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Sustainable Finance for Development Activities: A matter of creativity and skill

Sustainable development finance has become a major concern in both the North and the South. The OECD has indicated that overall official development assistance (ODA) is not likely to increase under present circumstances. Aid effectiveness studies conclude that the sustainability of development interventions appears to be highly related to the ability of local institutions to generate local revenue. Criticism of traditional development programmes increasingly focuses on so-called aid addiction and dependency syndromes among governmental and non-governmental agencies. Donors are pressing recipient organisations to generate alternative forms of finance that can sustain their activities in the longer term.

This brief provides some lessons from non-governmental organisations (NGOs) and governmental organisations that have tried alternative financing arrangements.

The score is mixed at best. Euphoric reporting about thriving initiatives hides the fact that most efforts by NGOs to establish alternative financing mechanisms have not been totally successful. The success rate is estimated to be between 10 and 20 per cent only. Where there have been successes, it took creativity and careful management, and resulted in drastic changes in traditional donor-recipient relations. In particular, access to alternative funding resources enabled NGOs to strengthen their independence from donor institutions and to become more responsive to local priorities.

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Searching for Funds and Opportunities

In response to the development finance crisis, organisations are seeking for innovative financing instruments. At the international level, taxes on (airplane) tickets, kerosine, weapon sales, use of oceans or ocean-products, foreign exchange transactions, on capital and on income have been suggested as ways to raise new funds. Elsewhere, endowments, private-public partnerships, funds to which stakeholders contribute and tax or levy regulations have been established. Debt conversions appear to be less of a solution than expected. Commercialisation of services and products is another option with many suggesting that Southern institutions be contracted to carry out research for Northern countries. Arrangements like this have been made for software development in India, so it could be feasible for other sectors and applications. And, among donors to African agricultural research, a sustainable financing initiative focuses solely on ways to establish new financing sources.

What is Alternative Finance?

Alternative forms of finance do not exist as such. Instead, we should see them as financial instruments that apply to specific groups of users, in a particular context. They are alternative in the sense that they are alternative forms for certain groups,

Better insight into institutional conditions required to reach the poor also resulted in new ideas and new opportunities for funding. Micro credit management, for instance, developed from a better understanding of how existing instruments can be adapted to suit the needs of new 'unorthodox' categories like impoverished villagers. The linkage between traditional small scale and informal savings schemes, such as the so-called Rotating Savings and Credit Associations and more formal saving and credit schemes (as in the Grameen Bank) opened up new perspectives. Institutional conditions, such as legal frameworks or (in)formal finance networks, are thus a crucial factor in all financing mechanisms. When they are difficult to meet, new financing options hardly develop. When they are met, it leads to immense opportunities.

Micro-credit programmes such as Grameen and other initiatives like the Ecumenical Development Cooperative Society (EDCS) have proven that the poor are more “bankable” than is usually assumed. These initiatives show that once the institutional conditions relevant for the “formerly unbankables” are met, the initial scepticism can be swept away. Recovery rates of over 90 per cent are common.

Experiences have shown the very positive impact of credit on development. Economic activities are better served by loans than by grants. First, since funding through credits will focus on activities that are feasible and meet a real demand. If not, there is no profit and re-payment is simply not possible. For this same reason, adaptation to donor conditions is no option for the recipient. People will not apply for credit if criteria are not acceptable. The donor needs to adapt if it wants to be a credit provider. The sustainability of development finance is improved since credit creates a sense of ownership. Where the institutional context could be provided, micro-credit has eliminated loan-sharks, provided possibilities for those that were left out of credit facilities and boosted sustainable activities.

Debt conversion is another instrument that was developed to suit emerging institutional conditions. While it can raise considerable funds, it is a demanding funding mechanism. Though it may seem that there is something to gain for all parties, debt conversion is often not a realistic option. The mechanism starts from the premise that a creditor (either a private bank or a public body in the North) knows that the debtor (a Southern country) will never be able to re-pay the full value of its claims. A donor must first be found who is willing to redeem part of the debt value (redemption rates vary between 10 and 60 per cent) into hard currency. The government of the debtor country has to make a corresponding amount available to a development initiative in local currency.

Simple as it seems, the arrangement still needs a donor and thus the political will to assist in solving the debt problem. Redemption rates need to be negotiated and legal frameworks need to be in place. In West African countries, foundations to establish so-called counterpart funds could not be realised. Also, the recipient country needs to have the capacity to manage the funds and the willingness to make them available to a local development initiative that requires local currency funding. Thus, the amount of money is restricted by the local absorption capacity. On the other hand, this critical mass should be more than 2-3 million US dollars to legitimate the transaction costs.

Alternative Financing in Practice: Lessons Learned

Many financing mechanisms can theoretically be listed as potential alternatives to traditional NGO financing. In practice it remains to be seen how feasible many are and what it takes to arrange them. Until now, many success stories have been registered. However, failures are far more common, yet almost never communicated. It is essential that these negative experiences are also brought forward so that others can learn from them.

Some NGOs have been successful in attracting additional funding and in becoming less donor dependent. They finance development activities through revenues from, for example, operating an Internet link, establishing joint ventures with private and public bodies or operating a network of (rural) credit institutions. For instance:

- The Abokobi Agricultural Station in Ghana uses its facilities to 'sell' certain services, and to use the revenues to provide free extension and training services to the community.

- BINA SWADAYA in Indonesia derives part of its funding from agribusiness undertakings, selling publications and alternative tourism programmes.

- A Bangladeshi NGO (BRAC) raises some $US 60 million per year from its printing and clothing businesses and uses this to finance its social and educational programmes.

- The African Centre for Human Development in Ghana aims to establish local funding control. The Centre fulfils a national advocacy role, thus mobilising public opinion and the formation of supportive constituencies on important issues. Centre stresses the articulation of national capacity building networks and has established long term relationships with amongst others regional associations of communities in Ghana.

- The Namibian Development Trust initially proposed to finance its activities from a capital fund to be supported by its expatriate donors and a tax on mineral exports of the Namibian government. When both avenues were rejected, the Trust only survived by creating an income-generating consultancy department and restructuring personnel and tasks so that development activities could still be implemented.

The examples in this Brief describe cases in Brazil, Senegal and the SPAAR Sustainable Finance Initiative (SFI). The two NGOs operate under very different institutional and geographic contexts. They share a desire to combat poverty and generate greater

IBASE: Reducing Aid Dependence

The Brazilian Institute for Social and Economic Analysis (IBASE) is a public, non-religious, non-party and non-government citizenship organisation that aims to build democracy and develop society in Brazil. Its dominant form of action is advocacy: particular forms of exclusion are identified and, by way of analysis, information and public debate, are transformed into issues for society, governments and business. The basis of IBASE's work is identifying problems for democracy and formulating proposals, linking among a variety of actors and establishing partnerships, and mobilisinf public action. IBASE also monitors policies and participates in lobbying on policy proposals to combat exclusion. It considers its actions to be rather like those of a flea on an elephant: it is small, but it bites and it bothers.

Current experiences show that IBASE is achieving its aim through a variety of unorthodox means. It runs a large Internet provider, which generates a large part of its income. It engages in joint ventures with large enterprises, such as the national financial newspaper. It promotes the creation of small companies among its staff, to do certain tasks that can better be done in a commercial way. In so doing, it more than doubled its income between

Enda: Linkage with the Poor

“Enda Sahel et Afrique de l'Ouest Groupes Recherche Action Formation” (Enda Graf Sahel), based in Dakar in Senegal, is an autonomous branch of the international NGO, Enda Third World. It aims to foster socio-political changes by increasing the capacity of local actors to analyse their own situations, and to influence and change themselves, the institutions and the world around them.

In the late 1980’s, Enda Graf Sahel transformed itself from an organisation dominated by the concerns and priorities of foreign NGO’s into onw with substantial local ownership. Started in the early 1980's, it had realised that its poverty alleviation programmes were not hitting the mark. In an internal evaluation, it concluded that it did not follow local priorities and was insufficiently built on local networks of the poor, and that these were because of its dependence on expatriate funding and priorities. It therefore radically changed its approach and started to support 'savings and credit outlets' in public market places. The money obtained was reinvested in the communities according to the priorities of the members of the saving and loan schemes. The scheme quickly expanded to include 20 communities, mobilising approximately US$ 120,000 each month (60 million CFA francs).

autonomy from expatriate priority setting.

The cases show that funds can be raised from external actors as well as from the target groups. In Brazil funds were drawn from the public as well as national administrations and the private sector. The Senegalese case proved that even in the slums of Dakar, money could be found. The SFI experiences with financing governmental agencies appear to be very relevant for NGOs. The variety of alternative forms of finance is amazing: The results of some are impressive, drastically changing power relations between national and expatriate agencies engaged in fighting poverty.

Critical Success Factors

These examples describe how innovative NGOs made the transition and combined a logic of public aid with the logic of private enterprise. The conflicts between public and private interests can be managed, but only on the basis of clear statements of aims, strict management and the acquisition of new skills and competencies to provide adequate accountability.

However, the success rate in establishing alternative financing mechanisms is estimated between 10 and 20 per cent only. In studying successful and disappointing cases three aspects stand out:

- the enabling environment;
- internal changes;
- changed relations with others actors.

Environment: laws, trust and donor flexibility

A legal framework is needed to provide a conducive environment for alternative funding mechanisms. This may mean a clear status for foundations, associations, or cooperatives. It also means clarity about possibilities for NGOs to engage in commercial activities, and transfer these to other organisations like limited liability companies. The Brazilian case shows how IBASE exploited the various funding mechanisms to their fullest extent.

A second condition is a minimal trust between government and NGOs. Most NGOs start as public interest groups that are critical of government. Most governments in poor countries see NGOs as detrimental to their interests, especially if allied to strong pressure groups from rich countries. This is changing.

Many NGOs have opted for a collaborative approach with governments at the municipal, regional and national levels. Governments have found it in their interest to tolerate or even associate themselves with NGOs. This is becoming even more urgent when NGOs become more popular funding channels among donors.

This leads to a third condition: open-minded donor agencies. Although the volume of funding through Southern NGOs has increased significantly, attitudes in the North have not changed correspondingly. Donor agencies may have become less inclined to transfer responsibilities to recipients under accountability constraints imposed by their parliaments. All case studies point to the need for autonomy in priority setting and funding diversification - all also indicate the severe restraints the respective agencies came under.

Responsibility partially lies with the Southern NGOs themselves. They need to set clear standards for NGOs, especially regarding accountability to national governments, donor agencies and most importantly, their constituencies at the grass roots.

Organisation: capacities, logics and codes

Many financing arrangements require legal and financial restructuring, training of staff and long term planning. It may also be necessary to list and assess stakeholders, involve them in decision-making procedures and build partnerships. The SFI concluded that pre-requisites for success are a proactive approach, willingness to take initiatives, opening-up of the organisation towards stakeholders, clients and other actors, adequate transparency and accountability, and the capacity to undertake comprehensive processes including adoption of totally new organisational concepts.

To generate a sustainable resource base, the organisation needs to tap several diverse funding sources. The foremost need in doping this is to revamp management capacity, from a role of public subsidy transfer, advocacy and pressure group formation, to one of generating additional funding for activities in competitive markets. This means acquiring skills associated with fund raising, fund management, cost accounting, marketing and a different form of personnel management. Specific marketable competencies become more important, involving the training of personnel and the leaders of associated interest groups. Most NGOs have personnel with very general facilitation skills. This does not suffice to attract alternative funding.

The organisation needs to combine its existing public service logic with a new entrepreneurial logic. Therefore it needs to clearly define its core activities to maintain a clear profile. If idealistic mandates are maintained, clients and publics should be able to identify the organisation accordingly. If an advocacy role is maintained, it needs to be clearly defined so all members of the organisation and publics know what it stands for. If its mission is not clear, the organisation may expand in unforeseen directions and explode.

The survival of development organisations that work with alternative funding mechanisms, depends on their capacity to divest themselves of 'private' money-making activities when these come into conflict with their 'public' interest role. This is an "art" and probably responsible for the low success rate of only 10 to 20 per cent of organisations that engage in alternative funding arrangements. Most of the organisations simply fail to manage the inherent conflict between the respective types of activities. Stick to the core, and let the side-activities free - as long as they contribute financially to the core. Do not maintain at all cost the original organisation, but allow it to divest itself from successful activities and thus transform itself.

A professional code is necessary to guide the work of civil society organisations, especially those engaged in advocacy and looking for alternative funding. NGOs can hold each other, but also government officials

SFI: Private Funding for a Public Good

Over the past twenty-five years, African agricultural research and natural resources management institutions have relied on international donors and national governments for the vast majority of their support. Recently, national governments' ability to fund research institutions from public budgets has declined significantly and the ability of international donors to fill the funding gaps is also under pressure.

In response to this, a multi-donor Sustainable Financing Initiative (SFI) has been created to explore and develop alternative financing for agricultural research and natural resources management in Africa. Supported by the World Bank's Special Program for African Agricultural Research (SPAAR), the SFI is identifying alternative sources of funding, particularly from the private sector, and exploring new financial mechanisms. It is also looking at institutional reforms that will help research institutions to manage strategically, improve their financial systems and accountability, identify and respond to key stakeholders and clients, linking research and technology transfer programmes to their needs.

accountable and be perfectly clear about their norms towards the clients or constituencies. Most organisations do not adhere to such a professional code.

Other actors: states, markets and competitors

New instruments require different contacts with governments, business circles and other organisations. This involves new skills, new concerns, and new procedures.
Traditional public interest groups will have to learn the art of diplomacy, and combine it with the new role of consultant. This is not impossible. The Namibia Development Trust maintained its advocacy posture yet also dealt with the same *government* to get assignments. With governments allowing civil society greater space, these contacts are likely to grow.

With central governments providing less social security and other basic facilities, *entrepreneurs* and entrepreneurial NGOs can be reminded of their role in society. IBASE does this by involving mass media enterprises in their campaigns.

A third category is *like-minded organisations*, with whom alliances can be formed. This requires scouting with an open mind. In many countries this is hard, because NGOs are in fierce competition with each other for donor or local funding. ENDA pleaded, however, for the creation of national civil society fora, allowing such coalitions to be built.

The former dividing lines between NGOs and government are blurring, but also with business. This process needs to be promoted, if successful transformation of the respective organisations is to occur and alternative funding arrangements are to found.

UrgentlyWanted: A "Logical" Marriage

The development community in South and North faces historic changes. It will have to adapt its culture and structures to transformations in traditional North-South development relations. It has to prepare itself for international cooperation among new actors: public and private alike.

This is the real challenge. It will involve the use of other resources, which can only be effective if organisations transform themselves drastically.

Further Readings

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This Report

Policy Management Briefs are intended for policy-makers in public and private organisations concerned with aspects of development. Drawing from work of ECDPM, its partners and its associates, our aim is to provide succinct and readable summaries of current issues in the management of development policy. This brief draws substantially on the presentations and discussions in the ECDPM seminar Alternatives to Co-operation: Sustainable Finance as an End to Development that was held in May 1997.

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Northern development agencies have been the least pressed for such change. If they do not read the signs, they will isolate themselves into irrelevance. Southern agencies need to generate local funding -- from public sources or private sources. It will lead them from the agendas of Northern donors to the priorities of local interest groups.

Agencies that can marry the traditional logic of international aid with the upcoming logic of local alternative fundraising are likely to set the pace.