>
<td>Lost donors</td>
</tr>
<tr>
<td>Local government debt forgiveness</td>
</tr>
<tr>
<td>Necessary facility upgrades and repairs</td>
</tr>
<tr>
<td>Borrowing to expand to meet community needs</td>
</tr>
<tr>
<td>Lenders uninterested in IRS990s</td>
</tr>
<tr>
<td>Constrained by debt decisions of past leaders</td>
</tr>
<tr>
<td>Unaware how debt decisions were made</td>
</tr>
<tr>
<td>“We do not lend to nonprofits just for them to fail.”</td>
</tr>
<tr>
<td>Nonprofits are not like small businesses.</td>
</tr>
<tr>
<td>Opening a lending division just to work with nonprofit clients</td>
</tr>
<tr>
<td>Leaving a job, because lending to nonprofits got harder, more restricted.</td>
</tr>
<tr>
<td>Nonprofit lending policies for equity, efficiency, and effectiveness.</td>
</tr>
<tr>
<td>Lending to nonprofits as a “giveback” to the community</td>
</tr>
<tr>
<td>Guilt over not being able to re-pay loans</td>
</tr>
<tr>
<td>The best advice for nonprofits using debt: Do not if you can avoid it.</td>
</tr>
<tr>
<td>Nonprofits are just as capable as small businesses. Banks do them a disservice by not expecting financial capacity.</td>
</tr>
<tr>
<td>Loan officer Credit Risk Certification and nonprofit lending</td>
</tr>
<tr>
<td>Collateralized operational loans that turn into long term debt (that on paper look like mortgages)</td>
</tr>
<tr>
<td>Highly leveraged organizations not worried about debt</td>
</tr>
<tr>
<td>Betrayal and tricks – springing debt as part of a conspiracy.</td>
</tr>
<tr>
<td>Board not involved; board overly involved</td>
</tr>
<tr>
<td>Combative relationships with banks.</td>
</tr>
<tr>
<td>Loan officers as old friends</td>
</tr>
<tr>
<td>Debt as one of the “four horsemen” of the nonprofit apocalypse.</td>
</tr>
<tr>
<td>Illinois budget troubles</td>
</tr>
<tr>
<td>Never being able to get back an investment</td>
</tr>
</tbody>
</table>
FIGURES

Figure 1: Research Framework (based on Maxwell, 2005)

Goals
Develop a better understanding of the decision-making processes underlying nonprofit debt decisions to: (1) Aid interpretations in quantitative studies based on IRS 990 data. (2) Help better inform lenders, borrowers, and grantors about the reality of nonprofit debt.

Conceptual Framework
Organizational decision-making theories. Interorganizational theories.
Traditional capital structure theories and previous empirical research on nonprofit debt.
Relationship among secured debt, facilities, and financial/organizational vulnerability.
Use of project evaluation and ratio analysis in choosing to borrow and choosing to lend.
Transactional relationship between borrower and lender

Research Questions
How do nonprofits decide to borrow (particularly large loan amounts)?
How do lenders (traditional and non-traditional) decide to lend to nonprofits?
How does the ecology of the capital marketplace and other external influences affect nonprofit debt levels?

Subset questions:
How are financial figures and analyses used in decision-making?
Who is involved in decisions and the interaction among these roles?
How do program-related facilities affect debt decision-making?
How does the largely normative practitioner literature compare to descriptions by lenders and borrower?

Methods
Content analysis of practitioner-oriented publications about nonprofit debt/borrowing/lending.
Deep financial analysis of high-debt, high-risk, medium human service organizations using IRS 990 data (e.g., ratio analysis). Case profile based on publicly available information to compare/contrast with interview data.
Semi-structured interviews about debt decisions and use with nonprofit leaders at target organizations.
Semi-structured interviews with lenders, from banks and nontraditional lenders, who work with nonprofit borrowers.

Validity
Triangulation of methods and sources, via interviews with different organization members, as well as document reviews.
Comparison with "best practices" as outlined by the trade/professional literature as well as consulting services.
Comparison with conclusions about nonprofit debt practices derived from quantitative research.
Triangulation via different theories on debt management.

Figure 2: Black box vs open systems framework

Input → Black Box (closed system) → Output

Open system (many shades of gray)
Boundary
Surroundings
Figure 3: Possible outcome models of decision-making factor relationships (early data collection)
A graphical depiction of a decision using a Bayesian network approach. Focus on influences rather than choices. An alternative to the binary decision tree of decision-making. Symbols:

Square – Controllable decisions.
Circle – Uncontrollable uncertainty.
Diamond – Values that can be measured.
Stop sign – Expected utility.
Arrow – Relevance
ADDITIONAL MATERIAL: QUALIFICATIONS

Qualitative methodologies in part on the researcher’s prior experience, which shapes the initial sensitization to the topic, analysis, and attaining theoretical saturation. And frankly, the researcher must also demonstrate they know what they are doing. Below I provide a narrative of how my skills aided me with my dissertation.

My doctoral fields in Public Affairs are public management and public finance, with a business minor on organizational theory and strategic management. An MPA in nonprofit management gives me a more practical view into the organizations I study. I focus my research on the nonprofit sector, particularly nonprofit finance. Additionally, I taught 300-level finance to public management students; I was required to use a corporate finance textbook, leading me to develop an additional interest in corporate finance that complemented my business minor. During my time in the IU Kelley Business School, I became acquainted with scholarly business research. This prepared me to consult the business finance and banking literature while analyzing and validating my observations, coding, and analysis. Later, I also worked at the Indiana Business Research Center, where I became more familiar with economics research.

Before this project, I primarily worked with large-n survey data allowing for statistical testing of hypotheses. I have a passion for statistics. But if I wanted to answer my research question, I needed a different methodology. Also, I wanted to learn something new during my dissertation research – to push myself. I did have a background in qualitative methods, which is what I needed. As a doctoral student, I completed summer workshops at The Institute for Qualitative and Multi-Method Research (IQMR) at Syracuse University as well as completed coursework in qualitative methods. Stretching back further, as an undergraduate research assistant, I applied axial and theoretical codes to interview transcripts to assess perceptions of
boundary ambiguity in a range of closed to open adoptions. I also extensively used hermeneutics in my religious studies major to analyze texts from a wide variety of religions. I learned Geertz’s method for “thick description” and ethnology in my anthropology/archaeology major.

Professionally, I have over two decades of experience in survey research design, questionnaire development, administration, and data analysis. In my undergraduate years, I worked as a field research supervisor at the IU Center for Survey Research, where I administered hundreds of surveys for a wide variety of projects. I honed my ability to interview people from a wide variety of backgrounds; completing these interviews required me to quickly establish rapport, and then continue engaging a respondent so they felt invested in the project (many never noticed I was reading the questionnaire verbatim, as the methodology required). I specialized in interviewing “uninformed refusals” – people who said no to the survey, because they did not trust the previous interviewer or understand the project. Overall, my field interview experience and skills were critical during my dissertation research.

Later as training coordinator I taught field interview techniques in IU’s graduate level sociology practicums. As project manager, I designed and managed dozens of different survey research projects, including: The National Survey of Student Engagement (NSSE) which included over 700 participating higher education institutions and millions of participants; its sister project, the Law School Survey of Student Engagement (LSSE); the Bank of America Study of High Net-Worth Philanthropy Survey 2006; The Indiana Poll in 2004 and 2005 – a statewide public opinion poll on a variety of topics including LGBTQIA+ civil rights, HPV vaccinations, the 2004 election, hate crime legislation, etc.; and the State Environmental Managers Survey 2005.
During graduate school, I worked on the *Indiana Nonprofits: Scope and Community Dimension's Project* and co-authored several reports targeted at practitioners, policy makers, and government officials. My doctoral work kept me grounded in nonprofit practice (sometimes focusing on datasets can take you away from where the data originates). These were all invaluable in helping me to deeply understand the theory I was learning and better prepared me to encourage participants in this project to tell their stories. I knew the jargon, which is essential for communication.

All of the above experiences honed my qualitative methodology skillset and were tools during my dissertation research.
CHAPTER 3: HOW DO NONPROFITS DECIDE TO BORROW?

INTRODUCTION

In this chapter, I seek to answer the question: How do nonprofits decide to borrow? My aim is to address the call to research for more theories of nonprofit finance. I do this by breaking down the larger research question into four sub-questions: What is debt? When do nonprofits borrow – what prompts them? Who makes the decisions? And which information do they use to inform their decisions? I answer these questions by comparing and contrasting three sets of information. First, the theoretical and empirical literature illustrate the researcher’s perspective.¹ Second, the practitioner literature teaches the normative “best practices” for nonprofits to use when deciding to borrow. Third, the case study data reveals how selected nonprofits make actual decisions about debt. These cases include purposely selected nonprofits with substantial debt, and that, based their IRS 990, looked financially vulnerable according to the standards of the empirical and practitioner literature. Using qualitative methods, I analyze these datasets to identify persistent themes, dimensions, and propositions, using both finance and organizational theory (particularly decision-making theory).

Three major findings emerge from this analysis. First, capital structure theory – the amount of debt an organization has in proportion to its total assets in order to maximize publicly traded firm value - ill-fits the nonprofit sector. This goes beyond already acknowledged problems (e.g., nonprofits have no owners). Tradeoff and pecking order theory (the two most commonly cited capital structure theories in the nonprofit literature) are predictive theories that try to

¹ I cover the literature much more in-depth in Chapter 1 which includes the literature review. I only give brief summaries here in order to compare/contrast with the practitioner literature and case study data.
forecast future firm values; they are theories of the marketplace, not of organizations, and especially not of nonprofits. To understand how nonprofits borrow, we need other more behavioral perspectives that focus on how individuals within organizations use information to make decisions.

Second, debt has many meanings. While capital structure theory itself does not place value judgments on debt, the nonprofit empirical literature implies it is dangerous (equating it with a measure of financial vulnerability). The practitioner literature revolves around the risk and perils of debt, when it explains how nonprofits should borrow. In some case studies, however, I found leaders who know their nonprofits have substantial liabilities, but say they have no debt; and some who do not know how their nonprofit made debt decisions. Debt is sometimes equated with “being in the red” or having financial problems. We must consider how these different definitions affect our future research (e.g., if we design survey research questions). We cannot assume that nonprofits make decisions based on their financial statement data.

Third, financial statements are not intended for internal nonprofit decision-making. Nonprofits construct these reports to communicate with the external world, not necessarily for use in their own financial analyses and decisions. Likewise, the IRS 990 collects information to monitor compliance with IRS regulations that give nonprofits their tax exemption. An organization might look great on paper, but be struggling in reality, and vice versa. Outsiders use financial statements as a signal about the nonprofit’s financial health, since they do not know as much about the organization as do its staff and board.²

² Information asymmetry and signaling theory (both behavioral) appear in capital structure theories as a way of explaining investor behaviors.
How nonprofits decide to borrow depends on financial management, of which financial statements are only a small component. This fundamental distinction is often overlooked in many empirical studies. Nonprofits use both quantitative financial numbers (most importantly monthly revenue/expenses) and more qualitative information obtained when lenders and borrowers are in close communication. When we use IRS 990 data to understand nonprofit financial behaviors (i.e., how nonprofits decide to borrow), we are therefore missing substantial important, critical information (e.g., monthly cash flow, tradeoff between debt service and program expenses, project evaluation, budgeting, etc.).

I begin by asking a very fundamental, yet especially important, question: How is debt defined? I compare the answers found in the empirical/theoretical, practitioner, and case study information.

**WHAT IS DEBT?**

Clearly the answer is liabilities, right? This is the definition of debt used in both business\(^3\) and nonprofit capital structure research, this is how debt appears in financial statements, and this is what basic financial management textbooks teach us (e.g., Finkler et al., 2006; McLaughlin, 2009). So, when I started my research on “How do nonprofits decide to borrow?” this is the definition I had in mind. It seemed straightforward until the data told me otherwise. I found that debt’s definitions and connotations vary depending on whether one examines empirical research, practitioner literature, and what I heard in my case studies. For example, the nonprofit practitioner literature rarely uses the term “capital structure,” while empirical research hinges on

\(^3\) In Chapter 6, I bring in more information from small business finance. For example, there is substantial research that traditional capital structure theories do not really work in the modern marketplace, particularly for privately owned businesses. However, nonprofit research does not cite these findings.
it. Nonprofit leaders in the case studies never use the term, and furthermore none used the term “liabilities.” But perhaps the most surprising finding is that some leaders said their nonprofits had no debt, even though the organization had a lot of it on paper (i.e., debt comprised 50 to 90 percent of total assets).

Definitions affect how nonprofits make decisions and how we understand them. This issue has appeared before in nonprofit scholarship. For example, Sulek (2010a; 2010b) published two papers, one on the classical and the other on the modern definitions of philanthropy, arguing that “proper definitions are critically important to the analysis and expression of ideas, for the meanings assigned to words fundamentally shape and direct the path of discourse. Perhaps nowhere is this more so than in an academic setting, where the definition of terminology employed by scholars determines what is studied, how and why it is studied, and by whom.” (p. 385; p. 193)

In this section, I compare the definitions and connotations of debt among the business and nonprofit theoretical/empirical literature, practitioner publications, and case study interviews with nonprofit leaders.

**Theoretical and empirical**

Modigliani and Miller’s (1958) model assumed the costs of debt and equity were the same in a perfect market. Therefore, any composition of the two would not affect the firm’s value. Tradeoff theory says that a firm’s capital structure decision depends on how it balances

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4 In contrast, practitioner-oriented business and investment materials regularly use the term “capital structure” and “liabilities” as well as very simplified versions of capital structure theories. The fact that “capital structure” appears in empirical work, but not in the practitioner literature, indicates a potentially worrisome disconnect between researchers and their subjects.
the costs (bankruptcy) and benefits (tax savings) respectively. MM Theorem and tradeoff theory do not place any value judgment on equity or debt. Neither is better than the other.

Pecking order theory says otherwise (Meyers & Majulf, 1984). It puts sources of capital into a hierarchy – internal funds, debt, and new equity – based on the premise that the cost of capital increases with information asymmetry. It is all about signaling information to investors. For example, when a firm uses debt, it signals that the firm has confidence an investment will be profitable, which translates into the message that the stock may be more valuable than its current market price. If investors believe this, it can increase the stock market price as they compete to purchase it. The firm sends out different signals to investors if it uses internal or external equity (i.e., cash reserves or issuing new stock). Debt’s role in pecking order theory is therefore more nuanced than in tradeoff theory.

Nonprofit finance scholars associate debt with financial risk. Tuckman and Chang (1991), in one of their most influential pieces, assert that high levels of debt (particularly measured as long-term liabilities to long-term assets) is one measure to identify financially vulnerable nonprofits. Other studies have examined the correlation between increased debt and decreased donor revenue in the IRS 990 data (Denison, 2009; Fama & Jensen, 1983; Yetman, 2007), on the assumption that donors want their funds to support current/future programs, not pay off old debts. That assumption is untested – I have not found any empirical work specifically on donor attitudes toward debt (e.g., donor behavior studies). The most adjacent research shows that most donors do not use Charity Navigator (a primary broker for nonprofit financial information) when they make their decisions about which nonprofits to support (Cnaan et al., 2011). Without knowing how donors behave, it is challenging to make a causal relationship that too much debt turns away donors and therefore would make nonprofits financially vulnerable.
This example illustrates a disconnection between the business and nonprofit connotations of debt. First, in business finance a firm’s debt is simply part of its overall asset composition. The firm chooses the best combination to maximize its total asset value. Investors, use capital structure as one small piece of information when they choose to buy stock and become owners. Risk does exist, but in the sense that all market decisions have risk inherent to them. In contrast, nonprofit finance theory associates debt mostly with risk, since it could affect donations, even though capital structure theory itself is not about revenue. Perhaps nonprofits scholars make this assumption because nonprofit finance research overwhelmingly focuses on revenues and fund development. Nevertheless, capital structure theories themselves have no connection to these issues, regardless of how important they are.

In summary, the original capital structure theories placed no value judgment on debt; using it could be as risky as not using it in a firm’s asset composition. In nonprofit finance, debt has a negative connotation and is associated with financial vulnerability. In the next section, I cover how the practitioner literature defines and connotes debt. This literature does not use the term capital structure but does warn nonprofits about how dangerous debt can be.

**Practitioner literature**

My content analysis of the practitioner literature reveals that debt is seen as an extremely risky, but potentially useful tool when in the right hands (i.e., a highly sophisticated, high-capacity organization). However, the focus on risk is evident in lurid headlines, such as debt as one of the “four horsemen of the nonprofit apocalypse” (Miller, 2010). News stories tell stories of nonprofits that “collapse in debt” or against all odds overcome “potentially fatal debt” (Bowman, 2018). Miller (the same who named debt as a horseman) also has argued that the nonprofit community needs to reframe debt without stigma (Mitchell-Wiggins and Miller in
interview with Edgington, 2010). When debt is not stigmatized, some authors still make it intimidating. For example, one metaphor for debt compares it to a circular saw, “a potentially deadly device, but … an essential tool for building big things. We cannot stop using the saw” (Taylor, 2009).

The practitioner literature advises nonprofits to exercise the upmost caution, when using debt, or it can get out of hand. “Without a realistic and well-informed assessment of the cost, time, and personnel needs, your decision to go ahead with a project will be seriously flawed,” Jenkins (2004) at the Nonprofit Finance Fund explains. “Your ‘project’ thus encompasses every activity and cost identified in your assessment, generally a far wider range than you have had in mind when you first contemplated the project.” When taking on debt, a nonprofit does not just risk the project, but the entire organization according to the practitioner literature. Furthermore, debt comes with a moral obligation. As one author explains, “Although nonprofits are urged on to greater heights of entrepreneurial behavior, when it comes to borrowing, they are not risking their own assets but the public’s, so they have a special obligation to gauge risk, limit it, and get the very best terms possible for any endeavor” (Bowman, 2018).

Overall, the practitioner literature tells us that at best, debt is a chainsaw and at worse a Biblical level apocalypse. Both connotations teach nonprofits to be extremely cautious around debt and avoid it when possible. The nonprofit empirical literature also associates debt with financial vulnerability. In the next section, I present the case study data which show that nonprofit leaders define debt in more nuanced ways.
Case studies

All the case study organizations had large amounts of liabilities. So, you could imagine my surprise when some nonprofits said they had no debt, when I asked, “How does your nonprofit use debt?” The first and second time this happened, I thought “sampling error.” After all, the most recent IRS 990 data I had was a couple of years old. Although unlikely, I wondered if the leaders did not know they had debt. In one case, the nonprofit was surprised with debt (taxes owed on donated properties), but they knew and talked about their debt. Luckily the leaders I talked to were just as curious as I was (although I wonder how many organizations declined to participate, because they thought the research did not apply to them). In the end, two “financial” themes emerged from the case study analysis (both the interviews and pre-interview financial analysis). First, a debt is only a debt when it is a financial problem. Second, debt is not capital structure as much as it is cash flows and/or revenue and expenses. The two are connected, because the latter is often a symptom of the former.

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5 In one case the nonprofit had paid off the old debt. Plowshares had received donated facilities and was surprised they came with debts. Even so, the leader described debt negatively. The troubles it had with this surprise debt and its struggles to get loans was part of operating in what the organization saw an overall unsupportive (even corrupt) community. Paying it off was a minor point in that.

6 Any future surveys of nonprofit debt should pay special attention to this language difference. Instead of debt, loans and mortgages might be better terms to use.

7 Cash flow is the money coming into and out of an organization over a particular period of time. The Statement of Cash Flows documents sources of cash: operating, investing, and financing. Most importantly in this context, it documents how a nonprofit manages cash to pay debts and expenses. It differs from the Statement of Activities, which reports on expenses and revenues, including donor restrictions, program functions, etc. While some data from the Statement of Activities and Financial Position appear in the IRS 990 dataset, information on cash flows does not. When IRS 990 references cash (e.g., non-cash contributions), the measurements are in terms of revenues and expenses or liquid assets.
For example, one nonprofit explained, “Well, CareHub is pretty fortunate that we don’t have a whole lot of debt. But what we do have is the backbone basically [sic]. The only debt CareHub has is our mortgage and [that is] not a debt.” This statement illustrates how debt has multiple meanings. In this interview, the leaders used debt to refer to a loan (i.e., the mortgage); but didn’t think of it as a debt, because it was current on the loan payments and those payments did not curtail any program spending.8 Similarly, YouthFirst’s leaders said, “We do not have any debt; we are always in the black,” although 99 percent of the organization’s total assets were debt – a mortgage for its new facilities and land negotiated by the current leaders. The leaders were not ignorant of the term (one leader had a substantial business background); rather, “no debt” meant they had no problems meeting debt obligations. The total amount of debt (or capital structure) was unimportant compared to that.

At LakeSide, the financial director had even more experience with nonprofit finance. We began the interview by talking about capital structure, liabilities, etc. and how they influenced LakeSide’s debt decisions. But midway through the interview, the leader9 stopped me. Essentially, he said, yes, they knew all the best practices procedures for deciding on and managing debt, but these really were not important in real life. What mattered most was paying

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8 As I explain more in “When to Borrow?” revenue sources were an issue for this organization. It relied on mostly government grants, which would not cover mortgage payments. Therefore, CareHub had to maintain a separate donor base to raise money for these payments. It planned to sell the facility and rent instead in order to streamline its finances and reduce the cost of maintaining the donor revenue stream. These donors were not put off by debt; they knew their donations were used to make the payments.

9In some cases, two leaders completed the interview together. The methodology chapter includes a table that documents what roles participants held.
the bills each month, without debt service payments affecting more essential programmatic and operational expenses. “Cash is king,” they explained.

At YouthFirst debt service payments did threaten the organization. The leader talked about the total debt amount, but still mostly focused on the monthly payments since these were the most problematic and demanded ongoing attention. Between state revenue cuts and an inflexible lender, YouthFirst had to choose between supporting its programs or paying the bank. When it chose programs, the bank “swept” not only YouthFirst’s operating accounts but staff health savings accounts, although the latter was illegal since the funds are the employees’ money, not the organizations. Here, too, debt was less about capital structure, and more about financial troubles and monthly financial cashflow management.

For YouthFirst, debt took on another connotation – misanthropic. YouthFirst’s board members (some being bankers themselves) tried to convince the lenders of “the long-term impacts and all I can tell you is they did not care. I think there was [the lenders] personality - that was small Napoleonic white man complex.” In another case, Plowshares felt deceived when it was saddled with debt, because a donation of facilities came with substantial property tax debt. When it could not get a bank loan to pay the past due taxes, the leader saw it as reflecting overall hostility to Plowshares by corrupt individuals. He mentioned one person in particular, “He’s a lawyer, he knows the bankers, and he and the bankers and everybody is in on it together.”

In contrast, some nonprofits gave debt a philanthropic connotation. ElmGrove, also dependent on contracts from the State of Illinois, talked more in terms of “being in debt to” lenders rather than having debt. The leader explained that the bank had given the nonprofit long term, collateralized operation loans during the Illinois budget crisis (risky loans for the bank), so
ElmGrove could keep serving the community. Overall, the leader discussed how the banks had been understanding and cooperative, since they understood ElmGrove’s mission. At GoodShepherd, the leader described banks as being “charitable” more than once, and how “they’ll go out on a limb” to help nonprofits, for which GoodShepherd is very grateful. Aspire and RiseFree too associated debt with a positive, good partnership with lenders. Finally, Skyward explained how lenders (particularly government lenders) in part forgave debts, because they wanted to work with the nonprofit because of its important mission.

Overall, the case study data show two financial themes for the definition of debt. First, “debt” means financial trouble; if there is no trouble, there is no debt. Second, debt is not an asset concept like liabilities; rather, it is covering monthly service payments. “Being in the red” is the definition of debt. In addition to these financial themes, debt also has an expressive connotation. Depending on the lender, debt represents the lender’s misanthropic or philanthropic intentions in the financial relationship.

In the next section, I offer a brief summary comparing and contrasting the different definitions of debt among the empirical, practitioner, and case study data.

**Summary**

In finance, sometimes definitions – like debt - seem pretty cut and dry and there are relatively few discussions about semantics as applied to finance, compared to management and organizational theory (e.g., what is leadership, what is an entrepreneur). In finance we often rely on data that derives from accounting and financial statements that adhere to various codified
standards (e.g., FASB\textsuperscript{10}). In my analysis, however, I find that the definition of debt varies between the theoretical/empirical literature, practitioner literature, and case study data.

Both business and nonprofit theoretical/empirical literature uses “debt” as a more colloquial synonym for the more technical/accounting term, “liabilities.” They are used interchangeably. The practitioner literature almost always uses “debt” alone, probably because most of it targets a wider, more casual audience and the former seems less intimidating than the latter.\textsuperscript{11} In the case study data, participants also used less technical terminology and talked about debt as a tool. Rather than an organization-wide targeted capital structure strategy (i.e., capital structure theory), they talked more about loans associated with particular facilities projects (e.g., mortgages). Moreover, many defined debt in terms of monthly revenue/expenses and cash flows – i.e., staying in the black.\textsuperscript{12} Because of this definition, some leaders argued their nonprofits had no debt, even though they knew they had loans and mortgages.

This semantic difference naturally poses some challenges for nonprofit finance research. To understand how nonprofits decide to borrow, we have to recognize they may be making decisions based on debt service payments for particular projects, not organizational wide, multi-year capital structure policies. Debt strategies can change with administrative turnover (some

\textsuperscript{10} FASB stands for the Financial Accounting Standard Board, which sets the standards for GAAP (generally accepted accounting principles) in the United States.

\textsuperscript{11} When I took courses in financial management, the terms were challenging. When I taught financial management, I gave my students a vocabulary cheat sheet, since they had the same troubles. Capital can mean so many different things depending on context.

\textsuperscript{12} Graham and Harvey (2001) surveyed managers about their decision to borrow. Their study upended many assumptions inherent in capital structure theories. For example, 60 percent said the biggest capital structure decision-making factor was financial flexibility. Financial flexibility firm can agilely react to market shifts (e.g., sudden decreases in revenue, changing cost of debt and equity capital, bear markets, etc.). This is neither pecking order or tradeoff theory.
leaders did not know how previous stakeholders made the decision that led to the debt),
indicating a best an inconsistent capital structure strategy, if there is such a strategy beyond
project-based decision-making. We cannot assume organizations have a planned and long-term
capital structure strategy, as suggested by traditional business theories.

In the next section, I present my findings on how timing affects nonprofit debt decisions.
As in this section, I analyze how the empirical/theoretical literature, practitioner literature, and
case study data answer the question: When do nonprofits decide to borrow?

**WHEN TO BORROW?**

To answer, “How do nonprofits decide to borrow?” we need to know when they borrow.
Timing is an important component of decision-making. It affects not only when nonprofits
choose to borrow and but also how long they have to analyze and choose the best options. Like
the previous section, I compare/contrast timing in the: business and nonprofit
empirical/theoretical literature, the practitioner literature, and the case study data.

**Theoretical and empirical**

Investors, who drive capital structure, try to predict when to buy and sell stocks, which in
turn affect the firm’s value. In static tradeoff theory, investors do not care about a firm’s
particular capital; but when a firm changes its capital structure, they react by rebalancing their
personal portfolios. With pecking order theory, investors try to predict and then react to signals
about the firm’s financial health, when it changes capital structure (Meyers & Majluf, 1984).
These theories are designed to be predictive – looking at past outcomes (e.g., financial measures)
to determine the likelihood of future events (e.g., firm value).
The timing of capital structure decisions is key. The costs of capital (debt, equity, etc.) change frequently, so the firm must watch the market to anticipate changes. According to capital structure theories, a firm’s timing affects investor behavior, which in turn changes the firm’s market value. When a firm makes a capital structure decision, investors may interpret it as a signal of the firm’s health (i.e., pecking order theory), and react accordingly in order to maximize their own wealth. Even if they are indifferent to the firm’s capital structure (tradeoff theory) they still must adjust their own portfolios and that in turn affects the market. But the question of “when does a firm borrow” challenges business finance scholars. While the market changes minute-to-minute, scholars rely on quarterly financial statements – static, dated portraits of a firm’s finances.

In contrast, descriptive theory looks at past data to see how variables align with behaviors, in this case what information influences a nonprofits decision to borrow, so timing has a different quality to it. Unfortunately, timing is not really addressed in empirical nonprofit debt research. In part, the IRS 990 dataset is to blame. Scholars often test correlations among financial measures for the IRS data, but there are not many panel models that can track individual and common behaviors among groups over time. Rarely do models include external data (e.g., changes in the IRS 990, changes in watchdog groups, external economic effects, community needs, capital availability, etc.) with could affect the timing of debt decisions.

In the next section, I present my content analysis of the practitioner literature – its answer about when should nonprofits borrow.
**Practitioner**

The practitioner literature’s answer: A nonprofit should only borrow when it is absolutely ready. It warns that a nonprofit should borrow only when it is *thoroughly and completely sure* there is little risk to the organization. Such surety only comes with in-depth, organization-wide analysis, and making sure the project (e.g., mortgage for a new facility) will have a net positive value for the organization. “When to borrow” is less about opportunities, and more about restraint. This dovetails with the practitioner literature’s definition and characterization of debt – as a powerful, yet dangerous tool. Its explanation of when to borrow can be grouped loosely into three sequential phases\(^{13}\) – the foundational, project analysis, and finding a lender – each of which I discuss in this section.

In the foundational phase, the nonprofit decides to borrow only after assessing its overall financial and organizational capacities. At the minimum, the nonprofit must have professional record keeping; at least one professional dedicated to preparing, managing, and analyzing financial statements (Packer, 2010); audited financial statements; and long and short-term financial goals and plans. Additionally, the nonprofit must plan and be prepared for the unexpected like financial shocks to revenue (Packer, 2010; Romano, 2011). Most importantly, the nonprofit must have high governance and management capacity; and finally, all financial decisions must reflect the nonprofit’s core values, mission, and vision (Renz & Gerke, 2001). In

\(^{13}\) “Sequential” is important here because the case study nonprofits did not always follow this order. Sometimes knowing a lender came before the decision to borrow. My analysis of lender interviews in the next chapter – How do lenders decide to work with nonprofits? – reveals that some local/community banks purposely encourage staff to join boards to identify needy nonprofits that would benefit from loans. They explain they solicit small businesses to get a loan, in order to make profit. With nonprofits, they seemed earnestly interested in acting philanthropically.
sum, the practitioner literature says a nonprofit should not even think about borrowing, unless it meets a long list of best practices. Only with these, can a nonprofit know when it is the best time to borrow.

The next phase – project analysis – builds on this foundation. The practitioner literature tells nonprofits to borrow when it is the right tool for the right job. However, nonprofits are urged to consider whether using internal funds makes more sense, or the nonprofit should not do the job at all. To make this call, the nonprofit must know if a project will pay for itself. Revenue (donations, fee-for-services, etc.) must cover the project’s expenses. This includes repaying the loan and monthly debt service payments, but also any additional expenses (e.g., electricity and sewer bills) and routine maintenance costs (e.g., custodial, and grounds-keeping services). Additionally, a nonprofit should not overlook future up-keep projects, both predictable (e.g., replacing a worn-out roof or flooring) and emergency (e.g., water damage from broken pipes). The practitioner literature also warns that facility-related projects typically go over-budget, so nonprofits must also plan for that. Finally, a nonprofit must know when the project will start paying for itself – when it will get a return on this investment. ¹⁴

¹⁴ Project analysis also requires nonprofits to evaluate the timing of the project and when it will have net positive results. For example, in a net present value (NPV) calculation all future dollar amounts must be discounted to present dollars. Additionally, a nonprofit should know when a project will start paying for itself, which can be years, so that may also influence when a nonprofit borrows. The practitioner literature commonly refers to this type of analysis, although in shorter article and not necessarily by NPV name. In addition to an NPV analysis, the nonprofit must also assess future risks like lower revenues and higher expenses. While I found the material easy to digest now, that was not the case when I was first exposed to in my master’s nonprofit financial management, although we all had learned some basic concepts in prerequisite classes. Similarly, project valuation was a challenge for undergraduate students in a 300-level “public finance for managers” course I taught. In short, the basics of project valuation can take significant time and effort to learn. In smaller nonprofits, without a dedicated finance officer and where the leader wears many hats, learn project valuation could be even more of a challenge.
Only after the foundational and project analysis have been completed, should a nonprofit look for a lender. The practitioner literature does not give this phase nearly as much attention as the other two. It is implied that nonprofits usually do not have many options, but there are a few tips. For example, a nonprofit should already have a relationship with a commercial bank before applying for a loan (e.g., business account) (Romano, 2011), and should have been building its credit rating (Ferraioli, 2012). Economic climate also affects timing. “[Nonprofits] may need money urgently today and are probably unable to borrow it from conventional lenders in today's credit squeeze, but their revenue will increase as the economy recovers, and they will be able to repay loans.” (Bildner & Kramer, 2009).

The next section presents the case study findings, which include far more nonprofit-relevant information about when nonprofits decide to borrow.

**Case study**

The case study data shows two dimensions to when nonprofits decide to borrow. First, some nonprofits have the opportunity to decide about debt, while others must act out of necessity. Generally, the former is not critical to carrying out the organization’s mission while the latter is. Second, some nonprofits have more time to proactively analyze their options and choose the best fit, while others under a time crunch must quickly come to a decision. These two dimensions create a matrix: opportunity <-> necessity and proactive <-> reactive. In this section, I present four examples for each combination of these dimensions

A good example of proactive-opportunity is Fundamentals.\(^{15}\) It had the opportunity to establish an additional location to better serve current and new clients. Proactively, it looked at

\(^{15}\) Also, the reactive getting personal loans thing out of necessity to preserve the organization.
its rent versus buy options. The nonprofit’s leader described the process as long and arduous. It had to complete extensive financial analysis, which required Fundamentals to hire a professional accountant. The whole approval process took about a half a year. In this case, the nonprofit had the opportunity to explore options proactively.

An example of reactive-opportunity is Aspire. Instead of looking for opportunities, opportunities dropped in the lap of Aspire. It decided to borrow when a similarly-missioned nonprofit was forced to close because of financial trouble. It turned to Aspire and offered it “a deal they could not refuse” – some properties that would help expand Aspire’s services. However, to get the properties, Aspire had to act quickly. Unlike Fundamentals, it did not have time to plan, but it did have a prior good relationship with a community-oriented bank, which made the process smooth.

Borrowing may be a necessity, but decision-making can still be proactive, as it was for YouthFirst. To sustain its services, it needed to improve or replace its facilities. Its leader explained that “they had a building that was over a hundred years old and was in trouble with the fire department every week and so they looked into rehab…it was sitting on a double lot.” Proactively, YouthFirst explored its options, and decided to build new, since rehabbing would displace current clients. To fund the project, it planned to rely on major donors and governmental support, but these sources pulled out during the state financial crisis. YouthFirst had to resort to loans, which they had planned to pay off before monthly service payments became too high.

Talking about situations, not the organizations approach.

16 The largest hurdle was finding a lender, since commercial banks refused Fundamentals’ applications, since it was not a small business. It decided when to borrow when it learned a CDFI served the area, even though Fundamentals’ needs were way below the smallest loan available. Although the loan officer chose to help anyway,
They were a “terrible drain on programming,” but “over time what we realized is that you cannot raise money to pay off debt.” Throughout this project, YouthFirst tried to act as proactively as possible for a necessary project.

During Illinois’ financial crisis, other nonprofits struggled. They had to borrow out of necessity without the luxury of proactive planning. For example, ElmGrove strived to pay off its debts, but suffered from lost and delayed revenues. It needed operational loans to cover expenses that were collateralized with organizational assets. “In order to have that mortgage, the prior administration had pretty much put up all of our facilities as collateral… All of our properties were mortgaged to handle that debt.” Even so, it currently is “almost totally maxing out [its line of credit] right now just to make payroll because our accounts receivable is over by nearly a million dollars.” Yet, ElmGrove could not shut down, since it was the sole service provider in the area. Under all these circumstances, ElmGrove acted out of necessity, but because of its financial circumstances, it could only make decisions reactively.

The next section includes a discussion of the empirical, practitioner, and case study findings.

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17 Yet, as LakeSide reported, donors are not eager to pay for more mundane projects like parking lots. Therefore, the nonprofit is caught between a rock and a hard place to finance the project. Unable to raise funds beforehand to pay the project, the nonprofit borrows. But then it is hard to get donations to pay off the loan.

18 In Indiana, GoodShepherd has pushed to persevere under similar circumstances, although without the troubles of the Illinois budget crisis. It took out a mortgage to renovate a donated facility in its early days and assumed the debt on a couple of other facilities later on. But currently, it is acting out of necessity when it makes debt decisions as a reaction to sharp downturns in donative revenue. At RiseHigh, the current director also had to act reactively when they took the position and discovered the nonprofit had so much debt it would likely fail within a few months. Consequently, it had to react quickly to preserve the organization and its area services.
Summary

Timing in capital structure theories is forward-looking – analyzing current data to predict the future, while decision-making theory tries to explain how individuals react to various information. Questions of “When” is more about conditions and prompts for behaviors. Nonprofit finance, without much longitudinal research, does not address “when” but rather mostly looks for relationships between financial measures. The practitioner literature uses different measurements, such as what benchmarks nonprofits must meet before they borrow and being proactive. The case study data shows two dimensions to decision-making timing: proactive vs reactive, and opportunity vs necessity.

The next section takes on the question of “who makes borrowing decisions” as described by the empirical, practitioner, and case study data.

WHO MAKES DECISIONS?

To understand how nonprofits decide to borrow, it is prudent to understand who makes the decision. The decision-makers have substantial influence over how nonprofits decide to borrow. This requires attention to who makes the decision, who implements it, and who manages it. When it comes to substantial or consequential decisions in nonprofits, the underlying concept of governance specifies that the board and staff collaborate and make the decision together; the staff researches and then proposes options, while the board makes on the final decisions. In this section (as before) I compare three sources – empirical, practitioner, and case study data.

Theoretical and empirical

In business capital structure theory, the firm (executives) and investors (owners) make decisions. In static tradeoff theory, investors do not care about what the executives think
(Modigliani & Miller, 1958); the firm makes its decision, and the investors make theirs. In pecking order theory, investor decisions hinge on how they interpret executives’ decisions. Since the executives have insider knowledge about the firm, their decisions signal their opinions about the firm’s health. Agency theory could also explain capital structure. To maximize their personal utility, executives might spend profits on things that do not maximize firm value but increase their own compensation; they might avoid debt, since it can put the firm (and their jobs) at risk. Owners/investors have the power to make a firm borrow, so that monthly debt expenses reduce executive’s discretionary decisions.

Since there is no publicly traded marketplace for nonprofits, nonprofit finance theory often uses donors in place of owners/investors (the former aligns with revenue the latter with assets). The assumption is that donors will not donate to a nonprofit with too much debt. They want their donations to support programs, not debt service payments. If nonprofits with lots of debt are in financial trouble, that risks donors’ returns or “dividends in kind” (Mitchell & Calabrese, 2018; Wedig, 1994). Debt may also clash with donor concepts of “charitableness.” (Denison, 2009; Fama & Jensen, 1983; Mitchell & Calabrese, 2018). In this paradigm, donors call the shots (at least in nonprofits reliant on such revenue).

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19 Investors can use arbitrage to create “homemade leverage” in their personal portfolios. For example, if they think the firm should be using debt more, they use personal loans to finance their stock purchases. In short, tradeoff theory says the investors are the decision-makers and the firm’s choices are irrelevant. The organization’s decisions are not important, other than balancing the benefits of debt (e.g., tax breaks) to costs (deadweight of bankruptcy and agency costs).

20 Say the firm decides to use internal financing for a project; if the firm has enough retained earnings to do that, investors might think it has rosy future prospect, since it can spend money now and not worry about saving for a rainy day. Using debt is also a positive signal; the firm expects a positive return on that investment plus enough to pay off the cost of the debt. Investors, however, are put off when the firm issues new equity (stocks).
Ashley and Faulk (2010) found debt to be a significant factor in foundation grant decisions; however, behavioral research does not support this assumption when it comes to individual donors (Sloan 2008; Szper & Prakash, 2010). Since so much nonprofit finance research focuses on revenues and donor decisions, researchers redesign capital structure theory as influencing donor decisions, which in turn affect nonprofit decisions. In corporate finance, this is akin to studying how a business’s capital structure affects decisions by its customers to buy its product, a topic different from capital structure theory itself.

Unfortunately many nonprofit finance datasets, like the IRS 990, do not include much information on governance and management. Surveys and case studies give us a more direct look at behaviors. For example, the IU Center on Philanthropy (2012) surveyed nonprofits on their financial literacy and knowledge.\(^{21}\) Case studies of arts and culture organizations document the dynamics of board and staff decisions about debt for large facilities projects (Woronkowicz et al., 2012).

In the next section, I present the practitioner literature content analysis.

**Practitioner**

To make a good debt decision, a nonprofit must have the utmost governance, management, and financial capacity, says the practitioner literature. Staff and board members must be highly skilled, committed to working with each other, and dedicated to the organization. To begin with, the executive director should lead the decision-making and see a facilities project through from beginning to end (Jenkins, 2004). “Long before any loan is approved, a financial

\(^{21}\) When they asked respondents about who made financial decisions, 38 percent said they made most decisions without help from others, while 44 percent said they rarely made decisions alone.
institution will most likely assess the character and competency of those persons who are the public face of the organization” (Packer, 2010). These individuals must confidently display their financial skills to impress lenders. (Renz & Gerke, 2001; Semble, 2015) and maintain the relationship with the lenders (Walker et al., 2015). Additionally, the leader should educate the board of directors and keep them in the loop; after all, they hold the fiduciary responsibility for the nonprofit (Klump & Cole, 2016; Walker et al., 2015).

If executive directors do not have a financial background, they must be willing to learn by taking college courses and completing trainings (Semble, 2015; Walker et al., 2015). In addition to a financially knowledgeable director, the nonprofit should have at least a controller or bookkeeper. By giving staff different fiscal roles, nonprofits make more prudent and rational decisions; it creates a system of checks and balances (Packer, 2010; Semble, 2015; Renz & Gerke, 2001).

The practitioner literature also says how the board should make decisions about borrowing. Most importantly, the board must be involved in all major financial decisions, because of their fundamental legal nonprofit duties.22 To focus on particular financial issues, boards can form internal finance, facilities, and project committees to undertake in-depth analysis and make recommendations to the larger board (Packer, 2010; Renz & Gerke, 2001). While ideally they should hire executive directors with financial skills, they must also be

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22 In addition to the executive director and staff, the PL says boards should be involved and approve all major debt decisions. Board members have three fundamental legal duties (as specified under state statutory law). First under the Duty of Care, they must give attention to the nonprofit, such as attending meetings and understanding finances. Second under the Duty of Loyalty, they must act in the nonprofit’s best interests (as opposed to their own). Finally, under the Duty of Obedience, they must ensure the nonprofit follows its mission and comply with all state and federal laws. But realistically, some boards do not know this (Buckhoff et al., 2009; Millensen, 2002).
prepared to offer technical assistance when the director does not have that background (Renz & Gerke, 2001). In the end, the board has the final vote on any debt decision (Renz & Gerke, 2001; Semble, 2015).

Like the top executive, the board is supposed to have a good understanding of nonprofit finance (Renz & Gerke, 2001). The staff has a responsibility educate the board about financial matter, like presenting them the most relevant information so that they can make an informed vote on a project (Nonprofit Assistance Fund (NAF), 2017; Lipman & Williams, 2004). But individual members also have a responsibility. They may have a broader vision for the organization’s future and long-term financial strategies (Semble, 2015). This includes how money connects to mission and how financial decisions can affect nonprofit legitimacy (Renz & Gerke, 2001). Finally, board members can use their personal networks to find lenders, consultants, etc. (Semble, 2015).

Between the board and staff, the practitioner literature emphasizes coordination, such as sharing and allocating responsibilities, defining roles, communication, etc. (DeVane & LaBarbera, 2010; Packer, 2010; Renz & Gerke, 2001; Cumfer, 2014). This includes aligning their goals and visions for the organization, the project, and the decision to borrow (Devane & LaBarbera, 2010; McCambridge, 2016). Establishing policies and procedures helps create a structure and strategy that endures even through staff and board turnover (Packer, 2010).

In addition to board and staff, a nonprofit may have other stakeholders participating in decisions. Some nonprofits assemble specific committees and/or hire consultants and financial advisers to help with debt decisions (Corwley, 2003; Kirschbaum, 2010; Renz & Gerke, 2001). The practitioner literature may emphasize the use of consultants since much of this literature
comes from accounting and consulting firms, who may be looking for new clients. Otherwise, nonprofits can draw on peers and their wider networks for help fill the gap in financial skills and capacity (Renz & Gerke, 2001; Corwley, 2003).

In the next section, I present the case study data’s answer to who decides to borrow in a nonprofit.

**Case study**

When arranging for the interviews, I asked to speak with the person most knowledgeable about the nonprofit’s debt (and finances in general). It is telling that many times it was the executive director, not a financial professional like a CFO. When the executive director gave the interview alone, those organizations did not have a financial officer (ElmGrove did have a staffer that handled financial operations but who did not make financial decisions). In four cases, the executive director and another chief officer (COO or CFO) worked together on financial decisions (Aspire, CareHub, NewDream, and RiseFree). The COO gave the interview for GoodShepherd, and the CFO the interview with LakeSide. In several cases, the most knowledgeable did not necessarily know who made the debt decisions that lead to the organization’s current capital structure.

My sample included smaller human service nonprofits. Almost all participants wore many hats, filling several roles like fund development, managing multiple projects, and providing direct service. This is typical in smaller human service nonprofits which have relatively few staff members. Even when a nonprofit has a sizable staff, it may not have any

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23 See the methodology chapter on sample selection and debt in the nonprofit human services sector.
dedicated to financial tasks, like analyzing the costs and benefits of a major debt decision. Many may have other technical skills, providing direct support to clients or managing programs (e.g., case workers).

As a result, individual leaders can have a lot of sway over nonprofit debt decisions and strategies. For example, CareHub’s leaders explained, “We’re not sure how that decision [about the mortgage] was made prior to us coming on board; we inherited the debt.” They speculated it made sense at the time, since the nonprofit needed a facility in order to deliver programs. Yet, it is not clear why it chose to borrow instead of rent. The current leaders plan to sell the facility to get rid of the mortgage and rent space instead since CareHub’s governmental contract/grants will not pay for mortgages but will cover rent. Because of that, they speculated that past leaders purchased the building, perhaps because the organization relied more on donors then. This explanation, in a way, creates an organizational debt policy (i.e., what revenue sources will cover what occupancy expenses).

At some nonprofits, a new leader ushers in dramatically new tactics about debt decisions, but this may reflect more that particular person, than the role/position. For example, RiseHigh’s current executive director had a much different debt strategy than his predecessor. Before him the nonprofit had relied so heavily on debt that it put the organization in danger. The current leader explained:

I know that before I came on debt was used pretty heavily to take on a lot of different projects. During the recession, [RiseHigh] took out a mortgage on one of our properties for operating purposes, some things like that. Once I came on, we eliminated it through either paying it off, or through either short payoffs or forgiveness.
Under his leadership, RiseHigh has started collaborating with other nonprofits, so it can reduce duplicate services, which in turn reduced the number of facilities (and debt) it needed. Overall, however, it was the director’s individual risk tolerance, debt philosophy, and personal skills/experience/network that brought on this strategic shift.

Similarly, several leaders spoke specifically on how their individual skills and experiences influenced how they made decisions about debt. For example, NewDream’s leaders emphasized their organization was not a charity, but a business. To them charities are inefficiently run organizations that cannot and will not spend wisely. They explained their business backgrounds were essential when they made their debt decisions and accounted for the success of NewDream overall. Additionally, the leaders at BetterTomorrows and RiseFree explained how their business backgrounds helped their nonprofits make good debt decisions. Other nonprofits specifically hired new executive-level directors with strong business backgrounds to resolve debt related problems (Aspire); or they said they would need additional staff with financial skills to be competitive for better grants and loans (Fundamentals).

Leaders also explained how their personal background in finance (or lack thereof) limited their ability to make debt decisions.

RiseFree:
We did not come up going through training, boot camp for Executive Directors, on accounting, and all that kind of stuff. You had a bookkeeper, and you had an external auditor, and you wrote your own grants.

ElmGrove:
[They’ll] promote you up to management where you will do no social work but you’ll be doing budgets and personnel and scheduling and policy and, all of a sudden, you’re in a realm you have not been trained for and I think this is the Achilles’ heel of a lot of organizations…We’re no different than anybody else but we wanted to address that as best we can and give our people some of those tools so that they can become good team members and leaders of teams.
BetterTomorrows:
I grew up within a family business, so I have been around entrepreneurship my whole life. Now some of the dynamics are a bit different in the for-profit world than the nonprofit. A lot of that too is just trying to teach yourself. I ask a lot of questions… Especially within the nonprofit world, [what] you see is that a lot of people with educational background which is not necessarily in a business-oriented background. You may have an individual running a corporation or a nonprofit organization who got a master’s degree in social work.

While personal experiences and skills affect nonprofit debt, reliance on an individual leader can also hamper access to capital. For example, the bank would not lend to Fundamentals, because it worried about consistent leadership:

[The bank] said I was too involved [in the nonprofit]. To them ‘too involved’ [meant] if I died tomorrow (basically in a car accident) would anybody else share my passion and pursue my vision to continue operating things as they are today appropriately? And it is like, well, in fairness to the situation, it is cost-prohibitive in any business to have more than one head person. We cannot compete with that as a small million dollar non-profit.

Access to capital can also depend on a leader’s personal relationships with lenders. At BetterTomorrows, for instance, the leader and their loan officer sit down over lunch to hash-out whether or not debt make sense for a specific project.

According to nonprofit best practices, the board should temper the decision-making power of an individual leader. After all, boards are legally responsible for major nonprofit decisions. Some organizations did have formal decision-making processes that involved both the board and staff. For example, LakeSide’s leader explained that:

[A financial decision] traditionally goes through that two-stage process where I present written material in advance, and I meet face to face with the finance committee. They make recommendations before the full Board. It is almost always that the full Board will approve what the finance committee recommends.
The codification of this policy was new – part of an overall effort to bring the organization in line with the types of best practices advised in the practitioner literature. Some organizations followed this general pattern, but without mentioning specific policy documents.

Overall board involvement in decision-making varied. When I asked leaders if the board could tell me about debt decisions (especially when the executive leader had little information), they explained it would not be fruitful. They argued that just like the staff, board membership turns over. Also, their involvement, time, and knowledge are limited. Board members have other important roles in the community and their own businesses, which limits the time they have left to give the organization (CareHub). Board members attend meetings but do little or no additional work for the nonprofit. At the meetings they are tired after putting in a full day at work beforehand (LakeSide; CareHub). This limits how useful board members are in organizational decisions in general. “In terms of [the board’s] ability to really be able to do anything with it, in terms of addressing the debt, that is not something they really understand well enough to be able to do anything with.”

However, sometimes boards can be too involved, which can lead to problems if the board and staff have conflicting goals. For example, Aspire faced a buy or build decision. The executives wanted to get a building as quickly as possible to support new programs; they researched the market and found some options to purchase property. When they presented the options to the board, the board rejected the proposal, preferring to build a new facility. They wanted to leave a lasting legacy and testament to Aspire’s accomplishments. They wanted “really upscale, fancy, expensive, additions that looked beautiful, but it was just not practical or affordable for a nonprofit our size in our area.” Overall, the board was “overly involved, and
delayed the process, and spent a bunch of money,” tens of thousands of dollars on design. More than a year later, the plan never coalesced. In the end, the board approved a building purchase.

Since then, Aspire has eliminated the board committee that caused the trouble. And instead of getting board approval for buying property, it has defaulted to rent instead since that does not need to be approved. Board turnover helped with this change, as well as cultivating a good board-staff relationship. As Aspire’s leaders explained, “Every Board has had a different personality based on the CEO at the time, and their level of trust in the CEO.”

Board composition is important for other reasons, too. Some nonprofits specifically recruited people with financial skills (e.g., accountants) and connections (e.g., bankers, business leaders). NewDream’s leader explained that these members filled-in the knowledge gaps he had about finance; they helped NewDream make more informed decisions. But a board’s composition does not always lead to better decisions. Take YouthFirst, for example, which had a board with skillsets similar to NewDream’s. Some members opposed certain types of debt for reasons unknown to NewDream’s leader. When YouthFirst had to negotiate with its lenders, some board members with financial backgrounds stepped-up, but others with the same skills did not. Overall, having skilled board members can be a good strategy, but only if they use those skills to aid nonprofit decision-making.

The board and the staff are not the only decision-makers. Donors and their revenue do influence choices. LakeSide borrowed because, “People are not interested in funding parking lots” or other utilitarian projects. To qualify for a loan, NewDream partnered with a former client, who then had substantial pull at the nonprofit. Skyward collaborated with other nonprofits on debt decisions, especially when they planned to share facilities. Often overlooked, lenders also play a role in several cases. This goes beyond an application/approval of financial
transactions. Instead, they collaborated with the nonprofit to help further its mission (See Chapter 4 for details).

Summary

To know how nonprofits decide to borrow, we must understand who makes these choices. Capital structure theory pays little attention to decision-makers. In nonprofit debt research, donors stand out as the major decision-makers, since they control revenue; some case studies illustrate the dynamics between board and staff members. The practitioner literature stresses “best practices,” particularly the normative idea that organizations need formal structures in which board and staff collaborate to make the most rational decision possible. This not only assumes the decision-makers have a financial background, but also that the organization has many individuals with whom to collaborate. The case study data show that individuals play a substantial role in nonprofit borrowing decisions. It is more about individual characteristics - risk tolerance, knowledge, experience, and capacities - than organizational strategy. Because of this, I propose the dimension: organization role <-> individual person. The more the decision-making relies on an individual the more important it is to consider personal characteristics to explain how nonprofit decide to borrow.

In the next section, I address which information nonprofits use to make their borrowing decisions, as described by the empirical, practitioner, and case study data.

WHICH INFORMATION DO THEY USE?

In decision-making theory, information acquisition and processing have a starring role. More information and greater processing capacity means more rational decisions. Information abets not only identifying options and choosing the best option, but it also influences the very beginning stages of decisions, such as identifying problems and establishing goals.
In this section, I analyze which information nonprofits use in their borrowing decisions by comparing the empirical, practitioner, and case study data.

**Theoretical and empirical**

The Modigliani-Miller theorem (1958) assumes a world with “perfect information” - everyone in the market knows all information (prices, personal utility, and cost functions) instantaneously. This allows them to hold the information factor a constant, while they focus specifically on a capital structure model. Business finance scholars can then test the theory by violating its assumptions (Baker & Martin, 2011; Bessler et al., 2011). For instance, pecking order theory assumes there is information asymmetry between investors and firm executives. In both theories, information availability is an important point (Myers & Majluf 1984).

For researchers, information availability is also important, because it is limited. Scholars must rely on periodic financial reports, while investors observe and react to the market in real-time. Scholarly information and investor information is asynchronous (Bessler et al., 2011). To address some of these issues, the market timing hypothesis uses a behavioral framework with current market data, which is controlled by information brokers like stock exchanges (Baker & Wurgler, 2002). In nonprofit research, scholars tend to discuss information in terms of financial transparency and what effects it may have on donor behaviors, specifically how donors react to financial information like debt (e.g., Jegers & Verschueren, 2006; IU Center on Philanthropy, 2012).

Nonprofit studies that specifically test capital structure theories almost universally rely on the IRS as the information broker. The IRS collects various financial information from nonprofits to document tax-exempt status. From this data, the National Center of Charitable
Statistics (NCCS) has published various datasets (e.g., Statistics of Income, Digitized, Core, etc.) that differ in the number of available variables and nonprofit type/size. With these datasets, we have operationalized debt measurements in a variety of ways, each with its own merits. Some examples include:

- Debt-to-assets ratio (Wedig, et al., 1988)
- Whether or not nonprofits use debt (Denison, 2009)
- Sum of long-term financial debt divided by total assets (Yan et al., 2009)
- Nominal categories of bonds, e.g., long-term, short-term (Denison, 2009)
- Total long-term debt, tax-exempt long-term debt, taxable long-term debt, and fixed investment outlays (Wedig et al., 1996)
- Total debt divided by total assets, and financial debt divided by total assets (Jegers, 2011)
- Total liabilities/total assets, and total financial debt/total assets (Calabrese 2011; Calabrese et al., 2012)

These measures largely come from adapting business finance measures to a nonprofit context. As noted before, this has challenges. For example, there is no comparable measure for firm value or external equity.

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24 The data the IRS collects has changed over time.
25 In Chapter 6, I go deeper into the business finance research and find that scholars there also struggle with measurements.
In the next section, I present how the nonprofit practitioner literature answers the question of which information nonprofits use (or should use) to make their borrowing decisions.

**Practitioner**

The practitioner literature focuses on how information can mitigate risk. This includes an in-depth internal financial analysis to assess if the nonprofit is ready to borrow and to evaluate potential projects (as I describe more in “When do nonprofits borrow? on page 118). In contrast to the empirical literature, the practitioner literature is less technical (uses fewer ratios and precise numbers) and more conceptual, likely because their readership includes a wide array of people interested in the nonprofit sector.\(^{26}\) The pieces only include numbers when they emphasize the nonprofit’s financial troubles.

Recommendations with finer financial details come mostly from CDFIs, which only lend to high capacity, professionalized nonprofits (e.g., NFF webchat, *New York Nonprofit Press* 2012; NFF’s Capital Structure Theory Counts 2002). Overall, the practitioner literature shows that a nonprofit has far more data than just what’s included in annual financial statements, such as monthly numbers and revenue forecasts. By incorporating qualitative information, the practitioner literature can speculate how donors may react to a new mortgage, for example.

The practitioner literature says that after a nonprofit finishes an extensive internal financial analysis, it must communicate financial information to the lender. This can be a challenge, since most traditional lenders do not understand nonprofit finance, it argues (Devane

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\(^{26}\) When I taught finance to management students, the first day I would ask them for the words they associate with finance, and then I generated a word cloud. “Boring” always was written large, “useful” appeared little, and “interesting” only once or twice. From this and other professional experiences, I am reasonably confident that finance enthusiasts are in the minority.
& LaBarbera, 2010; Dyjak, 2010). Conventional banks are more familiar with small business lending, so a nonprofit must present financial statements in a way they can understand. Nonprofits are also advised that they must strategize a way to teach lenders the nuances of nonprofit finance (e.g., different types of asset classes) simply and straightforwardly. The practitioner literature implies that traditional lenders mostly care about profits, not the nonprofits mission or a project’s social impacts. CDFI produced practitioner materials argue these problems can be avoided if nonprofits use them as lenders, since they know nonprofits better. Generally, CDFI loan applications look closer to grant applications than those from conventional banks.

In the next section, I present the case study findings about which information a nonprofit uses to make decisions about debt.

Case study

The different definitions of debt are a good clue that nonprofits may use information differently than described in the empirical and practitioner literature. Some nonprofits with large liabilities on their balance sheets said they did not have debt. While some said they used a lot of debt, none really spoke about a target capital structure. In the cases when they mentioned a target capital structure, it was zero; but barring some “angel donor,” they had to use loans to further their operations and mission.

The numbers they did mention – number and amount of loans, the necessary amount of revenue to pay them off, etc. – reflected the specific challenges they faced, the numbers most important to them. This poses a problem for researchers since we do not have access to this information as I discovered when I compared my pre and post interview data. Before interviews,
I used publicly available information (e.g., IRS 990 data and information from news, websites, etc.) to complete a financial analysis according to the empirical and practitioner literature. My findings did not match how the leaders thought about debt in their organizations. My conclusions were wrong from their perspective.

The reason for this discrepancy has to do with purpose of the information used. The IRS data are public, i.e., intended for audiences outside the organization (e.g., grantors, donors, government, etc.). However, Fundamentals made decisions based on internal information; it paid for an audited financial statement only because the lender required it. Internal and public information can tell different stories. YouthFirst explained, “On paper we looked awesome. But our point was in a nanosecond this can go belly up,” because the statements do not capture difficulties they had with their lender, their delayed revenues, and other financial threats to its financial viability. In my analysis of 990 data, they did show signs of financial vulnerability, but not exactly for the same reasons. For example, the IRS 990 data gave me no information about their fight with the lender or the problems with government revenue, which were YouthFirst’s major problems.

In addition, the case study data show that much vital information about debt can get lost or confused when nonprofits adhere to FASB standards. For example, RiseFree was not immediately familiar with the long-term liabilities I was referencing. The leaders explained, “We do need some debt, but not too much,” because the state government reimburses approved facilities and equipment purchases. The debt that came to mind was a revolving loan that was only a few thousand dollars. This contrasted with the sizable long-term liabilities reported in the IRS 990. Subsequent discussion revealed that those liabilities belonged to a separate organization. They emphasized, “They are separate. That mortgage is their mortgage; it is not us.
It is [theirs].” That nonprofit has its own operations, staff and board. Even so, FASB\textsuperscript{27} requires that both appear in financial statements, because of their close financial ties. It is a reminder that accounting rules aim to standardize financial reporting (external communication), which does not necessarily align with internal financial management or structures.\textsuperscript{28}

My conversation with LakeSide’s CFO further illustrates the point. In the first half of the interview, he talked about analyzing financial statements, but then he changed gears. “Cash is king,” he said. Staying in the black each month matters more than financial statement numbers, when he thinks about debt. He had talked about financial statement analysis, because of the new best practice policies and procedures that LakeSide instituted over the last couple of years. But when it got down to brass tacks, the most important information came from monthly financial management – making sure LakeSide could pay its bills on time.

“Paying the bills” emphasizes the importance of revenue/expenses and cash flow information. The practitioner literature does warn that nonprofits put themselves at risk if they cannot repay debt, but the case study data gives us a different angle. True, some leaders worried about ever being able to repay debts, but they largely addressed how debt service payments steal from more essential expenses.\textsuperscript{29} For example, GoodShepherd struggles to give employees

\textsuperscript{27} FASB or the Financial Accounting Standards Board sets the standards for generally accepted accounting principles in the United States.

\textsuperscript{28} This situation between two organizations is not unusual. Some may work closely together and others not as much. Therefore, the financial statement numbers might not represent the information they use when making the decision to borrow, although it might appear in the financial statement notes. Since the IRS 990 datasets only ask for a few financial figures, much gets lost in translation. Researchers have tested the accuracy of IRS 990, but largely in accounting terms (e.g., numbers matching up). They have not compared numbers against behaviors, like how nonprofits use this information. Instead, most scholars rely on the practitioner-oriented literature’s advice about best practices.

\textsuperscript{29} Charles (2018) found that annual interest expense ratios (not debt-to-asset ratios) has a
competitive salaries and benefits, which means it cannot fill positions with the “best employees” to get the “best results.” Without debt service payments, it would have more options. ElmGrove, too, worried it would have to ask staff to go without pay to make its debt service payments. When YouthFirst had to make a choice between paying the bank and covering its program expenses, it chose the latter; when it did, the lender swept the funds in its operating bank account. “The health accounts, they swept those, which is illegal. That is the employees’ money.” The case study data reminds us that financial numbers are just artifacts of larger behaviors, goals, circumstances, and decisions.

Nonprofit leaders also discussed revenue streams. For some, this converts to the availability of revenue sources. When asked about debt, GoodShepherd talked extensively about how its donor base has aged and dwindles over the years and how harsh local economic conditions mean there are fewer people with the financial means to donate. The leader always returned to one specific financial figure: the additional revenue and number of donors needed to pay off the total loan amount. At Plowshares both its debt and limited revenues, the leader explained, were evidence the community did not support the nonprofit. Nonprofits like CareHub and NewDream had “no debt,” because they had enough revenue to easily make debt service payments. The latter structured their fee-for-service model so that clients paid months in advance, providing the organization with funds to cover future expenses.

Cash flow information also figures prominently. Nonprofits that rely on government reimbursements must accrue expenses before receiving revenues. Sometimes the gap between

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statistically significant effect on future donations to arts organizations. My analysis found that nonprofit leaders thought about debt in terms of monthly debt service payments (which include interest expenses).
outlays and reimbursements can be weeks or months. To have the cash to pay monthly bills (cash outflows), nonprofits use short-term operating loans (cash inflows), which it then pays back (outflows), when government checks arrive (inflows). This system works until the government stops reimbursements. In both Illinois and Indiana, several nonprofits also watched the government closely to predict political shifts (Grønbjerg, 1993).

Nonprofits that had closer relationships with their lenders had more options for loans and had an easier time getting them. This closeness means nonprofits could communicate complex information (e.g., social impacts on the community) that would not show up in most loan applications; furthermore, they could cultivate a sense of shared mission (it sounded closer to a grantor-grantee relationship than a loan transaction). Some nonprofits explained this style of communication helped lenders understand when nonprofits struggled to make debt service payments. It also led to some lenders making long-term operating loans even though it was doubtful those would be repaid. Some also forgave loans. In both cases, the data indicate that the lenders forwent profits in order to help the nonprofit keep going (GoodShepherd, ElmGrove).  

Being in small, tight knit communities fostered this approach. Larger, more regional banks in bigger cities appeared to disregard such information (in YouthFirst’s case), preferring instead to only look at the financial numbers that ensured their profits. Neither Fundamentals nor NewDream fit the standard financial benchmarks their lenders used. In these cases, they received loans because quantitative information drove the relationships, fostering trust while still

30 Side note: On the IRS 990 Forms, long term collateralized operations loans may look instead like mortgages. Both are backed by assets, but they are used quite differently. It is like a home mortgage versus a home equity line of credit (HELOC).

31 I suspect these large banks had institutionalized strict policies and standard procedures for evaluating whether or not an organization (business or nonprofit) qualifies for a loan. In the next chapter on lenders, I do find that loan officers at community banks have much more leeway and that the community bank culture is quite different from that in large banks.
taking the lender’s profit motivations into account. For example, RiseFree and the lender collaborated on how to resolve a debt problem:

The way we were able to talk our bank into working with us is because we were straight up open, one hundred percent honest and virtually 100% everything we told them we would do we did and reported on it. We would not be in existence had the bank not been able to work with us. … I think the community mindedness let them to be willing to work with us, I can assure you they never lost money on us. You know without their generosity we would not have been able to do what we did but on the other hand they never lost a penny.

The loan officers knew the nonprofit well and visited frequently to make sure both parties understood each other. When RiseFree considered other lenders, it came back to this one because of the trust and report between them. However, it takes time to find and establish these relationships. NewDream noted that the days of handshake loans and trust between businessmen is gone; now it is all just about the numbers. The leaders then decided to contact a local, minority owned and operated lender. Instead of just going through the standard application process, the leaders invited the president to tour the facility, meet the clients, and see the work they do. On this basis only and before seeing the numbers, the president decided the bank would give NewDream a loan. Nearly the entire decision-making process relied on communicating soft information about shared values and goal.

BetterTomorrows and its lender collaborated closely on possible projects at a more interpersonal than interorganizational level. They considered community needs. Because of limited facilities, BetterTomorrows had to waitlist clients, who would sometimes die or end up in jail before they can receive services. While the state had started funding more services, thus providing additional revenue, but this could dry-up if the administration changes or another crisis
catches public attention. Conveying such complex information, required conversations. The leader would call the loan officer and say:

You want to go have lunch? We have lunch, we sit down, and I throw out: Hey! Listen this is what I am thinking. Does this sound like something that is feasible? They look at our relationship in the past…I talk about income projections. It is just a pretty informal discussion. That is one thing I appreciate about it. We sit down over lunch and just talk about what the vision is. We’re in a smaller community so the people that are on our board also have a relation with the individuals that work at the bank.

But this close interpersonal approach has its drawbacks. When people leave an organization, relationships change, and institutional information is lost. As I noted previously, several leaders were not sure about the decisions that lead to the nonprofit is debt. Informal agreements are lost. Skyward faced such a situation where there was a “gentleman’s agreement” that the lender would forgive the loan. “[With] changes in the administration, changes in city council, and changes in staff - There was nothing written down,” so Skyward was surprised when the lender asked them to repay it.

Over many years, we’ve had agreements with the city that were not in writing that came back to bite us really, really badly; so, everything gets put in writing just so it is clear. It is not because of a lack of trust. Everybody wants to know exactly what their role is and exactly what they should expect of other people. The best way to do that is to put it in writing.

Skyward recovered from its debt, precisely because the new leader cultivated relationships with other nonprofits – sharing information about the community and how to fix problems collaboratively. “It starts with the idea that we’re not going to be able to fix it on our own.”

Of all the information nonprofits used when they decided to borrow, community needs stood out. Because of community need, some organizations persist even during financial stress,
because the community needs their services. When I talked with CareHub they told me I did not understand borrowing decisions at all, when I use financial terminology.\textsuperscript{32}

If there is something that is detrimental to a community and a start-up program is going to have a significant impact and improve these problems, you’re going see a nonprofit is more likely to take on debt. They know their entire impact is going be well worth it even though they may not get a return or see that return in ten or fifteen years. It is really based on very much your community need and that is why these community needs assessments are so critical.

\textbf{Summary}

Nonprofit empirical finance mostly looks for the relationships among financial measures to interpret the IRS 990 data – measures borrowed and adapted to the nonprofit sector. Corporate capital structure theory aims to predict future firm value based on how investors respond to financial measurements like debt-to-equity ratios. This is different than a descriptive theory that tries to see what information influences decision-making behaviors. When scholars use financial datasets like the IRS 990, they (consciously or unconsciously) draw from the practitioner literature. Not limited to the annual data recorded in the IRS 990, the latter explains information and measurements more in terms of broader concepts than actual mathematical calculations. It also dives into analyzing more managerial and governance information, such as board/staff relationships. Overall, though, the thrust is using information to reduce debt risk.

Nonprofit managers did not adhere to these financial best practices. They drew on a variety of financial information, monthly expenses and cash flows being the most mentioned. It is not the expenses themselves, but rather how these eat into programmatic and core administrative spending. It is a question of financial management as a whole, not just financial

\textsuperscript{32} The example I gave was someone who used loans for college in order to earn a higher salary.
analysis. These measures are so important that in some cases they define what “debt” is – i.e., being in the red. Furthermore, these leaders described the importance of communicating more qualitative information through close relationships with their lenders. That way the lenders did not have to rely on just business-like financial analysis. They instead could more intimately understand nonprofit finance and more over the organization’s mission and purpose. This reminds me of communication in fund development; yes, numbers matter, but moreover teaching donors about the nonprofit is mission, vision, and purpose.

The next section includes a brief discussion for this entire chapter.

**DISCUSSION**

In this chapter, I seek to answer the question: How do nonprofits decide to borrow? I break this question down into the following components: 1) What is debt? 2) When do nonprofits borrow? 3) Who makes the decisions? 4) And which information do they use? To answer these questions, I compare three sets of information: 1) business finance theories and their application in nonprofit finance research, 2) the practitioner literature that informs the people working in the field, 3) and nonprofit case study data. I purposely selected these nonprofits that were small/medium size human service nonprofits with sizeable amounts of debt. Based on empirical and practitioner information, I assumed these organizations would be struggling with debt or at least be acutely aware of the decisions that lead to it.

First, capital structure theory clearly is a predictive economic theory. It fundamentally cannot test organizational behaviors like decision-making. This holds particularly true for nonprofits, since my findings in the practitioner and case study data demonstrate that nonprofits conceptualize debt differently. Rather than classical economic theories that stress rational
decision-making, behavioral finance with descriptive theories addressing risk aversion, logical biases, heuristics, representative bias are more useful.

I had hoped a particular decision-making theory (like political, garbage can, or contingency) would appear out of the case study data – an alternative to the rational decision-making assumptions. Instead, the case study analysis showed evidence that many different theories could fit – political, contingency, etc. Furthermore, individuals have substantial power over decisions in smaller organizations. Instead of organizational characteristics, personal characteristics (e.g., tenure, education, experience, and individual risk tolerance) may matter much more than we suspect. Business finance research has found this to be true, even though nonprofit finance does not reference these studies. I speak more about this in Chapter 6.

Second, we see the difference between accounting and behavioral definitions of debt. The empirical literature uses measurements like capital structure which do not appear in the practitioner literature. The latter focuses more on loan amounts. Capital structure is an organizational financial strategy that targets the particular debt-to-equity ratio that could maximize firm values. In contrast the nonprofit practitioner literature approaches debt more broadly. Done well, it views debit as one of the crowning jewels for nonprofit professionalism, since it requires high financial, management, and governance capacities.

The case study data demonstrates how finance exists and operates within the organization itself. What numbers and calculations matter the most depend on the circumstances. Debt is not always a synonym for liabilities and monthly payments often matter much more. This presents a scholarly challenge, because what nonprofits look like on paper does not necessarily reflect their financial behaviors or situations.
Third and finally, finance often relies on numerical data. Measurements and ratios certainly do matter in financial decisions – How could they not? – but more qualitative information also has a role. Financial measures reported on paper can be lost in translation between a nonprofit and its lender. Cultivating relationships and trust overcomes this obstacle. The nonprofit can communicate its mission and its role in the community to show the loan’s potential impacts, not just the profit the bank can gain from interest payments. In these relationships, some nonprofits and lenders may collaborate closely, rather than a formal apply-review-accept process. Others are unable to establish such a relationship.


CHAPTER 4: HOW DO LENDERS DECIDE TO WORK WITH NONPROFITS?

INTRODUCTION

Over the past couple of decades, nonprofit finance scholars have tried to answer the “capital structure puzzle” – how nonprofits make decisions about debt. The lack of dedicated nonprofit finance theory has been a primary challenge (see Chapter 1). Most research on nonprofit debt uses capital structure theories from business finance – theories that predict the relationship between financial ratios and firm market value. Nonprofit scholars have run into many challenges adapting these theories to the nonprofit context, where there are neither public markets nor owner/investors (among other differences).

Prediction, however, does little to tell us about behaviors. In the previous chapter, I answered the question, “How do nonprofits decide to borrow?” I used qualitative methods to analyze practitioner-oriented literature (telling nonprofits how they should decide to borrow) and case study data (how nonprofit leaders explain their decision-making). I found that the nonprofit PL placed a heavy emphasis on how nonprofits should apply for loans, that they should expect it to be challenging, since lenders work mostly with small businesses and will not have the time/interest to learn about how nonprofit finance. Or that lenders will judge nonprofit applicants by small business loan rubrics.

The case study data, however, showed much greater diversity. In some cases, lenders went out of their way to collaborate with nonprofits, in other cases relationships seemed intractable. Lenders obviously play a significant role in how nonprofits borrow. The lender decides whether or not a nonprofit can borrow and how much. Having zero liabilities in the IRS
990 data may tell us nothing about whether that nonprofit chose not to use debt; rather, it could be lenders declined their loan applications.¹

But how do lenders decide to work with nonprofits? To understand this question, we must turn to explanatory theories; they tell us why and how a certain phenomenon exists, and they include decision-making and other organizational behavior (see Chapter 1). As in the previous chapter, I seek to document these decision-making processes, but here from the lender perspective.

My empirical data include content analysis of practitioner literature (PL) pieces that target professionals in the field including trade journals (e.g., *American Banker*, *The Risk Management Association (RMA) Journal*, and *The American Banking Association (ABA) Journal*), presentations, blog posts, and other sources. Additionally, this dataset includes what I learned and observed in a Risk Management Association certification course for nonprofit lending.² Overall, the practitioner materials tell loan officers and lenders how they should work with nonprofit organizations.

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¹ Indeed, that is often the case for small businesses. The Federal Reserve Bank (2019) found that 70% of small employer firms have outstanding debt, with 68% owing less than $100,000. In the same year, 43% applied for financing and only 9% were refused by lenders. Capital structure theories are designed for publicly traded firms, not privately owned ones.

² The Risk Management Association (RMA) is a professional membership association for the lending services industry (https://www.rmahq.org/who-we-are/). A summary of the Lending to Non-Profit Organizations course can be found in the RMA course catalogue - https://www.rmahq.org/MeetingDetail.aspx?productId=687880574. The course is designed for lenders with little to no nonprofit background. At the end of the course, attendees should know: the key nonprofit sector characteristics, key nonprofit accounting concepts, using nonprofit-specific ratios to assess financial conditions, and identify credit needs.
Also like the previous chapter, I compare this practitioner-oriented information to interviews I had with lenders that work with nonprofits. However, unlike the nonprofit borrower interviews (where leaders talked about their current lending institution), the lenders sometimes described their organizational approach, but more often spoke about their personal careers at many different institutions (e.g., a loan officer who worked for community and regional banks, as well as a Community Development Financial Institution (CDFI) over their career) (see Chapter 2).

Several themes recur though the data: how lenders define nonprofits, how lenders perceive themselves, and finally how they make a loan (i.e., what information is most important, how they collect it, etc.). I present the findings for each in turn. The next section addresses how they define/perceive/characterize nonprofit borrowers.

**WHAT IS A NONPROFIT BORROWER?**

In my analysis, I observed differences between how the PL and the interview participants characterized nonprofits. For example, few mentioned large, fee-for-service nonprofits like hospitals and universities. Instead, they generally describe nonprofits as: reliant on donations or government funds, less professionalized, and smaller. Most often lenders talk about human service charities. The data indicate that how lenders define and characterize nonprofits influences how they lend to them. As with the nonprofit PL data, the lender data shows that lenders use definitions useful for their work. In this section, I present my findings on PL perspectives first, followed by interviews with lenders.
Practitioner literature

Overwhelmingly, the lender PL described nonprofits in terms of risk forecasting, management, and reduction. For example, Fox (2006) explains that “truly knowing our customers – this is the simple most important thing we can do to grow and protect our businesses.” The titles of practitioner pieces include phrases such as “safely” lending to nonprofits and “demystifying” nonprofits (Swift, 2014; Shepherd, 2015). Many pieces elaborate on risks, by comparing and contrasting nonprofits to small businesses, on the assumption that the reader knows little about the nonprofit sector but is familiar with small businesses. Risk includes anything unfamiliar – finances, governance, market, etc. Additional knowledge is necessary in order to know assess and reduce risk.

To do so, the PL defines nonprofits in terms of their financial measurements and structure – i.e., the numbers. Instead of normal business income, nonprofits rely on donative and governmental revenue (e.g., grants, contracts, major and minor donors). Only a very few authors mention that nearly half (48 percent) of all public charity revenue comes from fees for goods and services from private sources (McKeever et al., 2016). The RMA training manual does mention fees, but still heavily focuses on donations. Most likely donative revenue dominates nonprofit descriptions because it is alien – so different from more familiar small businesses revenue, and thus a source of risk if lenders misunderstand it. Nonprofits have unreliable donative and

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3 This refers to the financial definition of risk, not high/low risk clients. Financial risk is the chance that what you will not earn what you expected on an investment – usually in terms of losing your investment. It is based on historical trends; increased risk can be quantified as wider standard deviations. Rationally, investors should be interested in reducing risk as much as possible to avoid losses.

4 Another 25 percent of all nonprofit sector revenue comes from fee for services and goods from government sources. Only 13 percent comes from private contributes and 8 percent from government grants (McKeever et al., 2016).
governmental revenue, Biery (2016) explains. While this might be accurate, to a banker this is a huge red flag.\(^5\) In the lender PL, revenue that appears to be unreliable or irregular means nonprofits are more likely to struggle with debt service payments.

In addition to the oddness of nonprofit revenue, the PL also characterizes nonprofits in terms of their assets. It urges lenders to not assume nonprofit all assets can be realized, as can business assets. Only unrestricted net assets can be freely spent. In comparison, temporarily restricted net assets can only be spent on specific items/projects or at certain times, and permanently restricted assets (a.k.a. endowments) can never be spent (Taylor, 1994). Furthermore, in contrast to businesses, “nonprofits use fund accounting financial statements to show how money is spent to carry out their mission, instead of how much money was earned” (Whitlock, 2015). To a lender's surprise, it might find that assets [e.g., designated funds, endowments, and other trust assets] held by not-for-profits are not private corporate property, but rather constructive or implied charitable trusts for the benefit of the stated non-profit mission” (Biery, 2016). In terms of reducing risk, nonprofits and their lenders cannot use these “special” assets as collateral. In short, the lender PL emphasizes the unusual financial structures of nonprofits and associated risks.

In addition to these financial risks, the PL defines nonprofits as having missions and motivations different from businesses (Benoit, 2011; Quinn et al., 2006; Sheppard, 2015; Streeter, 2014). For example Biery (2006) explains:

Generally, for-profit entities have the goal of maximizing profits for the benefit of their shareholders. Not-for-profit entities have no shareholders—instead they

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\(^5\) That is not to say business do not have lumpy income, but that income may be reliably lumpy. For example, the holiday season is when they make their most sales year after year.
operate with a goal of fulfilling their stated mission. Such a fundamental difference in purpose provides a vastly different landscape for lenders, and certain expectations that lenders bring with them from the for-profit context need to be closely examined when engaging in not-for-profit lending.

To lenders, the primacy of mission and lack of ownership means they cannot hold any one person accountable for the loan like they can with small business owners (Benoit, 2011; Biery, 2016). Board members and staff come and go, but they are not owners, who by definition have strong financial ties to their businesses (Swift, 2015; Walsh, 2005; Kelley, 2011). To the lender PL perspective, the fact that nonprofits do not prioritize their finances is a red flag.

The lender PL literature points to inherent tensions between nonprofit missions and finances – the money versus mission balance (Benoit, 2011; Walsh, 2015; Fogel, 2010; Johnson, 2015). Authors explain that nonprofits are so incredibly dedicated to their missions that they neglect their finances – e.g., financial statements, attention to revenue, paying employment tax, etc. The PL emphasizes that nonprofits are riskier since they rarely prioritize securing revenue to pay back loans and instead focus on revenues to keep their programs going. In many respects, the lender PL (and the RMA) exemplifies a stereotype of nonprofits as “philanthropic amateurs”6 – small, charitable, and lacking professionalism. However, the examples and exercises presented in the literature are drawn from larger nonprofits, such as universities.

In addition to pointing to the importance of unusual finances and missions, the authors also define nonprofits by their service to communities. They explain banks cannot easily foreclose on properties without damaging community relations and upsetting both current and future clients. These community needs notably include schools, arts organizations, and churches.

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6 See Salamon (1987) and Smith and Grønbjerg (2006) for a further explanation of the term “philanthropic amateurism”
Authors use the terms “nonprofit” and “charity” interchangeably, indicating their definition of nonprofits only includes 501(c)(3) organizations. The PNC Bank’s presentation explains that “Assuming it serves primarily low- or moderate-income people, the NPO may focus on arts and culture, physical neighborhood revitalization, social services, child or elder care, education, health care, CDFIs, (or) faith-based activities” (Neiderberger, 2008).

Some pieces divide nonprofits into different categories, developing a nonprofit taxonomy. Not surprisingly, the authors propose a classification system most relevant to lenders. For example, the RMA certification course divided nonprofits into three groups: 1) Private colleges, schools, and universities, 2) Churches, and 3) Charities, professional membership associations, and civic organizations (e.g., orchestras – their example, not mine) that make “charity loan” requests. The nonprofit sector taxonomy aligns with the first category (educational organization) and the second (religious organizations). The third category, however, includes a wide variety of different nonprofits that nonprofit scholars distinguish among. It also confounds the IRS classification system, which considers educational, religious, and arts organizations (like orchestras) all as 501(c)(3) charities (along with many other types of services), different from professional membership organizations that are usually classified under 501(c)(6).

It is curious that the RMA presents the IRS classification tables at the start of the training, but then ignores it. Why? The explanation may be related to the distinctive financial structure of nonprofits. Each of the three types of groups used by the RMA has specific financial and other characteristics. For example, the RMA explains the risks are different if you lend to independent

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7 The lengthier RMA training materials do include a chart of the different 501(c) organizations, but the class glosses over it in under a minute; other than that, the training exclusively looks at 501(c)(3)s.
versus denominational churches. To calculate risk, lenders should use special ratios that include congregant numbers. In the case of educational organizations, ratios should include student acceptance and graduation rates. When taken from this perspective, the third category may not be a hodgepodge. Rather the RMA considers them to have similar risk-related issues (e.g., relying on donations or membership fees to repay loans). Lenders primarily care about whether or not a nonprofit borrower can repay the loan, so it is not surprising the classify nonprofits on the basis of criteria that are meaningful to them.

In the next section, I present my observations and analysis of interview data as it pertains to the definition of nonprofit organizations from the lender perspective. The loan officers and lending leaders also compare nonprofits to businesses but place a much larger emphasis on nonprofit community roles than financial characterizations.

**Case studies**

Banks (traditional lenders) and the nonprofit lenders (CDFIs and credit unions) had different perspectives, expectations, and definitions of nonprofit borrowers. At the beginning of

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8 In Chapter 5, I propose that the Community Reinvestment Act (CRA) influences lender definitions of nonprofits, too. To receive their CRA credit lenders can lend to nonprofits, working in low- to middle-income communities, within the lender’s geographic “footprint,” and offering CRA approved activities. These activities are usually charitable (e.g., computer literacy training).

9 That is not to say nonprofit scholarship has the best taxonomy method. Hall (2006, p 32) explains, “the terms nonprofit sector and nonprofit organizations are neologisms.” The IRS uses this definition, because to receive a tax exemption, nonprofits cannot have private inurement or owners. It is a convenient term but does not really capture the essence of the sector – volunteerism and collaboration. For example, at one ARNOVA (Association for Research on Nonprofit Organizations and Voluntary Action) conference session, the speaker passionately spoke about how participants have forgotten the “voluntary action” component and just look at incorporated and registered nonprofits. Furthermore, there is the dark and “grey matter” of the nonprofit universe (Smith, 1997; Grønbjerg & Pollak, 2010) found that only 23 percent of Indiana nonprofits appear both in IRS and state government registries. Nevertheless researchers (including me) rely heavily on IRS registries.
my research, I expected the nonprofit lenders to emphasize the differences between for-profit and nonprofit borrowers. But at the credit union, they (a manager and loan officer) did not. They explained nonprofits as just another type of specialized industry. For example, they argued, loan officers must have specific skills for working with the restaurant industry; nonprofits are no different. They said nonprofits and small businesses face similar challenges (e.g., leadership structure, financial skill capacity, providing budgets, etc.). Just like nonprofits, small businesses have missions other than just making profit.10

The CDFI participants shared this view: that both nonprofits and businesses share the same challenges, like limited resources, broken business models, overspending, fragile revenue structures, etc. But they also explain that nonprofits have additional challenges: revenue constraints, negotiating government contracts, not being in control of their prices, operating at the margin, etc. To them, a big problem is that nonprofits do not believe they can be professional or be high-capacity organizations. Nonprofit leaders are “incredibly smart, talented people” capable of learning these things, whether they started off as a “social worker or a choreographer, or a licensed principal.” But if they do not learn to be more financially-savvy, they can end-up with bank loans that can hurt the organization.11

10 Several small business owners I personally know want to draw a salary but are consumed by the passion for their work whether that be appliance repair, running food carts, or architecture. Moreover, the entrepreneurial business research shows empirically that small business owners have many goals in addition to “maximizing profits.” I develop these themes further in the conclusion.

11 An expert gave this example: A temporary housing nonprofit got a bank loan to construct an additional building. The loan covenants prohibited it from borrowing any more until that loan was paid off. The nonprofit did not pay much attention to the covenants until it had a federal grant opportunity. The grant would bring considerable revenue; but it would need an additional building. The revenue would far exceed the costs, making the nonprofit in a better position to cover its expenses – including any expenses allocated to paying off a new loan. It could pay off the old loan even faster. Even though the benefit-cost valuation was a net positive, the bank
The CDFI participants also explained that nonprofits have more “moral hang-ups” about debt than businesses - e.g., is it ethical to keep a rainy-day fund if you could spend that money feeding more hungry children? This is an example of the “break even culture” that limits a nonprofit’s financial options, the participants explained. Some nonprofits will not use lines-of-credit, because they think it “shameful,” according to the participants. “Businesspeople on boards and even government people on boards, who use debt all the time, somehow [think], it is different than if a non-profit uses credit to manage their business.” One CDFI explained that when nonprofits do not borrow, they miss out on opportunities to further their missions. In total, CDFI’s believe nonprofits can be just as professional as any business, that they are full of potential and can make good clients, but certain barriers (logistical and ideological) standing in their way.

In contrast, for-profit lenders appeared to adopt the small/charitable/unprofessional nonprofit stereotype, although they also shared some similarities with the CDFI perspective. For example, one lender explained the difference between nonprofit and business revenue. They “are not in the business of making widgets” – i.e., they cannot increase their revenue just by increasing production; instead, they have to rely on donations and government funds. Also, one bank vice president explained that nonprofits tend to be risk adverse, not borrowing even if it would further the mission.

enforced the “no new debt” covenant. In the end, the nonprofit found a CDFI, which understood the grant opportunity and worked to take over the loan. In this account, CDFIs exist, in part, because nonprofits do not have the skills to deal with banks. The CDFI does not just make loans; it teaches nonprofits how to manage those loans. I discuss this sort of CDFI intervention and lender niches in the next chapter on nonprofit capital market ecology.
But unlike CDFIs and credit unions, the for-profit lenders\textsuperscript{12} did not expect nonprofits to be professionalized. Their attitude seems to be that nonprofits can grow their financial/management/governance capacity, but that is not a prerequisite to getting a loan. In part, lenders explain that nonprofits serve the (both the nonprofit and the lender’s) community. Lenders also had personal connections with nonprofit leaders. For example, some bank members sit on nonprofit boards, executive directors, and loan officers play golf together, or their kids play on the same soccer team. Because of these personal connections, a nonprofit loan is not just a transaction between two organizations, but an investment in the lender’s personal community. One lender explained that some banks loans and corporate sponsorships are tightly coupled – both methods for supporting nonprofits.\textsuperscript{13} Overall, it appears the for-profit lenders define nonprofits in terms of their service to the community.

In the interviews, lenders did not really describe a taxonomy like the PL. Overall, the credit union’s characterization of nonprofits most likely comes from their experience working with a variety of nonprofit organizations – both large and small across various industries – across the state.

**Summary**

The analysis shows that a lender’s decision about making loans to nonprofits depends on how it defines nonprofits.\textsuperscript{14} The PL lenders see nonprofits through the lens of financial risk and most commonly characterize nonprofit finances as strange, and staff as having fewer skills. The

\textsuperscript{12} Some lenders had worked at both for-profits and CDFIs. For simplicity, when they talk about their for-profit experiences, I refer to them as for-profit lenders.

\textsuperscript{13} In the conclusion, I discuss how lending to nonprofits has philanthropic themes.

\textsuperscript{14} Below, I present my findings on how this interacts with how lenders define themselves and finally how they make loans.
interviews give a more nuanced definition. The CDFIs and credit union had high expectations of nonprofits. They view nonprofits as financially capable as businesses, but their ethics and misplaced priorities hold them back. The for-profit lenders defined nonprofits as essential members of their shared communities; lending to them benefits everyone. These for-profit lenders mostly came from community banks\textsuperscript{15} and their attitudes toward nonprofit lending is shaped by the bank’s market region. When it just serves the local community, it has a tighter, more personal bond with the nonprofit.

**WHO IS THE LENDER?**

Lender decisions about making loans to nonprofits also depend on how they see themselves\textsuperscript{16} In the PL and case study data, I observed two primary dimensions that answer the question, “Who the lender?” The first dimension is organizational <-> individual, and the second is transactional <-> philanthropic.

**Practitioner literature**

In the lender PL, it is often unclear if the lender is an individual or an institution. Perhaps the authors intend to speak to a wide audience of lending professionals, including managers and owners. In the pieces that do make a clear distinction, the authors explain how the loan officer must remember their obligation to serve their own institution (Swift, 2014; 2015). For example, “Do not confuse charitable support and your fiduciary responsibility to the bank” (Swift, 2014).\textsuperscript{17}

\textsuperscript{15} In Chapter 5, I discuss how community banks specialize in relationship-based lending compared to commercial banks.

\textsuperscript{16} Reciprocally, their decisions shape their “lender identity.” In Chapter 6, I analyze these observations in terms of sensemaking theories, namely how decision-making defines organizational identity.

\textsuperscript{17} In the RMA course, I asked a couple of the loan officers about their fiduciary responsibility to the bank. They explained it is something said all the time but does not really make a difference.
One author wrote a horror story about a loan officer who did not keep his bank in the loop, and the disaster that followed. If he had only talked with his superiors, the argument was, he would have known how to properly assess the nonprofit is creditworthiness and the loan would not have failed (Sheppard, 2015).

To ensure bank staff do not deviate from the bank’s general polices, the PL advises lenders to codify nonprofit lending policies.\(^{18}\) They should “follow sound procedures and collaborate professionally with community nonprofits” instead of relying on individual loan officer skills and preferences (Benoit, 2011). This includes standardized underwriting procedures and only working with nonprofits in line with the lender’s charitable preferences and strategy. This also ensures there is no personal preferential treatment to some kind of nonprofits instead of others – e.g., lending to one denomination of church instead of another – that could create public relation problems (RMA manual; Biery, 2016; Sheppard, 2015). Standardized systems also reduce the amount of specialized learning and attention lenders must give their unusual nonprofit clients (RMA training).\(^{19}\)

Additionally, lenders are portrayed as conservative and risk adverse. This goes beyond assessing nonprofit finances, organizational structures, and future plans. They are also watchdogs (RMA training) and have a responsibility to watch out and report for profits “that cloak themselves in a nonprofit name” (Fox, 2006). They must keep an eye out for financial malfeasance and fraud, including everything from embezzlement to supporting terrorist

\(^{18}\) I.e., avoiding principal-agent problems via institutionalism.

\(^{19}\) Within the bank, this is a pretty clear example of using institutionalism to manage a principal-agent problem.
organizations (Blanchard, 2007; Hall, 2015; Fox, 2006). Furthermore, the PL says lenders can enforce nonprofit best practices, including adherence to Sarbanes-Oxley (SOX) rules (Blanchard, 2007; Fox, 2006).

Only a couple of authors make distinctions between different types of lending institutions. For example, PNC20 divides them into traditional versus community development lenders. It explains that both institutions have measurable goals, but traditional lenders use business credit policies, while community development lenders have policies that are specific to a particular area and mission. Traditional lenders “easily book deals,” while a community development lender gets “involved early, identifies potential partners, and manages internal expectations” (Niederberger, 2008). The RMA training materials, however, do not make distinctions between different sorts of lenders.

The PL also talks about lenders as an industry that is exploring nonprofits as a new, underserved, potentially profitable marketplace. These themes were highlighted in an RMA keynote conference speech (Fox, 2006), 21 or giving an award to a bank for capitalizing on the “nonprofit rehab niche” – loans for converting old buildings into living spaces (Cocheo, 1996). But authors warn that lenders must “make sure [they] understand the nuances involved before committing to nonprofit borrowers” (Whitlock, 2005). While working with nonprofits gives the industry the opportunity to pass CRE tests and meet CRA requirements (Fox, 2016; Access Intelligence, 1997; Sheppard, 2015), but requires work. To succeed, the industry must invent

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20 PNC Bank operates in over 20 states and is a subsidiary of PNC Financial Services Group.  
21 The speech included topics such as: the regulatory environment, low interest and commercial real estate loans, the competition between larger and smaller banks, more robust underwriting practices, and how “many sights [are] now trained on nonprofits.” The RMA includes 16,000 individual members and over 1,700 institutions.
standardized underwriting polices, protocols on what types of nonprofits to work with, and strategies for managing these loans in portfolios (Fox, 2006). Above all else, lenders are interested in making profits according to the PL.

In the next section, I discuss how case study participants defined themselves and other lenders.

**Case studies**

Participants in the case studies represented a variety of lenders (e.g., for-profit community and regional banks, credit unions, and CDFIs), so it would be tempting to define lenders along these organizational types. The trouble with that approach is most participants talked about the lending industry as a whole, and/or about their individual careers and experiences across many different lenders. This captures their perception of their institutions and the larger industry. At the same time, they personally approve the loans; they like working with nonprofits, and so they work for institutions that allow it. The institution is a tool for them to do nonprofit lending work and meet their personal career objectives.

First and foremost, all participants described themselves (and/or their current employers) as dedicated to the local community and/or the nonprofit sector. In the case of the credit union, the participants affirmed they worked with all sorts of community members. Others spoke more boldly about their public service motivations. For example, the president of one bank explained that the bank should be at the heart of the community, like the “local pub” in older English towns - a place for people to gather, make deals, grow the local economy, and improve lives. At another CDFI, the participant explained that they decided against any kind of geographic

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22 I talk more about worker and organizational identities theoretically in Chapter 6 – Conclusion.
expansion, so they could keep their local focus. Keeping the focus small means that lenders know borrowers at a personal level, too. In these cases, a lender is someone who serves the community through their business. When not dedicated to a geographic community, CDFIs that served several states defined themselves through their dedication to the nonprofit sector. In either case, mission and relationships were core to the lender identity. The actual process of lending was more a function of seeking to meet those goals than of making a profitable investment.

That is not to say lenders are not profit motivated. They do want nonprofit loans to succeed. Some participants describe themselves as “recovering bankers,” meaning they moved out of institutions that prioritized finance over good work. In the RMA class, for example, I talked to some participants about the idea of “maximizing profits for owners” in the context of nonprofit lending. One participant literally rolled their eyes, while another explained it is more about personal work satisfaction than making profit for some remote owners.

Even so, participants talk about how the industry is trying to reach out to the nonprofit marketplace for business reasons. “I think every bank is trying to develop a nonprofit clientele. Some do it better than others.” To some participants, this meant encouraging banks to invest in their nonprofit lending infrastructure. That was hard, though, because there are so few formal training programs, explained one participant who was developing a nonprofit lending unit. Process helps lenders make good loans that nonprofits can pay back. One participant explained her institution ceased nonprofit lending when they had to foreclose on a nonprofit client. “We are not in business to make nonprofits fail,” they explained. But over time and with some additional learning and improved processes, they rebuilt their confidence and started working with nonprofits again. Overall, lenders see themselves as learning and evolving institutions.
In some cases, lenders seemed to have a more philanthropic bent. For example, the lender who described the bank as the “local pub” also heavily encouraged (if not required) staff to sit on nonprofit boards and volunteer. By doing so, they could identify organizations that would benefit from loans. From this perspective, lending to nonprofits was “a giveback” to the community – an additional way to fund nonprofits other than just donations or corporate sponsorships. Corroborating this, some participants explained that some banks’ nonprofit lending programs are tightly coupled with their corporate sponsorship and other nonprofit giving. Which nonprofits were supported depends partially on the bank owner’s philanthropic preferences. In some cases, lenders see themselves as community philanthropists perhaps even more so than as businesses with nonprofit-specific lending programs.

Less explicitly, participants described the amount of technical assistance (the hours, effort, learning, and responsibility) involved in a nonprofit loan. While credit unions encouraged nonprofits to use SCORE (a nonprofit with volunteer business experts dedicated to mentoring and educating small businesses) and other nonprofits to improve their business skills, CDFIs offered free training classes and program to help unprepared nonprofits acquire the skills to apply for and manage a loan. In both cases their loans end-up more tailored to the nonprofit’s needs and circumstances – something they explain does not happen in traditional banks. From this perspective, lenders are mentors and educators.

In for-profit banks with fewer nonprofit borrowers, loan officers volunteer more extensively. They personally mentor borrowers, spending extra time to get to know the nonprofit on a deep level. Some participants described forming deep relationships, almost to the point of becoming important stakeholders. Not only do they collaborate with borrowers, but they also work with them though the payback process. They are there to catch any challenges and
difficulties early (e.g., delayed cash flows), and are willing to modify the loan to make sure the nonprofit can pay it back without harming its programs or financial viability. With this in-depth involvement and stewardship, lenders almost become a part of the nonprofit.

**Summary**

How lenders define themselves dovetails with how they define nonprofits. In the PL, the lender is a risk assessor and therefore nonprofits are defined in terms of risks. The PL assumes the lender’s goal is to maximize profits. According to the case study participants, nonprofits are service organizations and lenders have a special responsibility to make sure the loans benefit the nonprofits. The lender does have profit motivation, but also a strong community service responsibility. One bank president explains this happens more in the smaller community branches than the ones in larger cities, suggesting geography might play a role in lender identity.

In the concluding chapter, elaborate on identity and lending. For example, I found a substantial literature stream on community banking culture and how that influenced lending practices. Studies find that as larger banks buy up smaller banks, this changes the institution’s culture, identity, and lending practices. Similarly, research finds that prosocial lending is more likely to happen when loan officers are given more autonomy – whether they identify as individual loan officers or more as a small part of larger institution.

**HOW DO THEY MAKE A LOAN?**

A loan is an artifact of two organizations coming together to make a decision. Before I presented the findings on how lenders described nonprofits and how they describe themselves, since this influences how they make their decisions. In this section I present findings on the PL’s
answer to how to lend to nonprofits, followed by answers from interviews with case study participants.

**Practitioner literature**

According to the PL, before even working with a nonprofit client, the loan officer must decide if they want to commit substantial time and effort to learning about the sector and helping nonprofits that have fewer financial and organizational skills than their normal small business clients. However, the lending institution probably does not have a standard nonprofit underwriting and evaluation process. This not only means more work but also more pressure, since the loan officer has to develop criteria themselves. If the loan fails and the lender needs to foreclose, it will likely create not only bad publicity for the bank, but financial loss, since it is difficult to find good nonprofit collateral. In sum, the PL characterizes nonprofit lending as both more arduous and risker than normal lending to small business clients.

With all these burdens, why would a loan officer even decide to work with nonprofits? Overall, the PL makes it intimidating. But some authors note that some nonprofits (like community development and nonprofit housing organizations) are easier to work with, because they are generally more professionalized and have facilities that can be used for collateral. Also, the nonprofit sector offers new opportunities, since it is a rather new and untapped marketplace, so the bank may encourage nonprofit lending (DeGiovanni et al., 1996; Cocheo, 1996; Nadler, 2003). Lenders might also be swayed by the nonprofit’s mission and community work, especially during hard economic times (Fogel, 2010; Buckoff & et al., 2009). But as Wallace (2011) warns, the loan officer must use a “rational decision-making in line with company interests, instead of being bamboozled by a nonprofit’s mission.” Overall, the PL’s first step in lending to nonprofits is to ask the question, “Are you sure you want to?”
However, it is important to note that the PL puts less emphasis on this question, compared the stress it places on information, like nonprofit accounting differences and statements (Benoit 2011; Blanchard, 2007; Hall 2015; DeGuivanni et al 1996; Cocheo, 1996; Walsh, 2005). The message appears to be: How to lend to a nonprofit depends on how well you know nonprofit finance. Knowing how to read financial statements is essential, since it is a key communication tool (Benoit, 2011; Swift, 2011; McCurdy, 1996; Love & Stischek, 2016; Schreier, 2010). Lenders must learn before they can lend. For example, the third sentence of the RMA course says it will cover nonprofit financial accounting under FASB Statement of Financial Accounting standards, particularly understanding contributions received and made and nonprofit financial statements.

Important financial measures emphasized in the PL include cash flow, revenue/expenses, and assets. For example, liquidity measures whether or not a nonprofit has the cash on hand (or how quickly it can get cash) to make its debt service payments. Some authors give specific ratios (e.g., Swift, 2015; Uvlong, 2017; RMA training manual) but most approach cash availability more conceptually. For example, authors explain that nonprofits (particularly small ones) never have excess cash (Biery, 2016; Swift, 2015) and net zero at the end of the month; but nevertheless, they still might be creditworthy. In contrast, Benoit (2011) suggests loan officers require more liquidity from nonprofits than small businesses, because “nonprofits barely have cash sufficient to cover payroll and expenses” and “operate on peril’s edge.” For extra protection, the lender might consider a liquidity covenant, which requires the borrower to maintain a minimum level of liquid assets – e.g., cash (and assets that can be converted into cash quickly) to ensure debt service payments are made (Love & Stischek, 2016; Quinn et al., 2006; Swift, 2015). Part of lending to a nonprofit not only depends on financial measurements, as the
authors explain, but how to interpret those measurements in the specific nonprofit context, part of the general theme in assessing nonprofit finance.

Authors focus on the features of governmental and donative revenue sources, rarely mentioning fee-for-service revenue. With government funding, for example, they note that revenue may arrive after expenses as reimbursements (Walsh, 2005). The PL also advises lenders to understand how to interpret pledges (i.e., how collectable they are) instead of simply interpreting them as revenue (McCurdy, 1996; Taylor, 1994; Kelley, 2011). Relatedly, authors warn lenders that some donations cannot be used to pay debts, that nonprofits can freely use unrestricted donations, but usually not temporarily restricted, and never permanently restricted funds. “One of the biggest mistakes many community bankers make when lending to nonprofits is not differentiating between permanently restricted, temporarily restricted and unrestricted funds” (Biery, 2016).

Additionally, the PL considers raising donated revenue as more of an art – not as simple in the business world (Taylor, 1994). For example, the lender may want to investigate donor demographics. If most donors are elderly, how does the nonprofit plan to preserve this revenue stream as donors pass away? (McCurdy, 1996). If major donors are a major source of revenue, lenders should see how committed they are to the institutions (McCurdy, 1996; Kelley, 2011). Furthermore, lenders need to modify financial ratios to fit the nonprofit context (e.g., program expense ratios, fundraising efficiency, operating margin, and revenue diversification) (RMA training; Walsh, 2005). For specific types of nonprofits, the PL considers it prudent to measure things like the number of congregants at a church or student admittance at a university (Uvlong, 2017; RMA training; Quinn et al., 2006). Generally, the PL emphasizes that measuring reliable revenue is more complex for nonprofits than with the more familiar small businesses.
When deciding to lend to a nonprofit, assets are also important – specifically the collateral value of those assets – in anticipation of a potential foreclosure (McCurdy 1996; RMA training manual; Swift, 2014; Nadler, 2003). Because nonprofit lending is risky, authors advise lenders to always have a Plan B in mind. But assessing nonprofit collateral comes with challenges. First, lenders should not mistakenly see endowments (permanently restricted net assets) as collateral, since legally these holdings cannot be converted to cash. In terms of facilities, some are specifically designed for the nonprofit’s work, so are not easy to resell (e.g., theaters) and a problematic collateral for a loan (Nadler, 2003; RMA manual). On the other hand, churches may have easy resale value, since congregants might be eager to step forward to keep the building (Biery, 2016) or another congregation may take it over.

But even with such precautions, the PL warns that foreclosure can have ripple effects on the bank’s income. “No one wants to foreclose on a church,” for example (Taylor, 1994). Foreclosing on any community serving nonprofits generates negative public relations (RMA training). Wealthy bank clients (particularly ones serving on the nonprofit board) might move their business elsewhere (RMA training). A bad reputation works against getting new clients, too (Nadler, 2003). Consequently, lending to nonprofits means lenders must understand the bigger picture. The authors explain that banks cannot force nonprofits into bankruptcy or might not be eligible for bankruptcy (Walsh, 2006; Fox, 2006). To successfully lend to a nonprofit, the lender should understand this and other legal rules surrounding nonprofit organizations. In light of these challenges, lenders may want to plan for forced mergers and other measures to recover their investment that may be less controversial (Swift, 2014).

On top of all these financial and legal matters, the PL also says the lender should understand the nonprofit’s governance and management. What are its bylaws and how often do
board and staff turnover (Swift, 2015)? Do board and staff agree about the borrowing plan (Benoit, 2011)? Since nonprofits do not have owners, it is important to know about the leadership stability and long-term governance and management plans (Swift, 2015). The PL warn lenders about situations where the executive director leaves and the new one does not believe in nonprofit borrowing. This adds another layer of work when deciding to lend to a nonprofit.

In addition to getting information directly from the nonprofit, the PL suggests lenders consult outside sources to vet the organization. These include: IRS 990 forms, GuideStar information, Charity Navigator ratings, and the Better Business Bureau’s Wise Giving Alliance (RMA training manual). In some cases, Dun & Bradstreet has credit risk ratings for particular nonprofits.23 The RMA course suggests consulting Moody’s Investor Service to assess the trends for a particular industry, like private colleges and universities. Not only do these reports include descriptions and summaries of trends, but also many financial figures and measurements categorized by credit rating (e.g., Aaa, Aa, Baa) and organizational size over time. Loan officers can compare these median measures to a nonprofit’s application to get a feel for their creditworthiness (RMA training manual).

Finally, the lender should assess the marketplace. This not only includes market trends (e.g., does the childcare industry look to be on the rise (Love & Strischek, 2016), but also at available funding programs. In particular, nonprofit lending could serve to satisfy the lender’s

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23 Most of the nonprofit case studies had credit ratings and they were all “low risk.” This contrasts with the conventional nonprofit financial vulnerability ratios, which flag them as nonprofits in finance trouble due to debt.
Community Reinvestment Act requirements (Choceo, 1996; Access Intelligence, 1997; Sheppard, 2015). I describe these market-wide aspects more deeply in Chapter 5.

Overall, the PL’s response to “how to lend to a nonprofit” is that it requires putting in a lot of work and extra effort. This does not just mean understanding the right financial ratios but looking more deeply into nonprofit’s structure and operations. The next section includes my findings from the interview data on what lenders say about how to lend to nonprofit organizations.

**Case study**

In the interviews somewhat different themes emerged. How to lend to nonprofits depended on the participant and lending institution’s mission, the formality/institutionalism of lending procedures, communication, and the market (including community needs). The participants did talk about the uniqueness of nonprofit finance, particularly revenue patterns and sources for donative charities; but they used these challenges more to illustrate their success in working with nonprofits, than as a risk, threat, or burden.

The previous section – What is a lender? – examined how participants described their own mission and values. I touch on it here again, because these characteristics motivate lenders to reach out to nonprofit organizations. It is possible to interpret this finding as advertising – trying to grow the client base and compete with other lenders. That is part of it. A lender (who currently worked in the for-profit sector but previously for a CDFI) discussed how at one time local for-profit banks were offering lower interest rates than the local CDFI. When that happened, that individual changed to a job with such a bank in order to work more again with nonprofits. However, the participants generally described outreach as finding nonprofits to help,
rather than as an effort to increase bank profits. For example, CDFIs advertise that they have special skills to support nonprofit borrowers. One lender specially mentioned outreach and giving back. All contrasted themselves with more conventional lenders that were not interested in helping nonprofits (or community organizations in general, including small businesses) and just saw them as another customer. In the interviews, whether or not to lend to nonprofits depended on the lender’s personal mission.24

How to lend to nonprofits also depended on the processes within the lender institution. CDFIs and the credit union both have standardized rubrics for evaluating the creditworthiness of a nonprofit applicant. As the credit union participants explained, nonprofits were like other highly specialized industries (e.g., restaurants), and worked with lenders experienced in that area. CDFIs also have formalized processes and nonprofit rubrics. In line with the PL, this evaluation includes financial and organizational analysis. They document their lending process quite extensively online (to the benefit of the researcher); their applications (compared to the for-profit nonprofit applications I could find) seemed closer to grant proposals than the standard loan application (e.g., asking questions about diversity and program outcomes). At another for-profit bank, the participant described how their more ad hoc nonprofit lending has evolved into a dedicated nonprofit lending unit. Another participant, familiar with the bank, explained this had to do with the owner’s deep philanthropic commitment to the community. The current process, however, sounded formalized and similar to the CDFI’s approach.

24 Most of the participants were personally involved in boards or nonprofits in other ways. If I was to analyze individual loan officers in a larger study, I suspect this volunteer behavior with their nonprofit work are indicators of a latent philanthropic attitude/motivation variable.
To lend to a nonprofit, the participants frequently mentioned the importance of knowing the organization and dedicated communication. In some cases, this communication came from interpersonal as well as interorganizational connections from living in a smaller community. In other cases, more one-on-one communication was needed when the standardized forms and underwriting process failed to reflect the true creditworthiness of the organization. Communication also includes staying in contact with borrowers over the duration of the loan and making connections among nonprofit organizations. CDFIs communicated their expectations to potential borrowers through their many instructional materials and presentations.

Finally, knowing the market matters just as the PL explains; however, this goes beyond industry trends (I will discuss markets more thoroughly in Chapter 5, which looks at nonprofit capital marketplace ecology, but it bears mentioning here as well). Part of lending to a nonprofit is understanding overall governmental trends and changes in the political climate. At times CDFI lenders and HUD programs add funds to the nonprofit marketplace – funds that make it easier to lend. As mentioned in the PL, governmental regulations like the CRA and certification requirements also influence decisions. The participants, however, downplayed these elements, focusing more on community needs assessments.

**Summary**

The findings show that how a lender institution defines itself and the nonprofit borrower influences how it decides to lend to nonprofits. In the PL, the lender seeks to make a profit from loans; to do so, they must be experts in understanding risk. Therefore, it also defines nonprofits in terms of risk. Finally, for this perspective, the decision to lend to nonprofits hinges on how lenders are able to identify and assess risk.
In contrast, the participants in the case studies (who currently work with nonprofit organizations), see themselves as part of a community and/or the nonprofit sector; they do want profit, but also want to benefit their overall community. They do conduct a risk assessment with those issues in mind, not just the probability of loan repayment. To mitigate that risk, they include a cultivation and stewardship of nonprofit borrowers (e.g., education and more in-depth communication) rather than a financial test of their credit worthiness and risk assessment. The formality of this evaluation process influences how decisions are made.

**DISCUSSION**

This chapter includes findings that help answer the question: How do lenders decide to work with nonprofit organizations? In analyzing the observations from both the practitioner and the case study interviews, a major theme emerged – lending decisions depends on how lenders define nonprofits and how they characterize themselves.

The PL sees nonprofit lending in terms of risk and returns on investment. Understanding what exactly a nonprofit is (and how it differs from small business) is central to mitigating risk by eliminating or reducing the unknown. In the same vein, the PL defines lenders in terms of risk managers. Sometimes the literature addresses individual loan officers, other times lending institutions, and even the wider industry, but one theme is consistent: Lenders should stay loyal to their institution and not be swayed by their personal beliefs about a nonprofit is cause. Overall, the PL drives at developing a modified form of small business lending for the nonprofit sector – a form that can be objective, systematized, and replicated. Lenders want to increase profits, and the nonprofit marketplace is a place to tap new clients. But until standard procedures are developed, the work is risky. Overall, the PLs response to “how to lend to a nonprofit organization” is to: 1) Remember profit motivation and the institution’s own goals, 2)
Understand how nonprofits differ from small businesses, and 3) Learn as much as possible to reduce risk to the lending organization.

The case study data includes interviews from participants already lending to nonprofit organizations. Their definitions of themselves and nonprofits are more nuanced. Yes, profit is important, but they describe nonprofits in terms of the community served and emphasized how lenders shared some of these goals to promote community by doing good business. That community might be geographic or, in the case of CDFIs, the nonprofit sector. Individual identities stood out more often, and individuals chose jobs at institutions to match their personal beliefs and motivations toward nonprofit lending. How to lend to nonprofits was based on more than a purely monetary transaction and included a focus on collaboration and communication. Each nonprofit loan is handcrafted with both the lender and borrower in mind, as one participant explained, rather than mass produced as in big banks.

These findings touch on several empirical studies and theories that could help us better understand the nonprofit capital structure question. These include motivational complexity, organizational identity, institutionalism, formalization, and sensemaking. Additionally, the banking literature has more to say on the different types of lending (e.g., credit-based vs relationship based) and how lending protocols have changed with the loss of community banking culture. I present this analysis in detail in Chapter 6.
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CHAPTER 5: HOW DOES THE ENVIRONMENT AFFECT BORROWER-LENDER RELATIONSHIPS?

INTRODUCTION

In Chapters 3 and 4, I presented by findings on how borrowers and lenders make decisions about nonprofit debt both internally and collaboratively. This gives us insight into the financial management practices and strategies within organizations and helps us better understand the nonprofit capital structure. Many nonprofit finance scholars have turned to economic theories to try to solve these questions (e.g., Bowman, 2002; Calabrese, 2011; Garcia-Rodriguez & Jegers, 2017; Denison, 2009; Yan et al., 2009; Yetman, 2010). However, the theories they use – trade off and pecking order - are theories of the market and are not intended to explain individual organizational decision-making, as I have documented in previous chapters. I turn now to a more explicit look at the structure of the nonprofit capital market, using the approach of ecological theories of organizations – shifting the unit of analysis from the individual nonprofits to populations of organizations, sectors, and industries.

I address the question: How does the environment affect borrower-lender relationships? To do so, I analyze how the practitioner literature and participants describe it. Their viewpoints are important since a decision-maker’s perception of the environment shapes their choices (Lawrence & Lorsch, 1967). I use empirical data and theoretical literature to explore these perceptions.

This chapter is divided into three sections. In the first section, I cover the “primary actors” – the populations of lenders and borrowers which interact in the nonprofit capital marketplace in terms of supply and demand. In particular, I analyze how borrowers and lenders find each other in the marketplace, and how the practitioner literature serves to repress both
supply and demand. The next section covers secondary actors or intermediaries. In particular, I
look at information brokers (e.g., GuideStar, Dun & Bradstreet), which can reduce information
asymmetry between borrowers and lenders by distilling financial data into easy to consume,
efficient formats. Simultaneously, they institutionalize norms on what a worthy borrower should
look like. Finally, I analyze how federal regulations (tertiary actors) influence the nonprofit
capital marketplace (e.g., creating and filling new ecological niches) by codifying the cultural
institution of community-based lending. These findings contribute to the development of a
nonprofit capital market model.

**PRIMARY ACTORS: USERS AND SUPPLIERS OF CAPITAL**

The primary actors in the nonprofit debt marketplace are borrowers and lenders. Previously in Chapters 3 and 4, I analyzed how they made decisions about securing (borrowers) and issuing (lenders) nonprofits loans or debt. I turn now to a more explicit analysis of the supply and demand for loans/debt using my data (practitioner interviews, case studies, and practitioner literature) along with scholarly work. I identify key factors that help sketch-out an image of the nonprofit loan marketplace that serves to discourage demand and supply.

**Capital structure theory models**

Capital structure theories (e.g., tradeoff and pecking order theory) rely on a neoclassical economic model of the capital marketplace, e.g., the supply and demand of the financial market. The borrowers (users/consumers) represent the demand side; they want the most bang for their buck, and that means a loan with the lowest interest rate possible. The lenders (providers) supply loans, and they want the most return on their investment possible (highest rate). The intersection of the curves (market equilibrium) is where the borrowers and lenders meet on the market price of loans (the nominal interest rate).
This extremely simplified mathematical model used in capital structure theory relies on certain assumptions. It only contains two variables (rate of return and quantity) to make a two-dimensional figure. However, the model assumes the market is composed of many rational actors that consistently make decisions to maximize their own personal utility; that these actors can exit and enter the market freely; that all parties want to maximize their utility, which is measured financially (monetary indicators); and that everyone knows everything relevant to those decisions (perfect information). Applying these assumptions keeps the model simple, so we can better understand the fundamental concept of supply and demand for loans.

But it is not a realistic one. For example, rational decision-making is impossible (see Chapter 2). When economists test models like this, they add in additional variables that violate some of the assumptions (e.g., imperfect and asymmetrical information, difficulties entering the marketplace where suppliers and demanders can meet to make agreements). For example, tradeoff theory introduces the tax deductions borrowers get (tax shields), and pecking order introduces information asymmetry (see Chapter 2) as key modifications.

**Nonprofit models**

So how are these financial market theories adapted to nonprofit sector debt research? Even though nonprofit scholars rely on the neoclassical model (since they use the theories based on it for their nonprofit capital structure research), my literature found nonprofit debt research does not cover the financial markets. Notably, there is neither a demand nor a supply curve that illustrates how many nonprofits want loans and how many lenders supply them.

One reason might be that nonprofit finance scholarship mostly focuses on revenue models (e.g., donative sources, revenue diversification, operational expenses, etc.) and not asset
composition (i.e., debt). For example, nonprofit debt studies juxtapose borrowing against running a capital campaign to get the money for a building project (see Chapter 1). The “how much revenue a nonprofit receives based on the nonprofit’s decisions” is the dominant, institutionalized, perception/framework of nonprofit economic behavior. This factor is important to a nonprofit capital market model, considering how much nonprofits focus on revenue.

By analyzing both the practitioner and lender practitioner literature (PL), I found a more complex picture of users and suppliers in the nonprofit capital marketplace. First, it is a supplier’s (seller’s) market. There might be more lenders than nonprofit borrowers, but few lenders are willing to work with nonprofits. As discussed in Chapter 4, lenders only hesitantly enter the nonprofit capital market, because of the long learning curve and higher perceived risk of nonprofits defaulting. Corroborating this, the nonprofit PL says that nonprofits should be extremely cautious about borrowing, since banks do not understand the sector and its particular financial contingencies (e.g., donative revenue, options for collateral), and also the risk of default. From this, it sounds like many nonprofits are competing for a limited resource (loans), and the banks get to choose among many applicants. If true, lenders have more power and influence than borrowers when setting the availability and price of loans.

But the picture gets more muddled because of the “fund development mindset” – the same revenue market focus seen in academic work. Nonprofits, which have limited staff and capacities, prioritize paying bills by raising revenue, whether from individual donors, grants, government contracts, or clients paying directly for services (see Chapter 3). Just paying the bills does not leave a lot of capacity to develop other skills, such as long-term financial planning and capital structure strategies. Therefore, when some nonprofits apply for loans, they tend to treat it like making a grant proposal or asking for donations (see Chapter 3). The nonprofit PL warns
against this approach – saying that if nonprofits want loans, they need to be professionalized and look like the small businesses they are competing with. Concomitantly, the lender PL tells loan officers not to think with their heart – explaining that mission-based appeals can cloud sound financial decisions (see Chapter 4).

Some participants described the market differently. K-Jansen¹ (who has experience working with nonprofit and for-profit borrowers) explains that he competes with other lenders to get a business to borrow from his bank. In contrast, he and others, like J-Davidson, seek out local nonprofits that could use loans to better accomplish their missions. In some cases, lenders are also donors. For example, local governments are more likely to forgive loans compared to CDFIs, as the director of Skyward explains.

I discussed this with an informant, who is a professor of city management and a former mayor. He explained how administrative and budgeting tactics make this possible. For example, the city government and other local stakeholders can create a kind of “shell nonprofit” with a very broad name specifically to fund a loan to the target nonprofit. The city gives a grant to the shell, the shell lends to the target nonprofit, and then forgives the loan. Functionally, the loan is a grant not a forgiven loan; the “shell tactic” obscures the grant. Cities can use this strategy when public would criticize the city for directly supporting the nonprofit (as in Skywards case).

Corroborating this tactic, K-Jansen explained that when banks cannot sponsor a nonprofit directly, they offer loans and forgive them. Therefore, some loans functionally are donations².

¹ See Table 8 for or Chapter 2 for more information about the lender interview participants.
² Instances of these strategies would be hard to detect methodologically
In the next section, I analyze challenges in finding the intersection of demand and supply curves.

**Finding the marketplace**

My analysis shows that nonprofit borrowers and lenders have trouble finding each other. The model’s supply and demand curves in certain regional markets might not “connect.” The lender PL says it is hard to find profitable nonprofit industries to invest in – professionalized nonprofits with regular revenue streams and marketable assets for collateral. A couple of pieces say that housing nonprofits are a lucrative market because of the availability of government funds and the high demand for housing means steady and robust revenue streams. These building projects also have higher collateral value. In case of foreclosure, there is a larger market for reselling housing, compared to youth centers or shelters.

My interviews with lenders corroborate this perception. According to B-Kelley and K-Jansen, lenders know that there are markets out there – pockets of nonprofits that want loans. But it is hard to find them. Nonprofit geographic density varies widely (Lecy & Van Slyke, 2013; Harrison & Thornton, 2014). Additionally, politics plays a role in predicting the market. For example, governments may increase funding for drug treatment living facilities for a few years, and then stop and reallocate that money to other causes. Industry trends also matter. Nonprofits in heavily regulated industries can be more financially unstable because regulations change. The RMA advises that these types of nonprofits are less desirable borrowers.

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3 Lecy and Van Slyke (2013) specifically studied human service organizations. Density per MSA varied a lot, from 7 to 2,665 nonprofits, with a mean of 228 and a standard deviation of 352.
In the next section, I discuss the challenge of measuring nonprofit demand and supply of loans.

**Discouraged demand and supply**

Just because a nonprofit borrower or lender is not in the market, does not mean it does not want to be. My analysis indicates that anti-debt nonprofit norms can stymie demand for loans (see Chapter 3). The nonprofit PL explains that only high-capacity nonprofits should borrow; small nonprofits, which face larger risks, should steer clear. Potential nonprofit borrowers may read this literature and decide not to borrow because the odds are stacked against them.\(^4\) As Fundamental’s leader said, “We’re not eligible for an enormous amount of debt that is out there that a lot of people take on, even though they fail at it. We do not even get the opportunity to fail or succeed because we do not qualify. It is a question on an application that immediately excludes us.” NewDream corroborates this.\(^5\) So why bother to do all the work, if it is just going to be disappointment?

When confronted with these findings, I returned to the literature to see if this phenomenon had been documented outside nonprofit sector research. It has. Business researchers have coined the term “discouraged demand” (e.g., Levenson & Willard, 2000; Berger & Udell 2003; Kon & Storey, 2003) and small businesses face challenges similar to nonprofits (e.g.,

\(^4\) But the same holds true of conducting a capital campaign, with all the planning and strategy and years it takes. Nonprofits like the ones in my case study do not meet the benchmarks (the two that had tried capital campaigns failed).

\(^5\) This has implications for the assumptions in the nonprofit adaptation of pecking order theory – i.e., nonprofits do not borrow, because it turns off their donors. Instead, my analysis suggests some nonprofits cannot (or do not believe) they can access the debt market. So, contrary to the assumptions underlying nonprofit adaptation of pecking order theory (i.e., nonprofits do not borrow, because it turns off donors), my analysis suggests that some nonprofits do not borrow because the odds of getting a loan are against them. Discussed more in the conclusion.
credit constraints and information rationing). When small businesses do not believe they’ll qualify for a loan, they do not apply. The “psychic cost” of potential rejection is too much. But business scholars say these discouraged potential borrowers are underestimating success since the number of discouraged borrowers is two times greater than those which apply for a loan and get rejected (Levenson & Willard, 2000).

Similarly, loan officers, while interested in lending to nonprofits, might not enter the market. B-Kelley explains “just the perception, the myths” about the nonprofit sector are a barrier. She went on to say, “There is just no incentive [for banks] to enter into the market.” Also, the PL explains some lenders do not have the flexibility to lend to nonprofits; a solely profit-motivated lender focuses on less risky loans to larger businesses. Consequently, loan officers might not have the flexibility to ignore the underwriting requirements, although some do.6 Some lenders evaluate loan officers based on their portfolios’ profitability, which can discourage them from lending to nonprofits. As discussed in Chapter 4, a nonprofit loan requires a greater time commitment – time that could be spent adding more small business clients to their portfolio. I could not find any scholarly work on discouraged supply/output/sales.

**Summary**

Most nonprofit economic research focuses on the roles and relationships among the nonprofit, governmental, and for-profit sectors. These include theories like the public goods / market failure (Wiesbrod, 1975); contract failure (Hansmann, 1980); interdependence theory (Salmon, 1987); etc. There has been much less work on financial topics, like the supply and

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6 At the time of the interview, M-Smith was the senior vice-president of commercial lending at a regional bank that regularly lends to nonprofits. At this bank, loan officers have nonprofit loans reviewed by underwriters, but then generally ignore this assessment for nonprofits.
demand for grants. We face challenges developing a simple capital market model for nonprofits, such as discouraged demand and supply. The overlap between donations and loans further complicate matters.

**SECONDARY ACTORS**

My analysis showed that borrowing and lending decisions depended on collecting, communicating, and analyzing information, and reducing information asymmetry; but, doing so depends on the how much the actors trust each other (see Chapters 3 and 4). Study participants explained that close relationships between banks and nonprofits allowed them to use more qualitative information and made decision-making more collaborative. If both actors are community members, trust and legitimacy is strengthened. In contrast, my practitioner literature analysis showed banks and nonprofits spoke “different languages,” making them more distant.

In the absence of close relationship, lenders can use information brokers to try to close this distance. These brokers specialize in collecting and packaging organizational information into easy-to-digest, highly standardized formats. In the nonprofit sector, some of the most well-known are IRS, GuideStar, Charity Navigator, and Charity Watch. In the for-profit sector firms like Dunn & Bradstreet (D&B) provide credit ratings. In this section, I analyze how these secondary actors affect nonprofit capital access. I summarize the different ratings for each case in Table 10 and will cover these details more in-depth throughout this chapter.

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7 My analysis found that business finance already has a substantial literature stream on trust, information, and relationship banking (e.g., Berger & Udel, 1995). I discuss business finance research more in Chapter 6.
Non-profit information brokers

My analysis found that nonprofit information brokers (e.g., IRS, GuideStar, and Charity Navigator) play a minor role in the decisions made by the borrowers and lenders I spoke with. The PL and the Risk Management Association training program reference them, but without much emphasis. These brokers play more prominent roles in the nonprofit fund development (grant) market, although surveys of donors suggest donors do not use information brokers, despite marketing efforts by the information brokers (e.g., Sloan, 2009; McDougle & Handy, 2014; Li & McDougle, 2016; Cnaan, et al., 2011). Research suggests that smaller nonprofits (i.e., those with limited capacity) cannot leverage these brokers as well as their larger counterparts (Keating & Frumkin, 2003; Froelich, et al., 2000). Moreover, information brokers’ measurement rubrics often penalize nonprofits for having debt.

In this section, I analyze the effects the most prominent information brokers have on the capital marketplace and organizational ecology. I begin with the IRS, since it is the primary data source for brokers like GuideStar, Charity Navigator, and Charity Watch (see Table 10 for a summary). Ultimately, however, as I argue below, the IRS data – and by extension the nonprofit benchmarking efforts - are probably not particularly useful for making nonprofit lending or borrowing decisions. Moreover, these broker efforts impose institutional pressures on nonprofit finance reporting.

IRS

Most nonprofit finance research relies on IRS Form 990 data and it has, arguably, shaped the field of nonprofit finance. It is a very attractive dataset. It is large, with over a million 501(c)(3) nonprofits, although only about 30 percent file financial information (NCCS, 2020). For those nonprofits, however, the data include many financial variables and other organization
information. Plus, the datasets are currently free but not in very usable formats. At the same time, the IRS data has serious limitations. While scholars acknowledge these problems (e.g., calculation errors, incomplete records, missing information on unregistered nonprofits, etc.), they do not really get at the heart of the matter: The IRS did not create this dataset for researchers or donors (or lenders for that matter). It was designed to monitor compliance with tax regulations, and the dataset reflects that.

The IRS is responsible for assessing which organizations can be exempt from Federal income taxes, and not overly reliant on for-profit revenue for activities unrelated to the organization’s mission (unrelated business income). Every year nonprofits must file the form to prove their still qualified for exemption. Generally, the larger and more complex the organization, the more data it must submit.\(^8\) Larger organizations face more scrutiny, because they are the caretakers of more donations and other public support. If they engage in is malfeasance, there is more money at risk.\(^9\) As a result, the amount of data required on Form 990 is biased toward larger organizations.

But while the IRS Form 990 data helps describe financial parameters of the nonprofit sector, it is unclear how useful individual forms actually are. The RMA training used IRS data to define and describe the nonprofit sector (e.g., size and diversity of organizations). The larger nonprofit practitioner literature stresses how important it is to fill out the form correctly. It

\(^8\) Currently, small nonprofits that have revenue less than $50,000 must only submit a half-page “e-postcard”. The 2020 Form 990EZ (for nonprofits with less than $200,000 gross receipts and less than $500,000 assets) is only four pages, while the full Form 990 is twelve, not counting potentially a large number of supplementary schedules.

\(^9\) It is similar in business research. One business faculty member explained that business scholars focus on the big, publicly traded companies, even though small businesses employ many more people, because that is where the most money is – and where the data are.
explains that everyone – donors, grantors, creditors, potential board members, etc. – will judge a nonprofit by its tax return (e.g., Butler & Butler 2016; Martin, 2018). Similarly, GuideStar explains how nonprofits can make their IRS Form 990s to look more appealing to donors. The RMA training mentions looking at individual IRS 990 forms; but, when I discussed the forms with the participants, they said they did not offer a lot of useful information – i.e., paying bills on time.

In short, the IRS has had a large role in defining what a nonprofit is. Voluntary organizations that do not submit IRS 990 forms (especially before the “e-postcard form) do not appear in nonprofit finance research, since they are not in the IRS dataset, even though originally its role was to decide whether or not an organization qualifies for a Federal income tax exemption. It is the National Taxonomy of Exempt Entities (NTEE) codes that influence nonprofit lending, by defining what nonprofits qualify for certain programs (which I explain more when I discuss regulators below). Yet, ironically, individual forms do not have much useful information for lenders. In my case studies, nonprofits did not mention using these forms to apply for loans (see Chapter 3). Nevertheless, the IRS nonprofit data is important in the nonprofit marketplace, because GuideStar and Charity Navigator use it to create their standards and would not exist without it as I show below.

GuideStar

The RMA training suggested that GuideStar is more useful than raw IRS 990 data. The instructor explained, for example, a loan officer might want to know more about a nonprofit after meeting its representatives and taking a loan application. The officer should check to see if the information on the application matches GuideStar’s information. If it does not, that “raises some red flags.” But loan officers don’t go further, because the 990 data do not include information
(e.g., monthly cash flows and expenses/revenues) directly related to its creditworthiness. (See Chapter 3 and 4).

Of course, GuideStar’s target market is not lenders, but donors. Fees to access the database make up most of GuideStar’s revenue according to their Form 990s (92 percent in 2019).\footnote{According to the 2019 Form 900, at the start of the year liabilities (mostly deferred revenue) made-up 63 percent of GuideStar’s total assets. Other liabilities include unpaid federal income taxes. Expenses also exceed revenues. But the end of the year (likely due to the merger with Candid) all of these liabilities seemed to have been paid off. Some major grantors funded the merger including the Bill & Melinda Gates Foundation, the William & Flora Hewlett Foundation, the Charles Stewart Mott Foundation, the Lodestar Foundation and Fidelity Charitable Trustees’ Initiative.} Annual subscriptions cost from $2,000 for a single user to $20,500 for ten. Given such rates, most customers are probably institutional donors analyzing nonprofit datasets to decide on grantees. GuideStar advertises large grantors (e.g., Amazon Smile, donor advised funds, etc.) to potential grantees. In 2016, GuideStar reported over 6.9 million individuals and organizations viewed its data. However, I could not find information on client lists.

GuideStar also markets itself on the size of its database. It claims to have “1.8 million IRS-recognized tax-exempt organizations, and thousands of faith-based nonprofits” both currently operating and defunct. Because these data come from the IRS, most organizational profiles only include information from their Form 990 submissions (but that is not available for most registered exempt organizations). GuideStar encourages nonprofits to update their profiles and add more information, arguing that profiles look more attractive to donors, specifically large, donor-advised funds like Fidelity (Kardos, 2017). That also serves to increase GuideStar’s value to those funders. In return, GuideStar rates nonprofits on their transparency. But most of my case study organizations did not have a rating, because they had not uploaded any additional
information (Table 10). The exceptions were: Skyward and YouthFirst (platinum), RiseFree (silver), and BetterTomorrows (bronze).

None of the participants mentioned GuideStar. When I told them that I used it to research their organizations, some were surprised their information was so public. My other informants working at nonprofits explained to me that whether or not an organization creates a GuideStar profile, depends on its revenue sources. It takes precious labor hours and analysis to update a GuideStar profile. If the nonprofit does not rely on donors who use it, the benefit-cost ratio isn’t worth it. While not a scientific assessment by any means, it does have face validity. Increasing transparency and reducing information asymmetry is only useful when someone cares about what the data say. GuideStar is a well-known and influential broker in the nonprofit sector, but its influence on the nonprofit capital marketplace is unclear.

**Charity Navigator**

While GuideStar is mostly an information clearinghouse, Charity Navigator explicitly rates nonprofits based on their IRS 990 data, not just on their transparency. It is a “charity watchdog.” RMA training mentioned these rankings can be useful. For example, if a positive rating means more donations, that is potential revenue that could help pay off a loan. The nonprofit practitioner-oriented piece, *Debt is not a dirty word*, goes further (Borowitz, 2012):

> You may think your organization has a good rationale for borrowing, but that does not mean lenders — or even your supporters — will agree. One of the primary criteria watchdog groups such as Charity Navigator and Charity Watch use to evaluate nonprofits is the percentage of available funds spent on programs. If a large portion of your budget is tied up in debt repayment, that is likely to affect how the public, including prospective donors, perceives your organization.

Charity Navigator currently offers two products – the Star Rating system and the Encompass System. The latter was released in 2020, so focus on the Star Rating system, the only
one available when I began my research. It included only 160,000 nonprofits, much fewer than GuideStar. That is because Charity Navigator seeks to rate and compare nonprofits. Thus, all nonprofits included in the rating system must fit certain parameters. For example, universities, hospitals, and private school are excluded as are smaller organizations. As it notes on its webpage\textsuperscript{11}:

\begin{quote}
It is our experience that the financial profile and governance practices of small nonprofits tend to be different from the thousands of larger organizations that we currently rate. As such, we have elected not to add small charities at this time.\textsuperscript{12}
\end{quote}

Charity Navigator notes that though it does not rate small charities, that does not mean they do not deserve donation. They may not be as professionalized, since they have smaller staff, and “devote the brunt of their time and resources to fulfilling their mission.” Charity Navigator advises interested donors to do their own research based on the charity’s website, meet with leaders, and use local information. The advice to look for more qualitative information and rely less on ratios and metrics is reminiscent of relationship lending (see Chapter 4). By implication,

\textsuperscript{11} See https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=33

\textsuperscript{12} Charity Watch (which rates less than 1000 nonprofits, using a variety of financial sources) provides a similar explanation:

\begin{quote}
[Our] charity rating methods suitable for larger organizations often cannot be fairly applied to much smaller charities given that the latter lack the economies of scale necessary to operate at the same level of efficiency. Small charities that assist underserved populations, that are fulfilling an unmet need, or that are new or in the process of scaling up to a larger size may still be worthy of donors' support despite Charity Watch's inability to rate them due to this comparability issue.
\end{quote}

I did not include it in a separate section, because it did not evaluate any of my case study organizations. And its methodology is much more inscrutable than GuideStar and Charity Navigator.
it is also pointing to two different nonprofit capital markets – one for big, professionalized nonprofits and another for smaller ones.

In the pre-2020 system, Charity Navigator explains it only rated nonprofits if they met certain benchmarks: 1) Seven years of Form 990s, 2) Over two consecutive years, revenue over $1 million, 40 percent of which must be public support; 3) At least 1 percent of expenses must be fundraising, and 2 percent to administrative expenses. Only two of my case studies met these benchmarks. YouthFirst and GoodShepherd scored 75 out of 100 in 2018 (Table 10). Despite the similarities of scores, my analysis of the interview data showed they faced different financial challenges. YouthFirst struggled to pay its debt service payments for a facilities loan when the Illinois budget crisis resulted in delayed reimbursements. The bank was entirely unsympathetic to its plight. In contrast, GoodShepherd’s revenues fell short because of a continually shrinking donor base; in the interview, the leader stressed how much more monthly cash it would need to keep-up with loan payments due and how finding new donors was nigh on impossible with the current economy. Its lender, a community bank, so far had been sympathetic to its plight, being more relaxed about timely payments.

In short, YouthFirst’s debt situation was more favorable – just delays outside its control; but GoodShepherd’s situation was much direr. Nevertheless, they scored the same. Within the new Star System, GoodShepherd received 2 Stars, meaning it meets most industry standards but underperforms. YouthFirst receive 3 Stars, meaning it meets or exceeds industry standards and performs better than most comparable charities. But if lenders specifically were interested in debt management, these ratings (the old and the new) do not convey the very different circumstances between the two organizations. That begs the question of how useful Charity Navigator is when making decisions about issuing loans to them.
Charity Navigator included my other case studies but did not assign them ratings in the pre-2000 system. It noted that Skyward, LakeSide, and ElmGrove had too little direct donation revenue and that BetterTomorrows, NewDream, PlowShares, and Fundamentals did not have enough revenue. But there were no reasons why CareHub, Aspire, and RiseFree were not rated, but my analysis for their IRS 990 suggested they were omitted because they did not meet the administrative and fundraising expense benchmarks. In short, most of my cases were not large and professionalized enough to warrant a rating – or had information useful to lenders.

After 2020, these cases did receive scores through Charity Navigator’s new Encompass product. The new automated scoring system meant Charity Navigator added 150,000 more organizations to its database, with the goal of attracting more users. My case study organizations received the following scores on a 100-point scale: LakeSide and RiseFree (100); CareHub (93); Aspire, ElmGrove, and Skyward (85); BetterTomorrows (82); NewDream (75); and Fundamentals (65). Plowshares did not receive a score since it filed a Form 990-EZ (Table 10). Each organization’s debt-to-asset ratio hurt its scores, except for LakeSide which scored 15/15 points. CareHub and RiseFree scored 8/15. The rest scored 0/15, even though the interview data showed some of these nonprofits were not struggling with their debts (see Chapter 3).

Overall, Charity Navigator uses its scoring/rating system to make nonprofit information more quickly and easily digestible, compared to GuideStar. According to it, a lender or donor can just look at the stars to see what charity is more successful and deserves financial support, on the assumption that charities with better scores/ratings offer a between return on investment. However, these “distilled measures” can distort IRS Form 990 data (with limitations I discussed earlier), although Charity Navigator does not address these limitations.
More importantly, perhaps, it is unclear why Charity Navigator chose its specific benchmarks and rubrics. For example, why do charities with liabilities-to-asset ratios under 50 percent receive “full credit” while those between 50 to 60 percent get only “partial credit.” It explains it is a measure of “solvency and/or long-term sustainability.” However, solvency is usually measured several different ways in addition to total debt ratios. (e.g., current ratio, quick ratio, interest coverage ratio, etc.). Solvency is the measure of how well an organization could pay off its debts, which includes liquidating all assets (e.g., selling off facilities) in the case of foreclosure. If banks are unlikely to do this (see Chapters 3 and 4), it isn’t clear how useful these ratios are to lenders? Lenders want to know how easily a borrower can make debt service payments, but Charity Navigator’s ratios do not really address these types of concerns.

In the next section, I analyze information on my case study organizations by for-profit brokers. I follow that with a comparative analysis of how useful for-profit brokers are to Charity Navigator and GuideStar. Specifically, do they reduce the information asymmetry that matters most for the lenders and borrowers compared to what can be achieved by exchanging the more qualitative information that the participant interview data suggest are important?

**For-profit information brokers**

Neither nonprofit finance scholars nor the nonprofit practitioner literature uses for-profit credit rating systems. But to lenders, these are their bread and butter. Out of all the information brokers mentioned in RMA training, for-profit brokers got the most attention. Checking credit ratings is a given in almost all lending transactions. These ratings are specifically designed to reduce information asymmetry by telling loan officers how likely it is that a potential borrower can pay back a loan. This contrasts with the nonprofit rating system that must rely on limited Form 990 data and serve both donor and lender users.
For my analysis, I used data provided by Mergent-Intellect – a service that provides a variety of business data, including information from Dun & Bradstreet (D&B).\textsuperscript{13} D&B has expertise with credit ratings and risk assessment, which makes it very pertinent to evaluating my case study organizations. Nonprofits may sign up and create an account for a variety of reasons. Many do because lenders and some grantors (i.e., grants.gov) require it. In its dataset, all organizations that sign up have a unique DUNS number, which indexes basic organizational information (location, phone, contact names, etc.), basic financial information, and credit rating measures.

D&B’s methodology is obscure and proprietary; but business practitioner websites speculate that some factors include: credit utilization ratios, recent credit searches, filing taxes on time, number of credit accounts, new accounts recently opened, and delinquent accounts (e.g., Becker, 2012). The information sources used by D&B are also proprietary. Since its measurements include monthly data, it must have sources other than the IRS 990 information for nonprofits (e.g., loan application files).

The Mergent-Intellect database provided two creditworthiness measures from D&B. First, the near-term credit outlook rating measures how likely an organization will pay its bills over the next twelve months. Second, the very near-term credit outlook rates an organization’s ability to pay bills on time (or at least within 90 days) over the next six months. Based on these descriptions, the measurements likely use some coverage ratios (e.g., interest coverage, debt-service coverage, cash coverage, etc.) and trend analysis to make predictions. Both types of measurements use an ordinal scoring (e.g., most/least likely to pay, low/high risk).

\textsuperscript{13} Mergent-Intellect is available through IU Libraries.
All my case study organizations received scores, except PlowShares which could not be found for unknown reasons (Table 11). For the near-term credit outlook, most of the case studies fell under the “low risk” category. BetterTomorrows and GoodShepherd were “medium risk.” The very near-term scores fell across the board. The “most likely to pay” were: Aspire, Fundamental, ElmGrove, and Skyward. The “likely to pay” were CareHub, LakeSide, and RiseFree. New Dream was “neutral.” The “less likely to pay” were Fundamentals and BetterTomorrows. NewDream and GoodShepherd were the “least likely to pay.”

In the next section, I compare GuideStar, Charity Navigator, and D&B scores with interview information.

**Comparison of information broker scores**

As part of my analysis, I compared D&B information to Charity Navigator ratings. Case study data are generally too small for a correlation comparison, but tables can indicate relationships that can be studied in future, larger-n studies.

I compared the internal consistency of Charity Navigator and D&B scores for my case study nonprofits. First, I looked at Charity Navigator’s scores (the overall score and the debt score) for each of my case study nonprofits (Table 12). There was no clear relationship between the two measures. For example, six cases received a zero score for debt, but their overall scores ranged from 65 to 85 (out of 100). Very likely this is because the overall score is composed of

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14 I search under several versions of the name, etc., but it is simply not there.
15 Because D&B only shares its most recent scores on Mergent-Intellect, I collected Charity Navigator’s most recent scores (overall and debt) for comparison. Most come from 2019, so there is a three-year gap with D&B scores. My analysis did not find any profound relationships between the two, but several had some face validity.
many factors (e.g., governance) not included in the comparison. Second, I compared the internal consistency of D&B’s credit risk score (moderate/low) to the “likelihood to make payments” score for each case study nonprofit. These were more consistent. Seven cases were both “low credit risk” and “likely to pay” (Table 13) – most likely because the latter is a component of the former. D&B just measures credit as opposed to Charity Navigator assesses a wide variety of nonprofit characteristics.

Additionally, I compared Charity Navigator and D&B scores. First, I found seven cases had both a high Charity Navigator overall score (85 or more) and were scored “low risk” by D&B, indicating consistency between the two scoring/rating systems (Table 14). Similarly, cases that D&B said were likely to pay also had higher Charity Navigator scores (Table 15). But any relationship between “likelihood to make payments” and Charity Navigator total score is ambiguous (Table 16), as is the comparison between credit risk and debt scores (Table 17).

These relationships are neither statistically nor substantially significant. More importantly, these types of analyses are included in the qualitative sources of information used in my case studies, so it is not surprising that they do not tell us much. But they do raise interesting questions about how different information brokers assess nonprofits and should be the subject for further research. In the near future, I hope to follow-up on these observations to see if they are generalizable.

**Summary**

Information brokers are secondary actors in the nonprofit capital marketplace; they standardize and score nonprofits so a data user can easily assess and compare them. The nonprofit information brokers rely mostly on annual data from the IRS Form 990s, while the for-
profit brokers appear to use some monthly data, but the source is unclear. The more debt a nonprofit has, the lower nonprofit information brokers rate it. The message is that debt is bad and the more debt, the worse off the nonprofit is. Depending on how much a nonprofit cares about its score/rating, it might decide not to borrow because of this normative pressure, resulting in discouraged demand. Notably, for-profit rating systems do not give low ratings for having debt but focus instead on ability to pay back the bank. The for-profit broker ratings are consistent with my case study findings. Paying the monthly bills is the top priority and that means having cash on hand.

**TERTIARY ACTORS**

While the primary actors are the borrowers/lenders, and secondary actors bridge gaps between the two, tertiary actors affect the entire ecology. The governmental regulators, described by the practitioner literature and participants, are the tertiary actors in the nonprofit capital marketplace. A well-known example is the Small Business Administration (SBA) – a governmental agency that seeks to improve opportunities for small businesses and entrepreneurs, including their access to capital. Loans to these types of businesses are pretty risky, since they have an extremely high failure rate – only half survive five years (SBA 2019). Banks are less likely to work with small businesses, unless there are other funding programs that reduce the risk. The SBA is one such program and may back loans up to 90 percent (like 7(a) loans depending on the program),¹⁶ so lenders do not face as much risk. Thus, it encourages banks to lend to small businesses more often and at a lower interest rate.

¹⁶ See documentation on the SBA website, e.g., https://www.sba.gov/partners/lenders/7a-loan-program/types-7a-loans
Nonprofits generally do not qualify for SBA loans, yet they face similar capital access challenges.\textsuperscript{17} Instead, the Community Reinvestment Act (CRA) has made capital more accessible to certain kinds of nonprofits (i.e., located in certain geographic areas and with community-related missions)\textsuperscript{18} according to the practitioner literature and study participants. But participants had mixed opinions about the CRA (and its revisions). In this section, I analyze how participants and the practitioner literature describe the role of the CRA in trying to improve nonprofit access to capital. I give particular attention to one revision, the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, which both created Community Development Financial Institutions and allowed bank mergers and acquisitions that resulted in fewer community banks. I use empirical and theoretical literature in the analysis.

**Community Reinvestment Act (CRA)**

The CRA is not specifically designed to help nonprofits, although nonprofits are affected. Congress enacted the Community Reinvestment Act (CRA) in 1977, because banks increasingly were not serving their local neighborhoods. Instead, they were pursuing more profitable, less risky clients. To ensure more equitable access to credit, the CRA encouraged banks to lend to individuals and organizations (including certain kind of nonprofits) within their local area. The goal was to meet the credit needs of the entire community.

\textsuperscript{17} Nonprofits do qualify for SBA loans for disaster relief.

\textsuperscript{18} CRA regularly updates examples of qualifying nonprofit programs. For example, loans to nonprofits that increase computer and information access and literacy is now acceptable. Qualifying areas including, “Public welfare investment, under 12 CFR part 24, that supports a nonprofit that provides general education degrees partially or primarily to LMI [low-middle income] individuals without a high school diploma.”
Because the CRA has been around for so long, the lender interviews showed it had become an integral part of normal banking operations. Matter-of-factly, M-Andrew explained that banks “have to provide your bank’s services within your footprint and provide equal service and opportunity” as a given. Similarly, M-Andrews explained that the CRA “assesses the institution’s record of meeting the credit needs of its entire community.” CRA requirements might now be hardwired into the banking industry, because they became effective 45 years ago – before most participants began their careers. But they also have repercussions if requirements are not met. J-Davidson claimed that a bank which fails its CRA test faces severe penalties (e.g., prohibited from opening new branches, merging or purchasing other banks); and if scores do not improve, it may be shut down completely.19

But while the CRA increased access to capital, neither borrower nor lender participants thought very highly of the CRA’s effects on nonprofit lending. To them, banks motivated by regulatory compliance are not real partners in the local community. They lend because they have to check off their CRA requirements, but not because they are intrinsically motivated to help the community or support the mission. The regulations conflict also with community banking ideals. For example, J-Davidson encouraged workers to think about the bank as the “village pub” – a place where small, private business owners come together and collaborate to make the town better. In comparison, the CRA trivializes the value of working with the local community by making it just another regulatory form to fill out. Skyward’s director explained that this is the problem with bigger, profit-oriented banks:

19 But when I researched the CRA, I found it did not mandate any penalties; instead, it is meant to encourage banks. Regulators take CRA compliance into account when a bank applies for branches/mergers/acquisitions.
My stereotypical vision is that large banks basically view it as meeting their CRA requirements. Small banks typically view it as being a good neighbor. In the end, what I find is that they all want a return on their investment financially, they all want a financial return on their investment. I guess I feel like I lack a good clear understanding in terms of what is that vision that they have for how their investment impacts things and where they expect that investment to go.

From K-Jansen’s perspective, yes, while some banks are just motivated by the CRA regulations, they have the potential to grow into a bank that cares about community:

> Banks are going to be interested in working with nonprofits because you have the Community Reinvestment Act, so they get credit for different work there. I think there are some people in some banks (probably some people in all banks for that matter) that the only reason they want to do stuff in the community is for CRA credit. I do not agree with that approach, [but] at least they are doing something still. But I think there is a growing base of compassion.

This reflects his personal vision and mission to reinvigorate community lending by establishing nonprofit loan programs. In this case, extrinsic punitive motivators can become intrinsically rewarding ones.\(^\text{20}\)

Additionally, my analysis reveals that revisions to the CRA over the years have frustrated some study participants – “a chaos in banking regulation,” as B-Jacobs described it. ElmGrove’s leader explained that banks that once worked with nonprofits stopped several years ago, because of regulatory changes. Such abrupt changes make the market unpredictable and erodes trust. A bank that once looked community-oriented turns out to be more profit motivated. This not only increases discouraged demand (discussed earlier in this chapter) but is compounded by the reduced ability of borrowers to shop for different lenders (limited information on the market).

\(^\text{20}\) My analysis found that some empirical literature supports the idea that lenders could internalize extrinsic motivations over time (Reid, 2012; Kennedy, 2021; Casey et al., 2017). For example, self-determination theory says people will integrate them to overcome loss of autonomy, a basic human need (Deci & Ryan, 1985; 2000).
Overall, the CRA might have improved nonprofit access to capital, but borrowers and lenders do not perceive it that way.

As part of my analysis, I investigated the history of CRA revisions and what factors could have contributed to these changes, since participants noted it negatively affects nonprofit access to the capital marketplace – i.e., loss of handshake loans. The Riegle–Neal Interstate Banking and Branching Efficiency Act (1994) is one of those factors. The Act’s primary titular aim was to allow national banks to operate across state lines; after it passed, banks could open branches outside of their home state. This allowed big banks to grow even larger. At the same time, the number of smaller, more local, privately-owned banks decreased, as they were purchased and consolidated by larger banks (Avery & Smaolyk, 2004).

The ecological niche formerly held by smaller, local banks is now dominated by bigger ones. For example, my analysis of FDIC data show that the number of community banks nationwide decreased by 70 percent (62,495 to 18,444) from 1994 to 2020. Over the same time span in Indiana, the number decreased 82 percent (from 1,988 to 357). Nationally, Hanauer and colleagues (2021) found that 4,277 community banks and 127 non-community banks operated in the United States. Larger national and regional banks increased the number of branches in urban areas and to a lesser degree in rural communities (Hanauer et al., 2021; Casey et al., 2017; Petach et al., 2021). However, branches of national banks do not replace the services that community banks offer. National banks impose their processes on local establishments, leaving less flexibility for the relationship lending practices that local businesses and nonprofits relied upon (Marquis & Lounsbury, 2007).
In my data, nonprofits expressed preferences for customized, relationship-based loans (i.e., lenders as stakeholders). But larger banks rely on more quantitative-based credit checks than qualitative information. The lender PL suggests loan officers do not much flexibility. Unlike M-Smith’s bank, they cannot simply ignore what their underwriters say. In contrast, community banks are less likely to adopt these new technologies (FDIC, 2020; Berger & Frame, 2007). Relatedly, business scholars have found that neighborhoods banks provide “local loans” which make credit more accessible, that small businesses are more likely to be approved, and less likely to default (e.g., Brevoort & Hannan, 2006; DeYoung et al., 2008).

CRA revisions influence the organizational ecology of lenders, which in turn affect nonprofit access to the type of loans they prefer. In the next section, I present my analysis on Community Development Financial Institutes – another product of CRA reforms.

**Community Development Financial Institutions (CDFI)**

The CRA forced banks to lend to local, potentially riskier organizations, instead of pursuing the most lucrative clients. But as participants explained, some banks treated CRA requirements as just another regulation, decoupled from the primary profit motivation of large banks, The CRA did not cultivate this community service ideal. CDFIs stepped into this breech. Created by the Riegle–Neal Interstate Banking and Branching Efficiency Act that allowed big banks to expand, CDFIs gave banks the opportunity to “contract out” their CRA requirements to specialist institutions entirely dedicated to low-middle income communities and disadvantaged communities – including nonprofits focused on such areas (Benjamin et al., 2016; Mendez, 1997). Thus, Riegle-Neal populated the nonprofit capital marketplace with a new type of organization, CDFIs, allowing large banks to withdraw from particular markets, and focus on their core business.
We generally refer to these organizations simply as “CDFIs,” because they are certified through the CDFI Fund, housed in the US Department of Treasury. They include both nonprofit and for-profit lenders, such as banks, credit unions, venture capital, and other loan funds. While credit unions and banks are regulated through the FDIC and NCUA respectively, the IRS regulates Community Development Loan Funds, Microenterprise Development Loan Funds, and Community Development Corporations (e.g., Illinois Facilities Fund, Community Investment Fund of Indiana). Nonprofit loan funds are the stereotypical CDFI and comprise over half of all CDFIs.\(^{21}\) Nationwide, about 20 percent of CDFIs are for-profit (CDFI Fund, 2021). To be eligible for certification, the lender must be a legal, non-governmental financing entity, with a community development mission that it carries out in conjunction with financing activities. CDFI’s provide financial services for communities and organizations underserved by traditional commercial lenders (McLenighan & Tholin, 1997). A CDFI is required to keep close contacts with clients, using such mechanisms as recruiting board members from its local market.

But with these restrictions come opportunities as well. In my data, three lenders and one expert currently or formerly worked at CDFI organizations. They described themselves as “recovering bankers,” who joined CDFIs to work for something other than just making a profit for a business. Comparing banks to CDFIs, they explained that the latter gave them more

\(^{21}\) One of the primary challenges to understanding CDFI impacts is that non-regulated loan funds use a variety of reporting methods that are options under GAAP (generally accepted accounting principles), compared to regulated ones, like credit unions. This creates its own information asymmetry issues for investors interested in investing in CDFI programs, one of the ways CDFIs get the capital to lend to nonprofits (Department of the Treasury, 2013). This has spawned information brokers specifically for CDFIs, e.g., Aeris. While non-regulated CDFIs make up the largest number of CDFIs, regulated ones are ten times larger in terms of assets (CDFI Fund, 2021).
freedom and flexibility to work with the “riskier” borrowers, not allowed by their former profit-motivated employers.\textsuperscript{22} As G-Jacobs explains:

\begin{quote}
We’re not subject to the same safety and soundness exams and regulations like the banks are. We do not take deposits so nobody’s insuring our depositors against losses. I mean, I think that it is perfectly appropriate that the federal government has protections to the taxpayers that prohibit banks from doing ridiculously high-risk things. The banks - It would be probably high risk if the banks were doing it, because they do not have the relationships and they are formula lenders and they do not provide the technical assistance.
\end{quote}

Even so, CDFIs still face competition from commercial banks, online lenders, and community banks because. CDFI loans are not necessarily cheaper for nonprofit borrowers, even when government-backing reduces loan interest rates (K-Jansen; Federal Reserve Bank, 2017). But there is also coordination and partnerships among different lenders. Participants explained that CDFIs avoid areas that are already being served by community banks, because they both have similar community-serving missions. For example, B-Kelly lauds the community banking industry in her CDFI’s state. “It has a strong community banking industry and so there are community banks that have great relationships and really want to work with non-profits and their loan officers often have authority to lend up to $50,000 or $100,000 on their own signature and they, of course, have an incentive to make loans to get business.” Consequently, there is no reason for the CDFI to insert itself into that market, if it is already being served, or for a CDFI to expand beyond its niche in this case.

Other CDFIs actively collaborate with other lenders. At the national level, the CDFI Fund and the Opportunity Finance Network help connect CDFIs and other lenders. CDFIs can also form local networks, where for example, a smaller CDFI can partner with a larger CDFI on a

\textsuperscript{22} Part of this is one-on-one funding.
Some actively collaborate with community banks to fulfill local needs (Jagtiani & Lemiuex 2016; Davis & Wilcox, 2013). G-Jacobs explains her CDFI is part of a larger lender consortium with

…nice programs we offer to this day and it is a way that we can leverage our much more limited capital with banks where we’re taking some of the risk on their behalf. We’re helping to mitigate their risk and give them CRA credit for making loans in low-income neighborhoods.

CDFIs can also step-in to refinance bank loans that have overly restrictive covenants or are at risk of default (L-Turner; YouthFirst). G-Jacobs talks about tight relationships between her CDFI and their community banks. When a loan applicant comes to her CDFI, she might refer them to the community bank, if it has a program that better suits their needs, and vice versa.

While the interviews make this sound like an ad hoc process, Federal regulators (e.g., Office of the Comptroller of Currency) have rules about how CDFIs and banks manage these relationships, especially the financial side (OCC, 2019). For example, banks can support CDFIs via grants, loans and equity-equivalent investments (similar to impact investment). They can also purchase loans, much like banks buy home mortgages. The bank receives CRA credit, when the CDFI makes a loan that complies with CRA rules (e.g., within the bank’s local area and meeting community development needs). Banks can also provide technical assistance, like helping the CDFI develop underwriting standards and loan applications, sitting on the CDFI board, help with fundraising, etc.

But there is still the problem of finding the right marketplace. Smaller, local CDFIs - like community banks - know the local market. But most CDFIs tend to be concentrated in urban areas and are unequally distributed across the country. For example, Indiana has 10 CDFIs while Illinois has 35 (CDFI Fund). Some CDFIs have overcome the problem of finding markets by
locating offices in smaller to mid-sized cities. This allows staff to develop local knowledge and better coordinated with community banks, local governments, and other organizations focused on community development (Theodos & Gonzalez-Hermoso, 2021).

**Summary**

With the CRA, Federal regulators sought to encourage banks to lend to the local market, instead of just focusing on more profitable clients outside the community. This preserved access to capital in neighborhoods that faced challenges like poverty and unemployment. Banks which do not follow CRA regulations face penalties if they try to grow (e.g., establish new branches, engage in mergers). In a sense, regulators forced larger banks to provide the types of services the community banks did as described in my data. While this did increase nonprofit capital access, study participants said a bank that is just looking to check-off a requirement, does not truly invest in the nonprofit’s mission and community role. When CRA revisions allowed banks to grow even larger, it also created CDFIs that specialized in CRA-related activities. This allowed a sort of networked service provision (i.e., capital access) to grow from the coordination between large banks, community banks, CDFIs, government, and other institutions. Regulations affect the nonprofit capital marketplace by structuring and codifying the cultural institution of community-based and development lending.

**DISCUSSION**

In this chapter, I seek to answer the question: How does the environment affect borrower-lender relationships? In previous chapters, my analysis showed that lenders and borrowers do not make their decisions solely based on their own organizational needs; rather, they operate in an open system where the external environment affects their choices. To examine this the borrower-lender environment, in this chapter I analyzed perceptions of the nonprofit capital marketplace in
my practitioner literature and interview datasets, since lender perceptions of the environment shape their choices (Lawrence & Lorsch, 1967). Then I use additional data sources (e.g., FDIC banking data) and empirical literature (e.g., small business studies) to analyze and give context to these observations.

I draw three conclusions from this analysis. First, to use capital structure theory, we need to understand the nonprofit capital marketplace, so I began by analyzing supply (lenders) and demand (borrowers). I found that borrowers and lenders have trouble finding each other in the marketplace. Geographic proximity helps, as in the case of the relationship between local community banks, locally focused CDFIs, and nonprofits. The CRA’s geographic requirements also have effects. But larger CDFIs have trouble finding areas that need nonprofit loans. And instead of competing over small business clients, banks will investigate local nonprofits to see if they can benefit – almost like a donor trying to find a cause. Furthermore, loan interest rates and covenants do not necessarily represent the true agreement between borrower and lender.

Second, institutional pressures (i.e., rules, social structures, requirements, beliefs, and morals) shape the marketplace. Interview participants talked about the loss of the “handshake” loan; they believed in the institution of community banking, where decision-makers consider the nonprofit mission and local needs in addition to financial matter. My analysis shows the Federal regulations have used both a carrot (CDFI) and a stick (CRA) to preserve local lending to local areas, where loans are not as profitable. But these regulations also contributed to the decline of community banks, where a culture of community capitalism dominated. Empirical research shows these changes have affected small businesses and rural economies. My analysis indicates nonprofits might be facing the same challenges.
Additionally, the practitioner literature and information brokers push normative ideas of what a financially healthy nonprofit should look like. They say nonprofits should only borrow if they meet certain professionalized benchmarks. A nonprofit reading this message might be discouraged from applying for a loan, if it is just going to get rejected. Both the nonprofit and practitioner literature preach how risky and catastrophic nonprofit loans can be. For the nonprofit capital market, the result is discouraged demand and supply. The fact that some nonprofits have zero debt does not necessarily mean they are not interested in securing a loan.

Third, information brokers can connect lenders and borrowers. Nonprofit brokers (e.g., GuideStar, Charity Navigator, and Charity Watch) create databases of nonprofits and score them based on various rubrics. However, my case study organizations are largely unaffected by these rating systems. When they were scored, it was mostly the result of an automated algorithm that relies on annual IRS Form 990 data. In Chapters 3 and 4, I found that neither borrowers nor lenders use annual information; rather, the most important financial issue is the nonprofit’s ability to make monthly debt service payments. Dun & Bradstreet, a for-profit information broker, assesses these more relevant indicators and assigned scores to almost all the case studies. But D&B’s rubric is not transparent. Moreover, I found no relationship between any information brokers’ scores and how study participants used financial information. This disconnect raises questions about whether we have the right datasets to map a marketplace.

These findings suggest several theories and literature streams will help us formulate a better picture of nonprofit debt’s organizational ecology and market. For example, the empirical and theoretical work on small businesses echoes the perspectives expressed in the practitioner literature and participant interviews. The Small Business Administration cultivates and encourages that market; nonprofits, however, do not have an equivalent champion. The nonprofit
programs related to CDFIs and CRA are not as developed. Studying the environmental conditions that influence nonprofit debt also give us an opportunity to study intersectoral relationships. I discuss these items further in Chapter 6.
**WORKS CITED**


Department of the Treasury – CDFI Fund (Feb 5, 2013). Guarantees for bonds issued for community or economic development purposes; final rule. Federal Register (78; 24)


### Table 10: Case study nonprofit information broker scores, compared to IRS 990 and interview information

<table>
<thead>
<tr>
<th>Alias</th>
<th>GuideStar</th>
<th>Charity Navigator (Pre-2020)</th>
<th>Charity Navigator (2020)</th>
<th>Size</th>
<th>Total Liabilities / Total Assets (TL/TA)</th>
<th>Total Revenue / Total Assets (TR/TA)</th>
<th>ΔTL/TA</th>
<th>Long-term Liabilities / Total Liabilities</th>
<th>Tangible Assets / Total Assets LBE</th>
<th>Donative or Fee-for-service Revenue</th>
<th>State</th>
<th>Interview comments re debt problems</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skyward</td>
<td>Platinum</td>
<td>NR - Too little direct individual donations</td>
<td>85</td>
<td>$3,000K - 5,000K</td>
<td>50-75%</td>
<td>&lt;25%</td>
<td>&lt;10%</td>
<td>90-100%</td>
<td>&lt;50%</td>
<td>FFS/D</td>
<td>IL</td>
<td>Had troubles, but resolved</td>
</tr>
<tr>
<td>YouthFirst</td>
<td>Platinum</td>
<td>75-100</td>
<td>86</td>
<td>$3,000K - 5,000K</td>
<td>50-75%</td>
<td>50-75%</td>
<td>&lt;10%</td>
<td>90-100%</td>
<td>50-75%</td>
<td>D</td>
<td>IL</td>
<td>Previous troubles making payments</td>
</tr>
<tr>
<td>RiseFree</td>
<td>Silver</td>
<td>NR - potentially could be rated</td>
<td>100</td>
<td>$1,000K - 3,000K</td>
<td>75-100%</td>
<td>&gt;400%</td>
<td>+&lt;10%</td>
<td>10-50%</td>
<td>&lt;50%</td>
<td>D</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>Better-Tomorrows</td>
<td>Bronze</td>
<td>NR - below revenue threshold</td>
<td>82</td>
<td>$500K - 1,000K</td>
<td>75-100%</td>
<td>50-75%</td>
<td>NC</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>FFS</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>Aspire</td>
<td>None</td>
<td>NR - potentially could be rated</td>
<td>85</td>
<td>$1,000K - 3,000K</td>
<td>75-100%</td>
<td>200-400%</td>
<td>&lt;10%</td>
<td>75-90%</td>
<td>50-75%</td>
<td>D</td>
<td>IL</td>
<td>No troubles</td>
</tr>
<tr>
<td>CareHub</td>
<td>none</td>
<td>NR - potentially could be rated</td>
<td>93</td>
<td>&lt;$500K</td>
<td>&gt;100%</td>
<td>&gt;400%</td>
<td>&lt;10%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>D</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>ElmGrove</td>
<td>none</td>
<td>NR - Too little direct individual donations</td>
<td>85</td>
<td>$1,000K - 3,000K</td>
<td>50-75%</td>
<td>200-400%</td>
<td>No change</td>
<td>50-75%</td>
<td>50-75%</td>
<td>FFS</td>
<td>IL</td>
<td>Struggling with too much debt</td>
</tr>
<tr>
<td>Fundamentals</td>
<td>none</td>
<td>NR - below revenue threshold</td>
<td>65</td>
<td>&lt;$500K</td>
<td>75-100%</td>
<td>100-200%</td>
<td>+&gt;50%</td>
<td>75-90%</td>
<td>50-75%</td>
<td>FFS</td>
<td>IN</td>
<td>Troubles finding lender initially</td>
</tr>
<tr>
<td>Good-Shepherd</td>
<td>none</td>
<td>75-100</td>
<td>85</td>
<td>$1,000K - 3,000K</td>
<td>50-75%</td>
<td>50-75%</td>
<td>NC</td>
<td>50-75%</td>
<td>&gt;75%</td>
<td>D</td>
<td>IN</td>
<td>Troubles making payments</td>
</tr>
<tr>
<td>Lakeside</td>
<td>none</td>
<td>NR - Too little direct individual donations</td>
<td>100</td>
<td>$5,000K - 7,000K</td>
<td>50-75%</td>
<td>200-400%</td>
<td>+&lt;10%</td>
<td>&lt;10%</td>
<td>50-75%</td>
<td>FFS</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>NewDream</td>
<td>none</td>
<td>NR - below revenue threshold</td>
<td>75</td>
<td>&lt;$500K</td>
<td>75-100%</td>
<td>75-100%</td>
<td>+&gt;50%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>FFS</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>Plowshares</td>
<td>none</td>
<td>NR - below revenue threshold</td>
<td>None</td>
<td>&lt;$500K</td>
<td>50-75%</td>
<td>90-100%</td>
<td>+&gt;50%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>D</td>
<td>IN</td>
<td>Trouble getting loans</td>
</tr>
</tbody>
</table>
Table 11: Case study D&B scores and ratings compared to IRS 990 and interview information

<table>
<thead>
<tr>
<th>Alias</th>
<th>D&amp;B score (Risk)</th>
<th>D&amp;B rating (Likely to pay)</th>
<th>Size</th>
<th>Total Liabilities/Total Assets (TL/TA)</th>
<th>Total Revenue/Total Assets (TR/TA)</th>
<th>ΔTL/TA</th>
<th>Long-term Liabilities/Total Liabilities</th>
<th>Tangible Assets/Total Assets LBE</th>
<th>Donative or Fee-for-service Revenue</th>
<th>State</th>
<th>Interview comments re debt problems</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aspire</td>
<td>Low</td>
<td>Most likely</td>
<td>$1,000K - 3,000K</td>
<td>75-100%</td>
<td>200-400%</td>
<td>&lt;10%</td>
<td>75-90%</td>
<td>50-75%</td>
<td>D</td>
<td>IL</td>
<td>No troubles</td>
</tr>
<tr>
<td>Fundamentals</td>
<td>Low</td>
<td>Most likely</td>
<td>&lt;$500K</td>
<td>75-100%</td>
<td>100-200%</td>
<td>+50%</td>
<td>75-90%</td>
<td>50-75%</td>
<td>FFS</td>
<td>IN</td>
<td>Troubles finding lender initially</td>
</tr>
<tr>
<td>ElmGrove</td>
<td>Low</td>
<td>Most likely</td>
<td>$1,000K - 3,000K</td>
<td>50-75%</td>
<td>200-400%</td>
<td>No change</td>
<td>50-75%</td>
<td>50-75%</td>
<td>FFS</td>
<td>IL</td>
<td>Struggling with too much debt</td>
</tr>
<tr>
<td>Skyward</td>
<td>Low</td>
<td>Most likely</td>
<td>$3,000K - 5,000K</td>
<td>50-75%</td>
<td>&lt;25%</td>
<td>-10%</td>
<td>90-100%</td>
<td>&lt;50%</td>
<td>FFS/D</td>
<td>IL</td>
<td>Had troubles, but resolved</td>
</tr>
<tr>
<td>CareHub</td>
<td>Low</td>
<td>Likely</td>
<td>&lt;$500K</td>
<td>&gt;100%</td>
<td>&gt;400%</td>
<td>-10%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>D</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>Rise free</td>
<td>Low</td>
<td>Likely</td>
<td>$1,000K - 3,000K</td>
<td>75-100%</td>
<td>&gt;400%</td>
<td>+10%</td>
<td>10-50%</td>
<td>&lt;50%</td>
<td>D</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>LakeSide</td>
<td>Low</td>
<td>Likely</td>
<td>$5,000K - 7,000K</td>
<td>50-75%</td>
<td>200-400%</td>
<td>+10%</td>
<td>&lt;10%</td>
<td>50-75%</td>
<td>FFS</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>YouthFirst</td>
<td>Low</td>
<td>Neutral</td>
<td>$3,000K - 5,000K</td>
<td>50-75%</td>
<td>50-75%</td>
<td>-10%</td>
<td>90-100%</td>
<td>50-75%</td>
<td>D</td>
<td>IL</td>
<td>Previous troubles making payments</td>
</tr>
<tr>
<td>NewDream</td>
<td>Low</td>
<td>Least likely</td>
<td>&lt;$500K</td>
<td>75-100%</td>
<td>75-100%</td>
<td>+50%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>FFS</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>Better-</td>
<td>Medium</td>
<td>Less likely</td>
<td>$500K - 1,000K</td>
<td>75-100%</td>
<td>50-75%</td>
<td>NC</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>FFS</td>
<td>IN</td>
<td>No troubles</td>
</tr>
<tr>
<td>Tomorrows</td>
<td>Medium</td>
<td>Least likely</td>
<td>$1,000K - 3,000K</td>
<td>50-75%</td>
<td>50-75%</td>
<td>NC</td>
<td>50-75%</td>
<td>&gt;75%</td>
<td>D</td>
<td>IN</td>
<td>Troubles making payments</td>
</tr>
<tr>
<td>GoodShepherd</td>
<td>Medium</td>
<td>Least likely</td>
<td>$1,000K - 3,000K</td>
<td>50-75%</td>
<td>50-75%</td>
<td>NC</td>
<td>50-75%</td>
<td>&gt;75%</td>
<td>D</td>
<td>IN</td>
<td>Troubles making payments</td>
</tr>
<tr>
<td>Plowshares</td>
<td>No data</td>
<td>No data</td>
<td>&lt;$500K</td>
<td>75-100%</td>
<td>75-100%</td>
<td>+50%</td>
<td>90-100%</td>
<td>&gt;75%</td>
<td>D</td>
<td>IN</td>
<td>Troubles finding lender</td>
</tr>
</tbody>
</table>
Table 12: Charity navigator overall score and debt score

<table>
<thead>
<tr>
<th>Charity Navigator debt score</th>
<th>Charity navigator score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero</td>
<td>3</td>
</tr>
<tr>
<td>Greater than zero</td>
<td>4</td>
</tr>
<tr>
<td>Less than 85</td>
<td></td>
</tr>
<tr>
<td>85 or more</td>
<td>3</td>
</tr>
<tr>
<td>Low</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 13: D&B Credit risk (12 months) and likelihood to pay (6 months)

<table>
<thead>
<tr>
<th>Credit Risk</th>
<th>Moderate</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Likely to most</td>
<td>0</td>
<td>7</td>
</tr>
<tr>
<td>Neutral to least</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

Table 14: Charity Navigator overall score (out of 100) and D&B Credit risk (12 months)

<table>
<thead>
<tr>
<th>Credit risk</th>
<th>Charity navigator score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moderate</td>
<td>0</td>
</tr>
<tr>
<td>Low</td>
<td>7</td>
</tr>
</tbody>
</table>

Table 15: Charity Navigator overall score and D&B likelihood to make payments over 6 months

<table>
<thead>
<tr>
<th>Likelihood to make payments</th>
<th>Charity navigator score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Likely to most</td>
<td>7</td>
</tr>
<tr>
<td>Neutral to least</td>
<td>0</td>
</tr>
<tr>
<td>Less than 85</td>
<td></td>
</tr>
<tr>
<td>85 or more</td>
<td>1</td>
</tr>
<tr>
<td>Low</td>
<td>3</td>
</tr>
</tbody>
</table>
### Table 16: Charity Navigator Debt to likelihood make payments

<table>
<thead>
<tr>
<th>Likelihood to make payments</th>
<th>Charity navigator score</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Greater than zero</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Likely to most</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Neutral to least</td>
<td></td>
<td>0</td>
<td>2</td>
</tr>
</tbody>
</table>

### Table 17: Charity Navigator Debt Score and Credit risk

<table>
<thead>
<tr>
<th>Credit risk</th>
<th>Charity Navigator debt score</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Greater than zero</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Moderate</td>
<td>Zero</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>
CHAPTER 6: CONCLUSION

This dissertation was inspired by Bowman’s (2002) statement: “The sad fact is that despite a growing literature advising nonprofit managers about finance, we know very little about how they make decisions.” (p. 308) We have few native nonprofit finance theories, likely because nonprofit finance is rather new compared to business. Until the 1920s, nonprofit financial reporting was sparse and inconsistent. Over the subsequent decades, nonprofit finances gained more attention with the growing size of charities, scandals and the exploitation of tax loopholes, and increased governmental funding (Weinstein, 1978; Sanchez et al., 2020; Joint Committee on Taxation, 2005; Arnsberger et al., 2008). In 1978, FASB decided to create specific accounting standards for nonprofits. But it was not until 1993 that FASB issued SFAS (Statement of Financial Accounting Standards) 116 and 117 to improve uniform nonprofit financial statements. In turn, this allowed for greater comparability of financial statements covered by these standards (Anthony, 1995).

Much of nonprofit finance has been built on the data from these statements and forms. From them, we have learned much about nonprofit revenue, endowments, size and structure. We have borrowed theories and concepts from business finance, public finance, and economics to help us answer our research questions. This is true public affairs research tradition – adapting concepts from other fields and making them relevant to the particular topic of concern, here the nonprofit sector (e.g., Lynn 1994).

Our research on nonprofit debt has been both challenging and creative. For example, we’ve borrowed neoclassical business finance theories, such as tradeoff and pecking order, to try to understand why nonprofits borrow and how much they borrow. Researchers have cleverly and
creatively adapted these theories to a nonprofit context. Overall, studies have both been very fruitful but also perplexing, since findings have been mixed and sometimes inconclusive. We’re not alone. To analyze some of my findings, I reached outside the nonprofit and public affairs literature. There I learned business scholars had come to similar conclusions; capital structure theories did not satisfactorily explain small and/or private business\(^1\) borrowing either (e.g., Bessler et al., 2011; Baker & Martin, 2011; Graham & Harvey, 2001).

Capital structure theories also do not tell us how firms actually make decisions; they are not designed to. But organizational theories can. Economics and organizational theory have always had a close relationship. As Williamson explains, “Economics should speak and listen to organizational theory” (1975, 402). Therefore, to answer Bowman’s (2002) point, my research relies heavily on organizational theory to ascertain how nonprofits make financial decisions.

To do so, I use qualitative research methods. My case studies include human service organizations because the decision to borrow may have substantial long-term consequences for not just the nonprofit, but also the community. First, they commonly need specialized facilities to deliver services (e.g., shelters, soup kitchens, childcare, etc.). Second, if these nonprofits falter, it has implications for the larger community. Therefore, the decision to borrow can be a heavy one. My case studies focused on smaller human service organizations with a lot of debt – so much so they could be financially vulnerable according to the “best practices” literature. Therefore, I believed the debt decisions would be forefront in their minds. As I argued earlier, that is not always the case. I also studied lenders; they decide whether or not a nonprofit can borrow. For

\(^{1}\) Arguably small, privately-owned businesses are much more similar to nonprofits than large publicly traded firms. For example, they use project-based loans and are not part of the stock market. They are smaller, with an average of 1 to 19 employees and their managers have lower financial literacy compared to public firms, according to the Small Business Administration.
comparison, I also examined themes in both the nonprofit and lending practitioner literature (e.g., trade journals). But I also examined capital structure theory, business finance, banking research, and economic sociology to help interpret my findings and check their validity.

Finally, I asked how the larger environment affects nonprofit and lender decision-making. Capital structure theories concern economic markets, and markets are where borrowers and lenders interact. To examine how this market operates for nonprofit lending I analyzed how the larger environment affects borrower/lender decisions from an organizational ecology perspective. Capital structure theories acknowledge regulatory effects on asset composition (i.e., tax policy); likewise, participants and the practitioner literature referenced changes in the environment, e.g., government funding programs, bank regulations, ability to locate markets, etc. Organizations cannot shut out the larger world when they make decisions, so we have to understand the environment in which those decisions are made if we are to understand financial behaviors.

Based on these and other findings, I have developed propositions and hypotheses that I hope will help future studies. I present these in this chapter. I also address study limitations and opportunities for future research in general. Specifically, I describe how my dissertation research can inform research on COVID-19 loan decisions. Finally, I enumerate how my research contributes to field, theory, and practice.

**PROPOSITIONS**

Qualitative research is essential in the development of any field or research topic. Its depth complements the breadth of information from quantitative studies. Qualitative research can: (1) identify gaps in knowledge (financial decision-making between nonprofit lender and
Proposition 1: How a nonprofit decides to borrow depends on its location and access to the “loan marketplace.”

While capital structure theories might not be the best way to understand nonprofit borrowing that in no way means markets are not important. Nonprofit borrower and lender decisions are dependent on their participation in and perception of the loan marketplace. At the most basic level, they have to find each other if they are going to agree on a loan. My analysis shows that geographic proximity helps. For example, some lenders are motivated to work with nearby nonprofits, because of CRA regulations. Affinity also matters; neighboring borrowers and lenders may share the same sense of community identity, local history, and values.

Furthermore, geographic proximity increases interorganizational and interpersonal crisscrossing networks among borrowers and lenders. Such interactions increase trust and decreases the perception that nonprofit loans are riskier. We can understand borrowing/lending decisions from a social capital framework as well. These connections increase nonprofit survival, because it gives the organization access to resources (i.e., loans) it would not otherwise be able to activate (e.g., Putnam, 2000; Schneider, 2009). Such networks are the lubricant for the relationship-based lending my participants described. These interorganizational/personal connections also help explain why some lenders are more lenient (even helpful) when their
borrowers run into financial troubles. But too much help can lead to troubles as well. For example, collateralized operation loans and too many missed payments contribute to “permanently failing” nonprofits (Meyer & Zucker, 1989).

Validating my findings, I found the small business research also documents relationships between debt use, lending, and geography. For example, relationship lending technology lets community banks fill a particular marketplace niche and bypass some competition with big commercial banks (Geiger et al., 2012). According to the Small Business Administration, community banks provide 60 percent of all small business loans; additionally, small businesses report more satisfaction with small versus large banks. There are fewer barriers of entry into the loan marketplace, too (Petersen & Rajan, 2002). Nonprofit finance has a few studies on how resource environments and geography affect competition for grants (e.g., Ashley, 2014; Ashley & Faulk, 2010). Integrating and extending this scholarship to debt could help explain how the marketplace affects how nonprofits decide to borrow.

Suggested hypotheses for future research

1A: The more knowledge a nonprofit borrower has about local lenders, the most likely it is to find one that fits its borrowing needs and the more it will be satisfied with the lender’s service.

1B: Compared to commercial banks, community banks are more likely to approve loans to nonprofits.

1C: When community banks lend to nonprofits, they are more likely to rely on relationship lending techniques than financially based underwriting standards.
Proposition 2: Economic, regulatory, and governmental programs affect borrowing and lending decisions.

Economic, regulatory and governmental funding programs (and their interactions) also affect nonprofit borrowing and lending decisions. During economic downturns and financial crises, nonprofits might not have the revenue to make regular mortgage payments, or take out a loan to pay for the cost of fixing damaged facilities. During such times, banking research shows that lenders become more risk adverse (i.e., less likely to lend to nonprofits). At the same time, the government may develop new funding programs during times of crisis (e.g., funds that support low-income housing projects) which can increase nonprofit revenue, making them less risky and more profitable clients, turning nonprofits into a new untapped market.

The real estate market also matters. For example, it is difficult to assess the market value of specialized facilities (e.g., a temporary night/rest shelter). As a result, the nonprofit might not be seen as having the necessary collateral to get the loan. Even if it secures a loan, but defaults on loan payments, a lender is going to be less inclined to foreclose, because of how hard it would be to find a buyer. On the one hand, foreclosing on a nonprofit can also create bad public relations, especially if it is the sole service provider in the area. On the other hand, forgiving loans or being lenient if payments are late can also increase the lenders’ customer base since lenders can use loans (that they plan to forgive) as a type of charitable contribution to sustain the community and its economic health, thus improving business conditions and bank services to those businesses (i.e., good public relations).

Political trends and regulatory programs also affect lending and borrowing. For example, the federal government instituted the CRA (Community Reinvestment Act) to ensure access to capital in low/middle income areas and (ideally) promote urban economic development. A lender
can receive CRA credit in a variety of ways, but lending to a nonprofit might the least costly, while foreclosing on a nonprofit means losing that CRA credit. Additionally, government funding programs like the CDFI Fund and CDFI certifications have created a new niche for certain lenders and corresponding opportunities for certain kinds of nonprofits. But then again this may increase competition among nonprofits and other CRA-approved possible borrowers.

The combined effects of economic, regulatory, and governmental funding programs can be hard to tease apart when we consider nonprofit borrowing and lending decisions. Some nonprofit researchers have studied how these elements affect the sector as a whole. Some have considered environmental conditions and nonprofit revenue (e.g., Froelich, 1999). But there have been relatively few effects to examine the environmental context of nonprofit debt. The complexities of the nonprofit debt marketplace deserve further study if we continue to use economic theories.

**Suggested hypotheses for future research:**

2A. Nonprofits that perform “community development activities” are more likely to get loans and avoid foreclosures.

2B. Increases in government loan subsidies and programs can increase the likelihood of a nonprofit receiving a loan, depending on the stipulations of that program.

**Proposition 3: Institutional logics at the ecological level affect both borrowing and lending decisions.**

Borrowing and lending decisions also depend institutional pressures – i.e., the culture, rules, history and values that guide action and provide meaning to actors (Thornton & Ocasio, 2008; Scott, 2013; DiMaggio & Powell, 1983). Organizations exist in institutional systems, and
as Scott (2013) PAGE explains, “We can better fathom an organization’s behavior by seeing it in the context of the larger action and meaning system in which it participates.” In my analysis, the relevant institutional frameworks for nonprofits are professionalism and amateurism. For lenders they are commercialism and community-orientation.

Institutional stereotypes play a role in borrower and lender behaviors. The nonprofit practitioner literature emphasizes that more professionalized nonprofits make better borrowing decisions. Also, a nonprofit that looks “business-like” appeals to loan officers, because they usually lend to small businesses. The practitioner literature also stereotypes lenders as commercial banks (e.g., profit motivated and thus disinterested in high-risk low-return nonprofit loans). The lender practitioner literature relies on the same nonprofit and lender stereotypes. For example, the Risk Management Association’s training emphasizes that lenders should standardize and systematize nonprofit lending procedures like they do for small business clients.

But interview participants had a different take on these stereotypes. Like the practitioner literature, lenders distinguished the amateur and professionalized nonprofit stereotypes. They described their nonprofit clients as amateur; these are the types of nonprofits that needed their help. Concomitantly, highly professionalized nonprofits like hospitals and colleges should be treated more like businesses. Likewise, they described how the stereotypical community bank is not just motivated by profit; instead, it cares about the community and the work of charitable nonprofits nearby. Within the community bank stereotype, loan officers are stakeholders that care about nonprofit clients so much that they are willing to customize loans and work with nonprofits during tough times.² For the human service participants in my study, being small and

² Business researchers have also found community banks resist conforming to large, commercial bank institutional logics (e.g., Marquis & Lounsbury, 2007).
amateur gives them access to certain types of lenders. The relationship takes on almost a
grantor/grantee tone.

Based on this proposition, I suggest the following hypothesis to test in future debt research:

3A: Community banks are more likely to provide technical assistance, customized loans, and
lenient covenants for nonprofits that conform more to the amateur charity stereotype.

3B: Whether or not a nonprofit has debt (and how much) depends on whether it can find lenders
that shares its values (e.g., believes in its mission).

3C: Highly professionalized nonprofits have less access to community bank loans.\(^3\)

3D: The more the lender conforms to the “community based” stereotype, and the more the
nonprofit conforms to the amateur charity stereotype, the more likely actors will use
grantor/grantee language. Conversely, the more commercial the lender and the more
professionalized the nonprofit, increases the likelihood of business-like transactional language.

**Proposition 4: Decisions about debt rely on both individuals and organizations.**

The nonprofit practitioner-oriented literature emphasized organizational decision-making,
based in processes, procedures, and policies. Likewise, the lender practitioner-literature also
emphasized loan officers should conform to the standards set out by their employer. Yet,
decision-making theory tells us that organizations do not make decisions; individuals do.

In my analysis, I found individuals held significant sway over nonprofit borrowing and
lending decisions. The nonprofit case studies had few executive staff members and overall lower

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\(^3\) This does not mean organizational size, although it is correlated. For wealthy nonprofits,
community banks do not necessarily have the assets available to make the size of loan they need.
organizational capacity. Therefore, instead of relying on a consistent organizational borrowing strategy, they depended on their own personal experience (e.g., prior work in a family business) and made choices based on their personal risk tolerance. Such a process shapes their attribution (i.e., the nonprofit made a bad borrowing decision, and the executive director blames himself entirely), and these emotions sway their future decisions. In short, how a nonprofit borrows may be based on personal dimensions of the individual making the decision to borrow. Without knowing the characteristics of these individual decision-makers, a nonprofit is borrowing pattern can look inconsistent, especially given high rates of board and staff turnover.

Business research validates this finding. Even in large publicly traded firms, an individual’s decision-maker characteristics – e.g., national culture, beliefs about market efficiency, optimism/overconfidence, gender, age, religion, etc. – affect a firm’s capital structure (e.g., Antonczyk & Salzmann, 2014; Brown et al., 2019; Graham & Harvey, 2001; Matthews et al., 1994). While we might assume firms use rational financial analysis to make decisions, in truth it is much more nuanced.

Similarly, depending on the lending institution, loan officers might have more or less personal control over the decision to lend. These personal characteristics can matter so much that a nonprofit will follow them to another bank, if the loan officer gets a job there. A loan officer also has more or less personal control over their own loan portfolio depending on their employer (i.e., community banks rely more on loan officer personal judgments). In my analysis, I found the banking literature affirms this: studies show that large, commercial banks keep tight reins on their loan officers, who are required to use standardized processes and rely on quantitative information to keep costs low (e.g., Bouslama & Bouteiller, 2014). Meanwhile community bank loan officers have much greater discretion.
Suggested example hypotheses for future research:

4A. The fewer executive staff members a nonprofit has, the more the personal characteristics of the staff (e.g., skills, experiences, education, and beliefs) will determine borrowing decisions. In larger, more structured nonprofits, executive staff members’ personal characteristics will still affect borrowing decisions, but to a lesser degree depending on the individuals’ power and influence in the larger group.

4B. Borrowing strategies will appear more inconsistent the more frequently board and staff turnover in smaller nonprofits. Nonprofits are more likely to have a consistent borrowing strategy if they have official, regimented decision-making rubrics and policies.

4C. A loan officer’s personal characteristics (e.g., skills, experiences, education, and beliefs) are more likely to influence lending decisions when they are employed at a community or smaller-sized bank.

Proposition 5: A nonprofit’s total debt is the accumulation of project-level borrowing decisions over time, not necessarily the result of an organization-wide debt strategy.

Capital structure theory assumes firms make executive, “top down” strategic capital structure decisions. However, my analysis found nonprofits make borrowing decisions on a project-by-project basis. For each project, they weigh the benefits and costs, the best financing options, etc. Debt decisions are made “bottom up.” Therefore, it is the accumulation of many different decisions, rather than an overall organizational strategy, that determines how much debt
a nonprofit has. A nonprofit’s total liabilities likely obscures all these smaller decisions from researchers.

Further muddying the water, a nonprofit might not use the same decision-making rubric for all projects. Contingencies matter. Say, for example, a community center’s furnace breaks suddenly and cannot be repaired, and temperatures are below freezing. Closing the shelter temporarily means many families will not have free afterschool care. There are no reserves, no angel donor, so the nonprofit must borrow. Under a time-crunch, it does not have the luxury to shop for the best loan deal. It does not have time to use analytical project valuation techniques (e.g., net present value). The center will prioritize fixing the problem immediately over any financial implications down the road (i.e., hyperbolic discounting). Urgency and necessity shape how the nonprofit makes decisions. Or a community center has thought about expanding for several years but needs additional facilities space to do so. Unlike replacing the furnace, it is not a critical urgent problem. Because it has time, decision-making may be more rational, and it can explore many more options and consider more information. There may also be different opinions about the importance of expansion among staff and other stakeholders (i.e., a political decision-making model). And there is the luxury of not doing the project at all.

In short, we cannot assume that how a nonprofit borrows is consistent. It becomes even more inconsistent when staff turns over in small organizations that rely more on individual decision-makers (as described in Proposition 4). How a nonprofit borrows also depends on how regularly it borrows. Over time it may refine and polish decision-making until it becomes an

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4 How much debt a nonprofit already has does factor into the decision, just like factoring in how a new program will affect pre-existing ones. Also, project-by-project thinking explains why some nonprofit participants said they did not have debt, only loans.
embedded organizational process, depending on heuristics (mental shortcuts). Alternatively, a philanthropically-minded loan officer can alert a nonprofit about a beneficial low-cost loan program that their bank administers, and then sits down and helps them decide which programs would work best. The cart comes before the horse – the loan before the project. In short, the bottom-line numbers of financial statements represent many different kinds of project-based decisions.

Suggested hypotheses for future research:

5A. Nonprofit that regularly make borrowing decisions are more likely to talk in terms of organizational processes instead of project-by-project based loan decisions.

5B. Nonprofits that regularly borrow will depend more on heuristics (e.g., anchoring on monthly cash flows).

Proposition 6: The liability numbers in financial statements are not synonymous with debt and borrowing decisions.

My analysis shows that debt has many definitions and connotations depend on one’s perspective. For example, monetary values from financial statements and IRS 990 come from the accounting definition of debt. Here the technicalities are important. First, liability and debt are two different concepts in this context. The former includes all financial obligations to parties outside the organization, while the latter only includes loans. In accounting, assets (e.g., liabilities and net assets) are resources the organization owns or controls, which have some future dollar value. Accountants calculate these numbers based on certain fundamental

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5 This is particularly relevant considering Proposition 5.
principles, such as quantifiable, commonly agreed-upon, dollar measure of resources.\textsuperscript{6} The subjective value of these assets to the nonprofit might be quite different; for example, the lender has an agreement with the nonprofit to forgive the loan in the future, so it is effectively not a resource owed to another party.

Second, financial statements are meant to communicate information to parties outside the organization (FASB, 1984). That is why they were created. Internally the organization might or might not use these financial measures. Instead, my analysis found that nonprofit leaders are more concerned about monthly cash flow – the ability to stay “in the black” and pay the bills. Or they use a form of risk assessment: Will the nonprofit be able to get enough revenue over the next several years to pay off the total loan value easily? If a nonprofit is operating at the margin – focused on immediate issues, trying to make sure it has enough cash to pay monthly bills – the most important financial issue might be the monthly debt service payments, not paying off the loan. We measure what is important to us.

These measurements reflect financial management behaviors that are not captured in financial statements and are not part of the standardized accounting measures, which (ostensibly) give outside parties a snapshot of the organization’s financial condition (not financial management). I say ostensibly, because business researchers have questioned if financial statements can fulfil this objective considering the diversity of firms and complexities of the modern marketplace.\textsuperscript{7} In my analysis, I found business researchers have been probing these problems more deeply than nonprofit scholarship at this time.

\textsuperscript{6} GAAP relies on ten basic principles: regularity, consistency, sincerity, permanence of methods, non-compensation, prudence, continuity, periodicity, materiality, and utmost good faith.

\textsuperscript{7} Firms can hide debt. For example, Enron used a variety of tactics, like special purpose entities,
Furthermore, debt is not always a financial concept. “Debt” has a wide variety of meanings in sociological, interpersonal, and even religious contexts (e.g., Graeber, 2011; Allon, 2015; Mooney & Sifaki, 2017). For example, I found some loan officers had stakeholder roles, aligned with the mission and civically invested in the organization. Sometimes this had overtones of a donor/donee relationship; loans at times sounded like intra-community resource transfers, rather than financial transactions and investments. Gratitude was also a theme. Sometimes a participant was sociologically “in debt to” a lender who’s been accommodating during hard financial times. The interpersonal and interorganizational relationships (Proposition 4) contribute to these definitions.

Suggested hypotheses for future research

6A. A nonprofit is more likely to say it has debt if it is a problem, e.g., trouble making monthly payments or worries it cannot be paid off.

6B. A nonprofit is more likely to say it uses debt when it is a tool and does not pose financial management challenges.

6C. A nonprofit is more likely to say it is in debt to if its lender is flexible and accommodating when the nonprofit has financial struggles.

to hide its debt. That is not meant to imply nonprofits do this! It is an example of how financial statements can tell a very misleading story. One of my study participants explained that their nonprofit looked great on paper, but it actually had a fair amount of financial trouble.
LIMITATIONS AND NEXT STEPS FOR FUTURE RESEARCH

There are many limitations to the research described here, but they also point to new future research possibilities. The largest limitation is that my findings are neither generalizable to all nonprofits nor even the human service organizations that matched my case selection criteria. Qualitative research like mine is not meant to be representative but to allow researchers to explore processes. I have been able to shed some light on how nonprofits actually engage in financial management behavior – how they decide to borrow. I also show how these behaviors deviate from “best practices” and the behavioral assumptions inherent to capital structure theories. This is a start to answering Bowman’s (2002) concern about nonprofit finance theory. But it is by no means an answer.

The results also depended on my skills, experience, and education. I have an MPA in nonprofit management, which covered many best practices, and experience volunteering in human service organizations. This influenced my case selection. My years as an Indiana resident encouraged me to focus on Midwest nonprofits. My primary research framework is public affairs (particularly public finance and management) which influences how I interpret organizational behaviors and economic concepts. I also have some business background (several semesters teaching corporate finance and a doctoral minor in business entrepreneurship), which granted me the ability to know how to search business literature and comprehend it. Pursuing the lender question any further would necessitate a business finance coauthor to ensure business theories and concepts are properly applied.

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8 Additionally, I used IRS 990 data to help choose my cases. I also used current and past publicly available data (e.g., news stories and past newsletters/announcements found in the Internet Archive).

9 My background in anthropology (particularly linguistics) influenced how I analyzed the
So, what are the next steps? Not survey research (as tempting as that is to someone passionate about survey methodologies). That fruit is not ready to pick…yet. We simply do not have enough information yet. First, we do not know what questions to ask. Before conducting this study, I would not have expected the collaborative decision-making between nonprofits and their lenders. Also, I observed several different kinds of decision-making; I believe there are many more. Second, we do not know the best way to phrase questions. Satisficing will be a hard problem to avoid without being careful; a participant who’s familiar with financial best practices but does not use them in actual decisions is likely to tell us what they think we want to hear.¹⁰

Finally, there are the fielding/recruitment challenges. If we do not use the appropriate blend of financial information when we try to recruit participants, our response rate will be lower for key demographics, particularly among less professionalized nonprofits. I strongly suspect it will be true of highly professionalized nonprofits, as well. We have a Goldilocks challenge – language not too technical, but technical enough. These are just a couple of challenges I would anticipate, based on my extensive experience as an academic survey researcher.¹¹ I plan to use surveys in the future, but not immediately.

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¹⁰ I believe I avoided this successfully in my case studies, because I was extremely humble about my education. I made clear that I had read a lot, but I was not sure how right it was. I explained how I wanted to learn how the real work got done, and that is why I chose to interview them. That tactic took some delicacy, which would be difficult in a standardized survey format. Satisficing is going to be particularly troublesome with lenders.

¹¹ I will add that when we want to interview lenders, I have some good ideas about how to get our sample.
Until then, my plan is to first follow-up with the original case study organizations. To thank them for their participation, I must send them a broad summary of my findings. That will also be the launch point for the next round of interviews – their evaluations and critiques of my findings. We often hear that academics do not discuss what matters most to nonprofit practitioners. We don’t produce the research they need. Since one of my major findings is that academics and practitioners conceptualize debt differently, I need to hear how practitioners assess my work. That would bring the project full circle and complete the data arch.

I will also about how they currently use and make decisions about debt. My findings indicated that attitudes toward borrowing depend on the project, decision-maker, and other contextual factors. By revisiting the case study, and asking more targeted questions, I can better develop that finding. These organizations have gone through changes in the last couple of years (e.g., staff turnover, growth, paying off debt, dissolution, mergers). My long-term plan is to touch base with the case study organizations every few years to learn if (and how) decisions to borrow evolves over time in order to identify factors that contribute to any changes. Over subsequent years, I will also add additional nonprofit case studies. The next round will include similar nonprofits from a culturally different area of the country, the Pacific Northwest including both West and East of the Cascades. My hope is to develop these cases into a larger project, to be shared with graduate students and colleagues, that will further the pursuit of nonprofit finance qualitative research.

The second project on my docket is a study of COVID-19 and debt. The world has changed since I collected my dissertation data. Nonprofits have withstood changes in demand, funding, and other economic effects. Now we have a unique opportunity to learn about borrowing/lending decisions. Our findings could help practitioners make better decisions, as well
as further nonprofit debt research. Such work would help frame and make sense of the challenges nonprofits have faced in recent years; it can also serve as a reference and preparation for when or if the sector is faced with similar chaos in the future. To that end, in the appendix I have included a preliminary proposal that explains how my dissertation research could be used for such a study (see page 257).

I also aim is to distill and refine of the most common terminology and concepts reflecting nonprofit attitudes and perceptions on borrowing, but only another round of case studies. Focus groups is a promising methodology to do so, as is Q methodology.\footnote{Q methodology is a qualitative/quantitative method for studying subjective viewpoints (in this case related to borrowing/lending) by using a by-person factor analysis. The participants would include borrowers and lenders. Later it would be extended to other stakeholders such as funders.} Studying nonprofit capital budgets and the budgeting process could also give us valuable insights, since they reflect financial decision-making more so than financial reports.\footnote{There are few studies of business and nonprofit capital budgeting. Public finance research could be a useful resource for research designs.}

In the meantime, we have the IRS 990 dataset. As I noted early, I am compiling a large dataset of all IRS 990 data. To reward myself for graduating, I will develop my Python skills – a tool that will help me scrape and compile information from a variety of sources. I plan to share the final product and serve all nonprofit finance researchers. In line with my research stream, I could measure turnover by changes in executive staff names from year to year. If this aligns with changes in asset composition, it will help determine whether individual characteristics are important. I can match staff names with LinkedIn\footnote{I used Linked-In data for my case studies.} data to add in experience and education. Market information could also help. I have sketched a way to include data that marks whether or
not a nonprofit is within lenders’ CRA-defined footprints; we would also need to mark whether
the nonprofit’s activities would make it qualify. However, there is no clear definition of what a
community bank is. (Researchers use the FDIC definition, much like we use the IRS definitions.
It is imperfect.) But there is recent research on the topic. Including shifts in regulatory and
economic trends would be desirable, as well as community-based income data.

In all these studies, I plan to use more of the business finance and management literature,
specifically studies of small/private business decisions. Currently, I believe these organizations
are more akin to nonprofits, since they do not rely on the publicly traded marketplace. I want to
test that belief to see if it holds. While large firms generally use a top-down strategy and issue
bonds, small business are more likely to use project-specific loans. The number of decision-
makers can be smaller and less reliant on highly technical financial and risk analysis. Small
businesses are also more likely to know their lenders personally and have a more community-
based approach, since they live in the area where they provide services and sell products.
Moreover, this gives all of us a great opportunity to do comparative analysis across sectors.

Overall, my research moves us closer to behavioral theories of nonprofit finance. My
hope is that the propositions, hypotheses, and suggestions for future research encourage us to
continue this research. I see an exciting frontier ahead of us.

15 For example, project valuation can include a variety of methods, some harder to calculate than
others. Studies of small businesses (particularly with few staff members) make decisions based
on their “gut feeling” or a simple calculation like how long it will take to pay off the loan
(Danielson & Scott, 2006)
CONTRIBUTIONS

Nonprofit finance research has achieved much, especially in the last couple of decades. In particular, nonprofit debt has garnered more attention as nonprofits increasingly turn to it as a means of meeting their mission goals. I chose to focus on smaller human service organizations, because they are particularly reliant on facilities, but do not necessarily have the means to carry out a capital campaign or do lifetime donor development (e.g., charitable bequests, charitable remainder trusts, etc.). When these organizations cannot build/buy/maintain their facilities, the communities that depend on their services can suffer for it. While my findings do have significant limitations, I still hope they make contributions to the field of nonprofit finance, its theories, and its practice.

My contribution to the field is information on observed nonprofit financial behaviors. As far as I can tell, my research is the first qualitative study of nonprofit debt. My analysis shows nonprofit borrowing decisions are as diverse as the types of debt they use. From a methodological vantage point, I show debt is not just liabilities, but a much more nuanced concept among nonprofit organizations and their lenders. A nonprofit is total liabilities is not necessarily an asset management strategy as in capital structure theory. Rather it is very likely an artifact of many different project-specific borrowing decisions made by both individuals, organizations, and collaborations between lenders and borrowers. While we might presume that Form 990, Part X, Line 23 “secured mortgages and notes payable to other parties” includes long term liabilities related to facilities financing, I also found that this line includes long-term collateralized operations funding and other types of loans. In short, the question of how nonprofits borrow reflect many different financial behaviors hidden in Part X, Line 23 and may explain inconsistent findings.
My findings about lenders also contribute to the field. Lender decisions to work with a nonprofit has a strong bearing on nonprofit total liabilities and borrowing decisions. Studying one without the other only gives us half the picture. My research is the first to study nonprofit lending decisions. The best unit of analysis might be a dyad – a borrower and a lender – but this is methodologically tricky, particularly in quantitative analysis. But using an open systems framework helps us understand the complex ecological and environmental elements that influence nonprofit debt. To take this approach, future research can draw on the extensive research on fund development that has already explored these options.

My research contributes to theory by offering testable propositions and hypotheses, that quantitative studies can test. These propositions are a steppingstone along the way to nonprofit financial behavior theories. While applying neoclassical capital structure theories to the nonprofit sector increased our knowledge, it sadly seems like a dead end at this point. Economic theories are not meant to explain organizational behaviors. Capital structure theorists have said this from the beginning. Borrowing and adapting theories is a strength in nonprofit sector research and public affairs overall. To that end, the small business literature offers us many opportunities to harvest ideas and test them in the nonprofit sector. Small businesses are in many ways more like small/medium nonprofits than large, publicly traded firms (e.g., few employees, often embedded in communities, uses loans instead of bonds, not constantly assessed for market value, have multiple motivations other than just profit, such as leaving a legacy, etc.).

Most importantly, I show the importance of choosing the right theory for the right job. Neoclassical capital structure theories are predictive and originated in a time when organizational theory still tended toward the older, closed systems approach. If the theorists took courses in organizational theory, that is what they would have learned. If economic and organizational
theory should “speak to each other,” they should do so in the present moment. But as disciplines have become more siloed, this has become harder to do. To answer how nonprofits make decisions about debt, descriptive and explanatory theories hold better promise. Indeed, behavioral economics and finance theories could further our research more than the neoclassical ones we’ve used. Additionally, nonprofit sector research has strong roots in sociology which also offers many economic, market, and behavioral theories more fitting the nature of the sector.

As for my contribution to practice, I give a descriptive account about how at least some nonprofit borrowers and lenders make actual decisions. Most of the practitioner literature is highly normative. It argues that only high-capacity, professionalized nonprofits can safely borrow, and too much debt is “one of the four horsemen of the nonprofit apocalypse.” It also assumes all loan officers are solely profit motivated and only use credit-based loans. My findings say otherwise. They provide an alternative picture of nonprofit borrowing. Some small, more amateur nonprofits borrow large amounts, and still are successful; not all banks are ignorant of nonprofit finance and entirely profit motivated. There are many effective strategies for borrowing and lending. Just because a nonprofit is “low capacity” does not mean it cannot make solid, low risk borrowing decisions.

The case study and lender participants confirm that the practitioner-literature’s advice is useful for some organizations. For others, fostering relationships and networks between small business and nonprofits in a community is a more valid and effective strategy. In particular, community banks have the technology and flexibility to use relationship lending that takes into account the complexities of nonprofit finance (not just the financial numbers) and use qualitative data (like knowledge of mission and the organization’s leadership) to structure a loan that benefits both the lender and the borrower. Specializing in this technology, community banks
have occupied a market niche that meets the needs of small businesses, which are not necessarily professionalized nor high capacity. The business finance research tells us that they face challenges similar to nonprofits when they apply for loans with commercial lenders. Perhaps the greatest challenge to nonprofit borrowing and lending is finding the right marketplace and the right match.

Overall, my study shows the wonderful diversity in nonprofit financial behaviors, the opportunity to learn more about them, and teach practitioners there are many ways to borrow successfully and manage debt.
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APPENDIX: COVID-19 GOVERNMENTAL LOAN PROGRAMS

In response to the COVID-19 pandemic, the Federal Government passed dozens of acts to sustain the nation’s economy and people. Among these were loan programs for qualifying businesses and nonprofits. For example, the Coronavirus, Aid, Relief, and Economic Security (CARES) Act (2020) included the Paycheck Protection Program (PPP); it gave a limited amount of loans to qualifying businesses and nonprofits, which were forgivable as long as they met particular requirements. The Economic Injury Disaster Loans (EIDL) program was also extended and modified (e.g., rapid grants).\(^1\) Nonprofits could also obtain funding support from states (e.g., Illinois Department of Commerce and Economic Opportunity’s Small Business Emergency Loan Fund).\(^2\)

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\(^1\) In additional to loans, the SBA offered some grants as well to certain industries and programs (e.g., Shuttered Venue Operators Grant program). Nonprofits might also find other Covid-19 crisis funding, such as emergency Childhood Development block grants, Family Violence Prevention and Services Act grants, special HUD grants, special SNAP grants, infrastructure grants for client internet access, etc. Indeed, there are so many programs, and many website resources designed to guide nonprofits, but there is no comprehensive list in any one place. It takes significant time to research, find, and apply to them. Nonprofits like the ones participating in my study likely do not have the research experience I have to find the right ones. Also, looking for these opportunities takes time. Both time and knowledge could be a substantial hurdle to using these resources and are barriers to entry into the COVID-19 resources market.

For any future survey, the various loan programs (some with very similar names or just distinguish by “waves”) are going to make question design difficult. A current nonprofit leader might not know which loans their organization applied to and received, if it happened before their tenure. Also, it was a tense time. Maybe details were not important enough to remember. This would affect not only our data quality, but also frustrate respondents and lower the response rate. If questions are worded well, it will be quite interesting to see how nonprofits distinguished between programs.

\(^2\) The National Council of Nonprofits has a summary of programs at https://www.councilofnonprofits.org/sites/default/files/documents/cares-act-loan-options-for-nonprofits.pdf. My case studies came from Indiana and Illinois, I searched for State-level programs. While there were some in Illinois, I could find none in Indiana. But as I noted above, it takes some digging to find programs.
These programs give us a unique opportunity to study how nonprofits make borrowing decisions. The context is rather unique, so the decision-making is likely to be more varied and we would need to examine variations and factors in decision-making. We can also study how nonprofits decide not to borrow. Some nonprofits do not have the opportunity to borrow, but in this context, all presumably had access to these loan programs, as long as they met the requirements. At the same time, we can more deeply explore how lenders make their decisions (e.g., how they decided to work (or not) with nonprofit and small business applicants). Below I introduce some possible lines of inquiry particularly for small nonprofits.\(^3\)

For example, my research showed the definition of debt is more complex than a financial or accounting definition – i.e., an amount of money given to a nonprofit, which must repay the full amount plus interest to compensate the lender. I found that some nonprofits define debt as being in the red at the end of the month, so loans were not necessarily debt. PPP loans were designed in part to pull nonprofits out of the red and into the black. So, do nonprofits see them as debt? Since PPP loans are forgivable, perhaps nonprofits characterize them more like grants. In part, this depends on how flexible the lender is when it comes to repayment or requirements (i.e., do PPP loans look more like debt than grants?). The PPP program gives us an opportunity to study further complexities in definition of debt and how it affects nonprofit financial behaviors. The same can be said of lenders. My research found lenders characterize nonprofit loans in a variety of ways: philanthropic givebacks, opportunities to educate/professional the sector, or

\(^3\) Some reports say that smaller nonprofits struggle more to receive PPP loans compared to larger nonprofits (e.g., Duren & Portes, 2020). The term “smaller” is problematic, since the SBA loan programs use the small business definition of small-to-medium sized businesses – fewer than 500 employees. Within the sector, a nonprofit that size would be considered quite large.
opportunities to profit from untapped markets. We can study how these perceptions affect how lenders make decisions when processing PPP loans.

Institutionalized stereotypes could also affect borrowing and lending decisions. For example, nonprofits might believe all lenders fit the profit-mongering stereotype and going to them could only lead to trouble. Therefore, nonprofits would be less interested in the PPP loans, which are administered by individual, mostly for-profit lenders. But EDILs are administered directly by the Federal Government – the SBA – which seems a more trustworthy and familiar collaborator. But some nonprofits might also distrust the SBA and the Federal Government and not borrow at all.

Based on my findings, we can expect lenders to have similar diverse perceptions. For example, some may believe nonprofits should not borrow, and instead rely on donations; they may believe nonprofit workers should volunteer, rather than be paid. In contrast, some community banks that like to “give back” to nonprofits might see the loans more like donations and prioritize nonprofits in need. But they may also be biased toward nonprofits that meet their definition of a nonprofit (e.g., human services, amateur, community serving). Certain CDFIs may prefer larger, more professionalized, higher-capacity nonprofits, since they have better skills to manage PPP loans and use them effectively.

In my analysis, I also show some nonprofit/lender decisions rely more on individuals than organizational structures. When one or two individuals make borrowing decisions, we’ll probably see they are more likely be more comfortable using a COVID-19 loan if they have a

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4 CRA requirements probably play a role, too, since my analysis suggests that it has influenced lender definitions of nonprofits. Some smaller PPP loans qualify for CRA credit while others do not. See https://www.fdic.gov/coronavirus/faq-era.pdf for details.
small business background (as was the case with some of my participants). Alternatively, they might have too much on their plate to apply. During times of crisis, immediate mission-related needs may supersede financial questions. If so, such individuals might view applying for PPP loans more hyperbolically – prioritizing near-term effects over far-term implications (e.g., the immediate cash infusion versus long-term financial issues).

Individual vs organizational decision-making will affect how lenders decide to work with nonprofits as well. In my analysis, I showed how nonprofit leaders and their loan officers can develop close relationships and collaboratively made borrowing/lending decisions. There’ve been anecdotes that loan officers have alerted their nonprofit clients to loan opportunities and walked them through the application process. But loan officer personal preferences can create inequities. For example, they may choose to work with nonprofits they personally support (using the government program as their own pocketbook). With good intent, they may choose nonprofits/businesses that they believe are more essential to the community than others. Alternatively, a loan officer might prioritize large, wealthy applicants, if their employer prioritizes profits (E.g., see Duchin et al., 2021; Atkins et al., 2022; Williams, 2004; FEMA, 2020; Deitrick et al., 2020; Maher et al., 2020).

Furthermore, knowledge of the marketplace matters according to my findings. Potential nonprofit borrowers may not understand the programs. For example, consider nonprofits that spend more on their facilities than salaries. They might not apply, because they believe PPP only applies to payroll expenses. But PPP can be used (and forgiven) for many different expenses, including mortgage interest and utility payments, repairing damaged property, rent, and supplies necessary for operations. For human service nonprofits struggling with facilities, this could be of great benefit if they know about it. Lack of knowledge about the details of EIDLs versus PPP
loans can also cause problems; EIDLs usually are not forgivable at all, so nonprofits may not understand the importance of missing the loan window, which is very limited, or when payoff is due.

Unfamiliar with different types of lenders, nonprofits might not know applying at a community bank is a better bet than a commercial lender branch office. A community bank is probably going to offer more technical support; the forms are designed for small businesses, making it harder for nonprofits to fill them out. It is likely some commercial lenders did not advertise the programs to nonprofits, perhaps because they are unaware nonprofits qualify for the programs or have demands for loans, especially if they believe nonprofits should not use debt and that for-profit clients are more lucrative. Just finding a lender could be hard. To mitigate this program, governmental and some nonprofit organizations have developed tools to find a lender, but to use these tools, a nonprofit must know about them first.⁵

Each of the above topics – defining loan programs, who makes decisions, what information they use, and the market – only touches on how my dissertation could help the field of nonprofit finance. It is also an opportunity to study cross-sector relationships and resource provision. We could study how nonprofits manage the loans, and whether states cut funding to nonprofits which use them. Like I did, researchers could compare/contrast the perceptions of academic studies, practitioner-literature, and participant interviews to help our research designs. While COVID-19 has brought much destruction and misery, there is the occasional silver lining. One of these is the opportunity to help the nonprofit sector by giving them better advice based on our future studies.

⁵ For example, the SBA maintains https://www.sba.gov/funding-programs/loans/lender-match
Works cited


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Education

Ph.D. in Public Affairs
O’Neill School of Public and Environmental Affairs, Indiana University
- Focus: Nonprofit Finance and Management
- Minor: Business
- Dissertation: Debt and mortar decisions - Nonprofit borrower (and lender) decision-making mechanisms, facilities financing, and nonprofit capital structure
  Dissertation committee chair & adviser: Kirsten Grønbjerg

M.P.A. in Nonprofit Management and Policy Analysis
O’Neill School of Public and Environmental Affairs, Indiana University, 2009

B.A. in Anthropology and Religious Studies, Minor in Latin
Indiana University – Bloomington, 2001

Research Interests
Nonprofit finance, management, organizational theory, and tax policies; research design, survey research, econometrics, and qualitative methods; human service charities and programs

Peer Reviewed Publications


**Academic Presentations**


Research Reports


Professional Research Experience

Research Assistant at the Indiana Business Research Center (2017 to 2019).
- Designed an interactive Tableau website tool for Indiana residents seeking to gain new skills, particularly after being laid off. Organized and distilled data from multiple state work programs and institutions to provide maximum information while preserving confidentiality.
- Reviewed academic and practitioner literature on measurement, ranking, and scales.
- Assisted in the organization and logistics of workshops.

- Co-PI Indiana Nonprofits Survey 2016-2017
- Coordinated the administration of the Indiana Arts and Culture Capacity Building Assessment, including project planning, questionnaire design, client relations, fielding, data analysis, reporting, and vendor contract management.
- Authored reports and analyzed data on Indiana nonprofit trend and topics.
- Mentored and trained MPA team members and coordinated daily project tasks.
- Currently serving as a statistical consultant.

Research Assistant for Congregations and Philanthropy Research under the supervision of Jen Shang (Summer 2009).
- Collected historical information on religious identity and philanthropy
- Research model and questionnaire design, semi-structured field interviews.

Research Assistant at the Indiana University Center on Philanthropy (Summer 2008).
Project Manager, Field Supervisor, and Training Coordinator at the Indiana University Center for Survey Research (1999-2007).

- Supervised research design, sample collection, questionnaire design, survey programming, project fielding, and data management.
- Notable projects include:
  - *National Survey of Student Engagement (NSSE)*, one of the largest and most complicated survey research projects in the world, which involves a sample size of over a million students from over 700 institutions from the United States, Puerto Rico, Canada, and Macedonia.
  - *Bank of America Study of High Net-Worth Philanthropy 2006*, the first in a series of foremost research on charitable giving activities and philosophies of households with incomes greater than $200,000 and/or net worth more than $1,000,000.
- Designed and managed field researcher training programs.
- Hired, scheduled, and supervised a team of field researchers (up to 100 employees depending on the project season).

**Awards and Honors**

- ARNOVA doctoral fellowship, 2016
- Graduate fellowship, Rumsfeld Foundation ($30,000) 2015-2017
- Summer merit fellowship, Indiana University, 2016
- Best Paper Award, Academy of Management Conference 2014
- Departmental fellowship PhD, Indiana University, 2009-current
- Conference travel support grants ($8000 in total), 2009-current
- Institute for Qualitative and Multi-Method Research SPEA Scholarship, 2012
- Departmental fellowship MPA, Indiana University, 2007-2009
- Inducted into Phi Beta Kappa, Theta Alpha Kappa, Pi Alpha
- Honors degree, Indiana University
- Academic Honors Scholarship, 1997-2001
Training and Certifications

- What Matters for Not-for-Profits: Revenue "Wreckognition" or Recognition? – Professional Development Seminar, Oregon Society of CPAs, September 2018
- Lending to Nonprofit Organizations (CPE credit), Risk Management Association, Indianapolis, September 2016
- Institute for Qualitative and Multi-Method Research, Syracuse University - Center for Qualitative and Multi-Method Inquiry, Summer 2012

Teaching Experience

Instructor of record V361 Financial Management. IU School of Public and Environmental Affairs. Fall 2012, Spring 2013, Fall 2013, Spring 2014, Fall 2014, Spring 2015. Overall course rating 4.2/5, Instructor rating, 4.3/5

Guest Lecturer on Nonprofit Finance. IU School of Public and Environmental Affairs. 2015-2016.

Teaching Assistant for Graduate Capstone Seminar on Charter Schools. IU School of Public and Environmental Affairs. Spring 2015.

Guest Lecturer on Survey Design and Data Collection for I590 Technology for Social Good. IU School of Informatics. Spring 2010.

Field Methods Training Instructor, Indiana University Sociology Research Practicum – Constructing the Family and These are My Experiences Projects. IU Department of Sociology and Center for Survey Research. Summer 2001 and Summer 2003.

Training Coordinator and Field Methods Course Developer. IU Center for Survey Research. Spring 2001 to Fall 2003.

Service

Member Nonprofit Panel Dataset Project Sampling Methodology Working Group. 2015-current.


Arts Council of Indianapolis presentation on “Indiana’s Arts and Culture Providers’ Capacity Building Challenges,” with Kirsten Grønbjerg. 2010.

Panel member for the “Untold Stories: Finding News in Community Organizations” for media professionals looking for better ways to cover the nonprofit sector. 2010.

Survey research consultant for the Serve IT Nonprofit Clinic. 2010.


Current Volunteer Work

Board Secretary. Roseway Neighborhood Association (Portland, OR). Tasks include strategic planning, event planning, communications and outreach efforts to enhance our community and respond to local challenges.

Board Vice President. Central Northeast Neighbors Coalition (Portland, OR). Tasks include coordinating with other neighborhoods to achieve our local objectives and those set-out by the Portland Office of Community & Civic Life.