Types of funding

It is useful to analyse our different sources of income into two broad classifications:

- Restricted or unrestricted– an indicator of flexibility
- Short- or longer-term– an indicator of continuity

Figure 1 combines the two classifications and illustrates how NGO income sources fall into different categories according to the level of restriction applied to the funds and their level of continuity.

Unrestricted funds are exactly what they sound like – funds that come to the NGO without restriction on how they are used, providing of course, they are used to fulfil the NGO's objectives. In general, grants from donor agencies are restricted funds since they usually come with terms and conditions about what the funds may or may not be used for.

So it is the income that an NGO generates through its own efforts that tends to be in the unrestricted category – such as membership fees, fundraising events, general donations and bank interest. This 'free money' brings greater autonomy, flexibility and security for an NGO and is therefore central to a financing strategy.

Figure 1 Funding Types Matrix

	Unrestricted		
Short term	General fundraising	Core financing	**Long term**
	Project funding	Programme funding	
	Restricted		

Take a moment to analyse your NGO's sources of income and see where they fit on the funding types matrix. In general, it is good to have a mix of funding types, but very important to have some in the top right quadrant.

General fundraising

Short-term and relatively unrestricted income, such as one-off fundraising events and public donations. Useful for building up reserves or for gap funding (i.e. where a project funding agreement fails to cover 100% of costs) but not for long-term commitments.

Project funding

Short-term and relatively restricted income, generally from institutional donor agencies. Being project-specific, these funds generally last for 1-3 years and are difficult to extend further leading to a loss of project continuity. This is the most common form of NGO financing.

Programme funding

Longer term with some restrictions, these are funds provided by funding partners where a strong working relationship has been established and where grants are based on programme themes.

Core financing

This is income which can be relied upon as regular and flexible, so is most likely to be used for the NGO's core operations. This type of financing helps to meet Norton's definition of financial sustainability: "The organisation and its core work will not collapse if external funding is withdrawn".

What's wrong with External Donor Funding?

External or institutional donor funding – i.e. from international or multi-lateral aid agencies such as DfID, USAID or UN agencies – is the main focus for most NGOs' financing plans. However, there are challenges associated with such funds.

Quantity problems

There is excessive demand for external funding across the globe. At the same time, donor governments are experiencing increasing demand for use of funds for domestic problems. Funds available previously may be switched to other beneficiaries at short notice, reflecting changing policy initiatives.

Quality problems

There are several quality issues attached to external donor funds:

- They tend to reflect external socio-political trends – i.e. the priorities of the donor country are uppermost and may interfere with local strategies.
- External financing tends to favour large NGOs who are considered (rightly or wrongly) to be a safer bet for the effective use of the scarce funds.
- External financing is often dependent on bilateral agreements that dictate terms to beneficiaries – e.g. only for use with specific target groups or regions.
- Political tensions have resulted where external donors have channelled funds to NGOs rather than national governments.
- Dependence on external finance may bring about political dependency: 'pawns of foreign interests'.
- External financing is usually in the form of time-limited project-specific grants – there will always be a need to return to donors for additional financing.
- External finance can lead to a lack of cost-efficiency and over-ambitious programmes. In particular dependency on donor funds can result in lack of attention paid to options for cost recovery, cost effectiveness and sustainable programmes.

Alternatives to Donor Funding

Unrestricted funding is liberating for any NGO. It allows NGOs the freedom to work to achieve their objectives in whatever way they think is best, without restrictions from donors. All steps should be taken to maximise the level of unrestricted funding available. This often requires a significant investment of time, effort and money.

Sources of unrestricted funding vary for all NGOs. An NGO has two broad options – self-financing and local financing.

Self-financing

Self-financing concentrates on generating income and support through an NGO's own efforts. Included in this category are:

- Membership fees and subscriptions.
- Fees for services, e.g. training and consultancy.
- Income generating activities linked to work of the NGO, e.g. publication sales.
- Income generating activities not linked to work of the NGO, e.g. renting office space.
- Investment income from reserves and endowment funds.
- Donations and gifts in kind from supporters.

Charging user fees for 'cost recovery'

Many NGOs are rightly uncomfortable charging fees for their services. Services have to be accessible to even the poorest and most deprived. However, recovering costs by charging fees brings three important benefits for NGOs:

- The level of income increases in direct proportion to the level of activity. This is a sustainable model.
- Fee income is unrestricted income.
- Beneficiaries value what they pay for more than what they do not pay for.

Fees can be set at a level which makes a contribution to the cost of providing the service, rather than covering 100% of the cost. Charging beneficiaries modest fees can really strengthen an organisation's sustainability. This will be good for tomorrow's beneficiaries as well as today's.

Local financing

Local financing concentrates efforts on gaining financial support from the local community and institutions. This includes:

- Fund-raising from the general public – e.g. through legacies and regular giving programmes.
- Fund-raising from specific sectors – e.g. legal or medical profession.
- Local government grants and partnerships.
- National government – as an NGO donor or NGOs as sub-contractors to government.
- Businesses – sponsorship and donations, or provision of skills and facilities.

Deciding on Your Funding Mix

Figure 2: The Funding Mix (adapted from Norton, 2003)

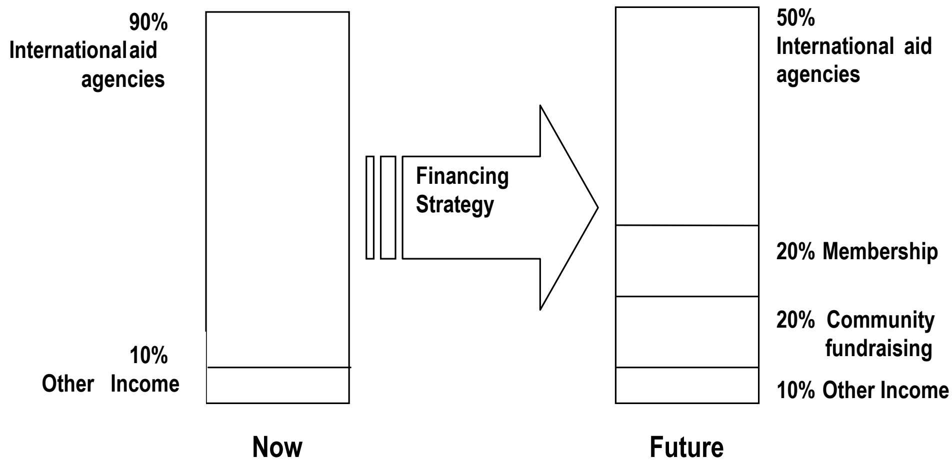

Figure 2 illustrates where an organisation is now and where it wants to be at a specified point in the future. The answer to *"How will we get there?"* is contained in the financing strategy.

Resources audit

In deciding the best strategy for diversifying your funding base, you should start by undertaking a **resources audit** in your organisation. This will help you to assess what is, or is not, feasible to achieve within a financing strategy.

Use the following headings as a checklist:

- **People** to organise the income-generating activity
- **Skills** and experience – e.g. marketing, fundraising, and 'saleable' skills
- **Money** to invest in the activity – e.g. for adapting office space to let
- **Capacity** to respond to requests – e.g. offering consultancy or training services
- **Contacts** with prominent people – i.e. those who have influence in business communities
- **Commitment** of supporters – e.g. to help with fundraising drives
- **Credibility** of the organisation – as a marketing tool
- **Time** to organise events
- **Markets** for your 'products'

Although there are many different possibilities, it must be recognised that financial self-sufficiency is difficult to achieve:

- self-financing involves a lot of time, effort and special skills;
- not all organisations' activities lend themselves well to self-financing schemes; and
- there is a danger that the organisation may lose sight of its objectives (the 'tail wagging the dog' syndrome).

How Much Financial Autonomy?

This is not a stark choice: full financial self-sufficiency or total donor dependence. And we must not forget that donor organisations do exist to provide funding.

100% Donor dependent	*Where are you?*	100% Self-financing

When considering financing strategies, your NGO may opt for a strategy somewhere in between the two extremes. One approach is to meet operating overheads (rent, staff salaries, maintenance costs, utility bills, etc.) through fundraising activities, and to finance programme costs through conventional donor sources.

In this way an NGO can more fully integrate itself into its local community, maintaining control over its long-term operational and strategic development, and access sources of external finance only for programme-specific activities.

Setting targets

A good starting point is to identify how donor dependent your NGO currently is and how long it could survive if all its external aid were suddenly withdrawn. We can use what is known as *ratio analysis* to do this – see the formulas below.

Taken together with other information, these indicators will give a picture of the financial vulnerability status of the organisation. You can then set targets for improvement in say, 5 years time.

Clearly, an NGO which is 100% donor dependent with sufficient funds to last approximately 10 days, is a lot less sustainable than one which is 50% dependent and has enough to keep going for 90 days.

The ideal target will depend on your own NGO's circumstances but once established, this can be used to guide the financing strategy.

To calculate where you are now, you will need the latest set of annual financial statements – i.e. the financial report including a Balance Sheet and an Income and Expenditure (sometimes called Profit & Loss) statement.

To calculate the 'Donor Dependency' ratio:

$$\frac{\text{TOTAL DONOR INCOME}}{\text{TOTAL INCOME}} \times 100$$ [result will be expressed as %]

To calculate the 'Survival Ratio' ratio:

$$\frac{\text{GENERAL RESERVES*}}{\text{TOTAL INCOME}} \times 52 \text{ or } \times 365$$ [result will be expressed in weeks or days]

* General Reserves are the unrestricted reserve funds saved up since the organisation began. They will be listed on the Balance Sheet and may also be referred to as General Purposes Funds or General Funds. If you cannot find this figure, use the figure for 'Net Current Assets' instead.

Alternative Financing: Issues for NGOs

The need for an entrepreneurial approach

The search for alternative sources of finance can be likened to an entrepreneur looking for investment opportunities. NGOs wishing to become financially self-sufficient or wishing to diversify their sources of funding need to adopt a more business-like approach.

Traditional budgeting practices in NGOs are based on allocating resources made available through external funding. A shift towards financial self-sufficiency requires a drastic change in approach to budgeting – i.e. you must set your expenditure budget first based on activity plans, then go out and find the income.

This may require a fundamental re-assessment of beliefs and practices within the organisation. Staff are often ill equipped in business practice and methodologies, and the culture of an NGO is often opposed to that of a for-profit commercial organisation. There is a risk that committed staff may be driven out by this change in the organisation's culture, strategy and practices.

Commitment to income generation

The motivation to move towards financial self-sufficiency should be a genuine one. Many NGOs may see this move as a question of 'packaging' their approach to donors. Whilst this is undoubtedly an important motivation in the ever-more vigorous competition for donor funds, an organisation that is motivated in this way is unlikely to have made a robust assessment of the implications of financial independence on the organisation.

An NGO's decision to pursue the route of alternative financing should be accompanied by a thorough strategy assessment and planning process.

Impact on organisation culture

NGOs, as values-based organisations, generally have a strong social ethos and identity, shared by members and staff. The changes that have been discussed above are often seen to threaten the sense of shared purpose or vision of the organisation.

Many NGOs, for historic and political reasons, may have a hostile view of business. The background of staff may be such that they have had very limited exposure to commercial practice. Some NGOs go as far as creating a separate organisational entity dedicated to fundraising, in order to prevent perceived 'exploitative' business practices affecting the rest of the organisation.

Increasingly, through changes such as privatisation and deregulation, business practice is becoming more acceptable and seen as essential for a professional approach to management.

Personnel problems

Related to this cultural issue, is the challenge of managing two different types of staff. It is likely the NGO will recruit new staff to administer fundraising and financial management activities.

Performance and incentive structures for these new staff may need to be significantly different to those of their colleagues involved in the conventional activities of the NGO. NGOs may perceive these differences in practice and culture to present serious management difficulties.

Legal and political considerations

By increasing the levels of self-financing, an NGO may make its legal status ambiguous. As a non-profit making organisation the NGO usually benefits from a series of legal exemptions related to, for example, taxation regulations. If, through changes in sources of funding, the organisation starts to make a financial surplus (i.e. 'profit'), the legal status of the NGO as a not-for profit body may be challenged. Depending on the legal environment in which the NGO operates, this lack of legal clarity may be a deterrent to alternative financing strategies.

Politically, the NGO may also find itself open to the criticism of 'disguised profit-taking' and exploitation, also damaging relationships with the business community.

Careful public relations strategy and transparent governance practices may go some way to smoothing political sensitivities.