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Capitalizing non-profits in South Africa: challenges and possible approaches for financial sustainability

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‘If an organization is to meet the challenges of a changing world it must be prepared to change everything about it except its basic beliefs as it moves through corporate life. The only sacred cow in an organization should be its basic philosophy of doing business’. (Thomas, J Watson, Jr)

Introduction

One of the formidable post-apartheid challenges for NGOs in South Africa is how to keep their organizations afloat. Prior to 1994, NGOs who were dependent on grants from overseas development assistance (ODA) were often able to prosper with these generous subsidies. In its comprehensive overview of development co-operation assistance, the Department of Finance showed that after 1994, funds earmarked for NGOs declined. This was the result of much of the ODA money - about 0.2% of the South African GDP - being redirected towards government programmes.

Many policy and service orientated NGOs have been at pains to establish a concrete partnership with government. There are many reasons for this, but perhaps the most important is that some NGOs have been viewed with suspicion because of the critical political positions they have taken in regards to certain government policy decisions and approaches to delivery. There has, however, also been a dearth of good NGO leadership and management capacity, and the years following 1994 saw the transference of many of these skills to government agencies and consultancies. In order to now stabilise the NGO environment and build on past achievements, skills and experience should have been retained within the NGO sector.

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Other funding sources include: Corporate Social Responsibility (CSR) funds, monies flowing from the national lotteries which are channeled via the National Development Agency (NDA), and overseas grants from foundations such as Ford, Rockefeller, and Kellogg. Over the last few years, these monies have either been maintained or increased, even though requirements for funding have become more regionally focused. The estimated value of private sector funds from South African corporates per annum is between R3-5 billion, and that of the NDA between R500million-R1 billion. In the case of CSR funding, the majority is dedicated to educational programmes and health issues. While the NDA funds are substantial, the institution has been beset with political problems and has shown a poor record in being able to disburse committed funds.

In summary, sources of funding for NGOs are several: foreign government grants and contracts; CSR funds; South Africa government grants through the NDA, National Research Foundation (supporting mainly university based scientific research), Water Research Commission and others; government service contracts; private bequests; and donations. The predominant receiving sectors are: education and training, health, and environment. The training sector includes skills development and other forms of self-help programmes aimed either at creating better job opportunities or enhancing entrepreneurship.

There seems to be a perception that philanthropic funds are on the decline. In fact, although there may be declines for particular sectors, anecdotal evidence shows that there is no decline in sum total. In addition, there is some evidence that replenishment of ODA funds may be on the increase in total, but has remained stable in terms of support to the non-profit sector. On the other hand, ODA funds from some countries - such as Denmark - have dramatically decreased (in this case due to a change in government). For certain sectors - such as the environment - this decline has been drastic and painful for many NGOs dependent on these funds. Declines in funds are not necessarily a result of lack of grant increases, but because of an increase in competition within the non-profit sector itself. This competition comes about as a result of new entrants, or the growth and influence of established NGOs. Increased competition for funds is also a result of granters having increased the level of grants for projects by a factor of 3:1 to the detriment of providing grants for operating costs. (Frumkin and Kim, 2000)

Perhaps a more interesting observation is that in the last 15 years the non-profit sector has become characterized less by voluntarism and more by the professionalisation of the sector. In other words, non-profit organizations are managed and run by professionals who make a career choice to establish themselves in the non-profit sector to earn a living, and at the same time to contribute towards achieving public interest goals. It is not off the mark to suggest that as the non-profit sector is staffed by professionals, they begin to take on the image of corporates or firms; the essential difference being that profit is not the NGO's end goal. A study by Frumkin and Kim (2000) suggests that the professionalisation of the non-profit sector has also meant that professional staff want to do away with the image that the sector is amateurish. The introduction of proper management standards and procedures is a way of creating a more regulated work environment and professional look.

This is also exemplified by the fact that the larger and more well established NGOs are now advised by corporate management agencies, and have considerable investment stakes in marketing and branding campaigns. Marketing campaigns are both a way of branding and differentiating one's self from the 'competition', and of selling the services of the organization. These campaigns depend on good PR. NGOs should begin to be seen as 'firms of a different kind', and this mental leap needs to be made both by funders and recipients alike. Already, some funders are demanding more business-like approaches from recipients, and as private sector contributions to the NGO sector increase, more of this corporate mindset is likely to rub-off on the NGO sector. Indeed, corporate sector funding is seen to be the new growth area not only for non-profit organizations in South Africa, but throughout the world.

In other words, NGOs are not merely public opinion makers and service providers; they also have to market themselves aggressively to capture a share of the philanthropic market in whatever form it is capitalized. Such marketing, and communication of organizational identity, takes the form of campaigns around major public issues, visibility of one's stance via different forms of public communication, and vociferousness around public issues. There is no doubt that public visibility is seen as a demonstration of performance, and that by attracting an audience you also attract potential new donors. Organizations that are dependent on individual membership contributions need to engage in campaigns with high levels of visibility in order to create and maintain a public persona and thereby attract future funds.

The ability of NGOs to capture ‘market share’, or benefit from available capital, is largely dependent on their positioning and ability to show management and financial capabilities. A recent review prepared by William P Ryan for the Rockefeller Foundation and Fannie Mae Foundation (2001) is entitled ‘Nonprofit Capital: A review of problems and strategies.’ It examines the North American experience of capitalization by a range of non-profits in different sectors, and offers a summary of literature reviewed and interviews conducted. The report identifies working capital as being the most important and pressing concern for all non-profits, as it is needed for day-to-day operations as well as investment in future activities. The paper ‘represents a map of sorts that describes the non-profit capital landscape’. As it describes current trends it is a useful read, and while focused on the US sector, it is of relevance outside of the US.

The issues and challenges presented in the paper show a great deal of similarity to those the South African non-profit sector is experiencing. Perhaps the most useful insight of the paper is that although non-profits work for the public interest, the manner in which they capitalize their organizations requires sound business models just like profit making firms. These business models encompass the need to dynamically manage the inter-relationship between management performance and the way in which capital raised is invested. The emphasis on management and leadership performance is critical. Just like profit-making firms, non-profits also face different cycles of capital availability. These are influenced by internal factors such competitiveness or entrepreneurship, as well as by changes in preference from grant providers or donors. What is clearly evident is that capital flux will be a consistent feature for the non-profit community, regardless of the sector/s in which it operates.

In South Africa, the competition for capital by the non-profit sector has primarily focused on blaming funders and grant makers for not doing enough to assist NGOs in their capitalization efforts. As the Rockefeller and Mae foundation report indicates, non-profit performance is also to blame. Such performance is defined by the non-profit’s ability to define its niche, market itself, secure management capability to ensure internal efficiency measures, and maintain these positions.

As far as staff is concerned, performance issues are politicised because of the nature of racial politics in South Africa. Politicisation of performance is also influenced by governance bodies such as the boards and trustees of non-profit organizations. There have been numerous cases where CEOs or certain staff have been removed because board members or trustees did not appreciate political dissension. In some instances, NGOs have had a flight of CEOs owing to political differences with the staff and board. Even where there is no racial tension, NGOs have found themselves to be ‘sites of struggle’ between different ideological groupings wanting to wrest control over resources and promote their particular ideology.

All of this affects performance, staff morale, and efficiency within an organization. Politicisation not only acts as a drag on performance, it also creates significant transaction costs, i.e. legal costs. This in turn further erodes the already narrow capital base that NGOs find themselves with. It also affects their ability to attract additional capital because granters are reluctant to invest in organizations that are perceived to be operating in an insecure and uncertain environment.

The NGO challenge, then, is to manage performance attained through mature leadership in order to create an organization with a clearly defined business model and a strategy to achieve the objectives of that model. Too commonly, non-profits define the political, policy or service agenda they want to pursue without simultaneously defining the business model that will allow them to capitalize such initiatives. The talk of a ‘business model’ is viewed as an ideological red herring as it suggests close association with the corporate sector, and many non-profit organizations are uncomfortable with this. Irrespective of these ideological hang-ups, and whichever way we choose to define our strategy, the ability to capitalize one’s operations and activities requires an understanding of the philanthropic market. The typical business model includes identification of: a) niche, b)products, and c) delivery strategy. A proper costing structure must also be included so as to ensure the long-term financial stability of the organization.

It is not unrealistic to suggest that the environment in which NGOs are operating these days is no different to that of commercial entities. As the Ryan Report notes: “Non-profits need capital to perform, yet no one wants to provide capital to a non-profit that is not capable of performing. This conundrum has profoundly shaped many of the responses to capital challenges. It may account for the general scarcity of philanthropic working capital, and it surely explains the emergence of several new approaches that stress accountability for performance as a condition for capital investment. Several observers even argued that providing too much working capital from external sources could be a problem, not a solution: non-profits might 'hide behind the capital', using it to compensate for poor performance, not for investing in better performance".

The general trend that is emerging within the non-profit sector is to support the implementation of a dynamic business model through innovative entrepreneurship. This becomes even more critical with the fact that the philanthropic capital market is becoming restricted – due not to lack of capital, but to increased competition for funds. Entrepreneurial skills are important in developing innovative ways in which limited capital can be leveraged. This is done through the positioning of the organization according to how and what it delivers. Some entrepreneurial opportunities for the service segments of the non-profit community can be built through alliances and partnerships with the government and business sectors.

Regardless of its form, entrepreneurial capacity will increasingly become the defining edge that will determine success or failure in the non-profit sector. Hitherto, NGO recruitment policies have been defined by technical content and project management capacity, rather than by a combination of content, management and entrepreneurial capability. Therefore, the issue of entrepreneurial capacity now has to be looked at seriously in the recruitment policies of the non-profit sector.

Entrepreneurial capacity offers flexibility and mobility to an organization in that entrepreneurial energy can be harnessed to take on the challenges that emerge from an unpredictable external environment. It can also lend structure and support to any innovative drive that the organization has as regards, for example, content and strategy. As one commentator writes: "Today's practitioners do not know who the next generation of social entrepreneurs will be, where they will come from or even if there will be a common "new social entrepreneur" profile. We do know, however, that we must recruit more and more talented people to our social purpose enterprises, we must encourage them to stay with us and, above all, we must proactively help them to grow into leaders". (Makjeska, K, 2000)

A business model must be tailored to be responsive to trends in the philanthropic market. The most enabling model is one that combines the comparative advantage of the organization with flexibility in capturing revenue streams from different sources. A great deal of durability comes from being able to provide a diversity of services. When an organization deals only with a single service or issue, its base is likely to be narrow. If the services/issues are sufficiently diverse and consistent with the objectives and mission of the organization, then it is likely to capture revenue from a larger segment of the market with different possible permutations. There are four interrelated elements here: a) trends in the flow of philanthropic capital, b) developing an appropriate business model to respond to this market, c) linking one's business model to funders' objectives and mission, and finally d) the recruitment of staff that are able to operate within both the business model and the mission of the organization. For an organization to successfully capitalize itself, a close synergy between these four elements is required.

In most cases the business model will also influence the organizational culture, and hence impact the manner in which activities are operationalized. It is critical to recognise that a strong relationship between the business model and the appropriate staff profile is necessary in order to execute the programme most effectively. A business model should define both the methods of capitalization and the standards of internal performance required to ensure the efficient use of capital generated by the organization. Business models should be somewhat flexible, and need to be revisited time and again to ensure that they are grounded in reality.

As the Ryan report notes, non-profits need to develop capitalization strategies that give them the ability to expand the portfolio of their unrestricted funds. The current trend is that donors are reluctant to provide core funds for operations, and would rather see funds going to support the implementation of activities. Unrestricted funds are critical in ensuring that operational infrastructure and cost are maintained, growth is managed, there is flexibility to invest in new areas of work, marketing and fund raising, and finally, that there are funds available to invest in human capital which is the heart of the organization.

There are different ways in which unrestricted capital can be secured, each with different combinations of pros and cons. Some of these options open to the non-profit sector are:

a) Conventional grants and donor funds, where project funding is secured by conforming to donor or granter objectives and areas of interest. These are retroactive; NGOs must respond to donor preferences by defining their own organizational objectives according to those of the donor. What is important here is the ability to secure overhead and staff costs that cover not only operational costs, but also provide some minimum ‘profit’. Because most non-profits and donors are not comfortable with this idea, this aspect has been controversial. However, because profitability is really determined by the way in which overheads are costed, it is ultimately managed by the grantee itself.

b)Conventional grants or funds where a framework or block grant is secured over a defined period. These tend to be proactive, as the donor has a partnership arrangement in which - either annually or every few years - the donor and recipient meet to define a programme of activities. The granter then provides funds for the implementation of these activities. These tend to be more programmatic than project orientated. Once again, the costing structure is important, as it determines how overhead and staff costs are covered through a programme. This is the preferred type of funding, as there is a real partnership relationship being established with the donor.

c) Organizations with sound management and financial accounting systems can also act as managers of funds on behalf of donors. Such opportunities arise when donors want to avoid managing these funds themselves in order not to over-extend their own administrative capacities. This can be a tricky area, and associated risks can be high, if proper accounting procedures and methods of verification are not in place. However, where service orientated organizations are involved, more technical aspects of their management skills and knowledge of the subject matter can be incorporated so that their role is not merely limited to the disbursement of funds.

d) Fee-based work and consultancies is an area that NGOs are increasingly getting to dip their feet into. Fee-based work has the potential to shift the organizational culture, assuming this method of capitalization was not part of the original working model of the non-profit organization. The obvious benefits are a potential for high returns due to commercial rates and the fact that income generated is not conditional and therefore unrestricted. The challenge is to deliver sound management that balances the tension between commercial and public priorities. Furthermore, an organization must have the right staff profile, and competency to be able to compete in a very competitive commercial environment. Fee-based work can also offer a welcome relief during a waiting period before additional funds for future long-term projects are secured. In this sense it is an expedient form of capitalization that offers a cushion in cases where there is a risk of losing staff competency. It allows organizations to maintain their skills base and competitiveness. However, like any venture, fee-based work requires upfront capital upon which the business can be built. One also needs to distinguish between short-term and long-term work, as there are different degrees of profitability and consequences for staff time and input. Fee-based work has similar risk profiles as normal consultancies; it is not risk averse.

e) Several NGOs have developed pioneering fund raising opportunities through membership schemes, securing of bequests, sale of merchandise, and use of lotteries and other methods. These methods provide for some flexibility in generating unrestricted funds, although many bequests tend to be conditional. Internal administrative capacity is needed to manage the marketing and processing of funds received, as many of these funds are small individual contributions rather than large sums.

f) More challenging approaches to capitalization are the use of bank loans and creating investment portfolios by investing in stocks or businesses. Some NGOs - such as the Kagiso Trust and South African National Civics Organizations - have been successful in pursuing these kinds of ventures. However, for smaller NGOs this is a high risk area; they are perhaps unlikely to be able to get into this game as it requires a substantial capital base.

g) Many NGOs have been successful in establishing more long-term endowment or trust funds, and use interest earned to cover operational costs. However, endowments can take a long time to mature. Furthermore, they require a substantial capital base for a critical mass of investment and revenue so as to generate the requisite interest-based income. Capitalization of the endowment fund itself is onerous. South African NGOs - such as South African NGO

Coalition (SANGOCO)- developed a few years ago an innovative approach to create investment and endowment funds. The capitalization programme was based on a co-operative model where different NGO members contributed a certain amount of money into a pool fund. Dividends from this fund would be shared on a pro-rata basis.

Generally, capitalization strategies require that several of the aforementioned approaches mentioned above be pursued simultaneously. These would need to be reflected in both short and long term strategies.

Concluding Remarks

While efficiency and cost-effectiveness are important in improving the profitability of operations, the study of Frumkim and Kim (regarding the relationship of efficiency and improved contributions)demonstrates that this is not sufficient in attracting additional grants from existing or new donors. The evidence they present is that a combination of administrative efficiency and marketing vastly improve the fund-raising capabilities of non-profits. The ability of an organization to position itself in the public domain is critical to donors who want to have an affinity and association with the services offered by the non-profit organization. Within the donor community there is a very evident trend towards more consciously creating their brand or identity via association with specific projects.

Much of the management literature seems to place emphasis on economising operations rather than on strategies for attracting funds. However, the reality is that economising - while critical to ensuring sustainability – is often done at the expense of strategising to maintain and acquire new markets. Ideally, these must be treated as if they are inseparable. There is no merit in having an organization that is economical in terms of its operations, but unable to break new ground in terms of the services it offers and the clients it supports. Historically, social organizations have struggled with measuring effectiveness in terms of tangible numbers because a large part of their work can only be measured through changes in human behavior, and not number of products sold. As such, publicity around their work has been seen as an indirect measure of their effectiveness, when in fact this can be due to no more than a good PR strategy.

Within a ‘profit-making’ or ‘cost efficiency’ mind-set, a non-profit goal has to be managed actively so that the tension between ‘profit’ and ‘non-profit’ ideals does not undermine the main objectives of the organization as a whole. The challenge of course, is how to incorporate these seemingly contradictory motives within one organizational culture. Non-profits are created to support or achieve a cause and as such, often find it ‘unethical’ or uncomfortable to talk about profit. In fact it is not so much an issue of profit as of ensuring effective cost-recovery and pricing for services. Realistically however, as non-profits become more professional and cost aware, profit making motives are merely disguised through language and other means. The increasing professionalisation and competition of the sector will force non-profit institutions to focus on ‘funding’ as the bottom-line. This creates a situation in which it is essential that leadership and staff accept, value, and accommodate any revised strategy being pursued. As Flanner and Deigmeier note: “We are living in a historical moment in time where it is possible to bridge the gap between these two distinct worlds and create a new way of operating non-profit organizations and businesses’. (2000)

Organizational Culture is defined as: “A pattern of shared basic assumptions that the group learned as it solved problems of external adaptation and internal integration, that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think and feel,in relation to those problems”. As such, organizational culture provides an opportunity to construct behavioural norms that are consistent both within the organization and in its relations with the external environment.

Many NGOs have to learn to do a balancing act on a tri-pod of culture, operational efficiency, and strategic positioning through marketing and promotion. Even more challenging than this for non-profits can be the aspect of risk taking. In a business environment risk taking is rewarded, whereas in a non-profit sector - due to is authorising environment among other factors - there is a more conservative approach to risk taking. Risk taking does imply that both success and failure need to be managed and accepted as a normal part of doing business.

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_ The paper is merely for discussion, and many of the issues I have raised here can be dealt with in more detail.